

**FEDERAL RESERVE SYSTEM**

**12 CFR Parts 217, 249, and 252**

**Regulations Q, WW, and YY; Docket No. R-[XXX]**

**RIN [XXXX]-AD [XX]**

**Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions**

**AGENCY:** Board of Governors of the Federal Reserve System (Board).

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Board is inviting comment on a proposed rule to promote U.S. financial stability by improving the resolvability and resilience of systemically important U.S. banking organizations and systemically important foreign banking organizations pursuant to section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Under the proposed rule, any U.S. top-tier bank holding company identified by the Board as a global systemically important banking organization (GSIB), the subsidiaries of any U.S. GSIB (other than national banks and federal savings associations), and the U.S. operations of any foreign GSIB (other than national banks and federal savings associations) would be subjected to restrictions regarding the terms of their non-cleared qualified financial contracts (QFCs). First, a covered entity would generally be required to ensure that QFCs to which it is party, including QFCs entered into outside the United States, provide that any default rights and restrictions on the transfer of the QFCs are limited to the same extent as they would be under the Dodd-Frank

Act and the Federal Deposit Insurance Act. Second, a covered entity would generally be prohibited from being party to QFCs that would allow a QFC counterparty to exercise default rights against the covered entity based on the entry into a resolution proceeding under the Dodd-Frank Act, Federal Deposit Insurance Act, or any other resolution proceeding of an affiliate of the covered entity. The proposal would also amend certain definitions in the Board's capital and liquidity rules; these amendments are intended to ensure that the regulatory capital and liquidity treatment of QFCs to which a covered entity is party is not affected by the proposed restrictions on such QFCs. The Office of the Comptroller of the Currency is expected to issue a proposed rule that would subject national banks and federal savings associations that are GSIB subsidiaries to requirements substantively identical to those proposed here.

**DATES:** Comments should be received by August 5, 2016.

**ADDRESSES:** You may submit comments, identified by Docket No. R-XXXX and RIN No. XXXX AD XX, by any of the following methods:

- *Agency Web Site:* <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.
- *Email:* [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov). Include the docket number in the subject line of the message.
- *Fax:* (202) 452-3819 or (202) 452-3102.
- *Mail:* Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW, Washington, DC 20551.

All public comments will be made available on the Board's web site at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room 3515, 1801 K Street (between 18th and 19th Streets NW) Washington, DC 20006, between 9:00 a.m. and 5:00 p.m. on weekdays.

**FOR FURTHER INFORMATION CONTACT:** Felton Booker, Senior Supervisory Financial Analyst, (202) 912-4651, or Mark Savignac, Supervisory Financial Analyst, (202) 475-7606, Division of Banking Supervision and Regulation; or Will Giles, Counsel, (202) 452-3351, or Lucy Chang, Attorney, (202) 475-6331, Legal Division, Board of Governors of the Federal Reserve System, 20th and C Streets NW, Washington, DC 20551. For the hearing impaired only, Telecommunications Device for the Deaf (TDD) users may contact (202) 263-4869.

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**I. Introduction*****A. Background***

This proposed rule, which is part of a set of actions by the Board to address the “too-big-to-fail” problem, addresses one of the ways in which the failure of a major financial firm can destabilize the financial system. The failure of a large, interconnected financial company could cause severe damage to the U.S. financial system and, ultimately, to the economy as a whole, as

illustrated by the failure of Lehman Brothers in September 2008. Protecting the financial stability of the United States by helping to address this too-big-to-fail problem is a core objective of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),<sup>1</sup> which Congress passed in response to the 2007–2009 financial crisis and the ensuing recession. The Dodd-Frank Act and the actions that U.S. financial regulators have taken to implement it and to otherwise protect U.S. financial stability help to address the too-big-to-fail problem in two ways: by reducing the probability that a systemically important financial company will fail, and by reducing the damage that such a company’s failure would do if it were to occur. The second of these strategies centers on measures designed to help ensure that a failed company’s passage through a resolution proceeding—such as bankruptcy or the special resolution process created by the Dodd-Frank Act—would be more orderly, thereby helping to mitigate destabilizing effects on the rest of the financial system.<sup>2</sup>

This proposed rule is intended as a further step to increase the resolvability of U.S. global systemically important banking organizations (GSIBs) and foreign GSIBs that operate in the United States. The proposal complements the Board’s recent notice of proposed rulemaking on total loss-absorbing capacity, long-term debt, and clean holding company requirements for

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<sup>1</sup> The Dodd-Frank Act was enacted on July 21, 2010 (Pub. L. 111–203). According to its preamble, the Dodd-Frank Act is intended “[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail’, [and] to protect the American taxpayer by ending bailouts.”

<sup>2</sup> The Dodd-Frank Act itself pursues this goal through numerous provisions, including by requiring systemically important financial companies to develop resolution plans (also known as “living wills”) that lay out how they could be resolved in an orderly manner if they were to fail and by creating a new resolution regime, the Orderly Liquidation Authority, applicable to systemically important financial companies. 12 U.S.C. 5365(d), 5381–5394. Moreover, section 165 of the Dodd-Frank Act directs the Board to promote financial stability through regulation by subjecting large bank holding companies and nonbank financial companies designated for Board supervision to enhanced prudential standards “[i]n order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions.” 12 U.S.C. 5365(a)(1).

GSIBs (TLAC proposal)<sup>3</sup> and the ongoing work of the Board and the FDIC on resolution planning requirements for GSIBs. The current proposal focuses on improving the orderly resolution of a GSIB by limiting disruptions to a failed GSIB through its financial contracts with other companies.

The largest financial firms are interconnected with other financial firms through large volumes of financial contracts of various types, including derivatives transactions. The failure of one entity within a large financial firm can trigger disruptive terminations of these contracts, as the counterparties of both the failed entity and other entities within the same firm exercise their contractual rights to terminate the contracts and liquidate collateral. These terminations, especially if counterparties lose confidence in the GSIB quickly and in large numbers, can destabilize the financial system and potentially spark a financial crisis through several channels. They can destabilize the failed entity's otherwise solvent affiliates, causing them to fail and thereby potentially causing their counterparties to fail in a chain reaction that can ripple through the system. They also may result in firesales of large volumes of financial assets, such as the collateral that secures the contracts, which can in turn weaken and cause stress for other firms by lowering the value of similar assets that they hold.

For example, the triggering of default rights by counterparties of Lehman Brothers in 2008 was a key driver of its destabilization that resulted from its failure.<sup>4</sup> At the time of its failure, Lehman was party to very large volumes of financial contracts, including over-the-

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<sup>3</sup> 80 FR 74926 (Nov. 30, 2015). For further high-level background on post-crisis regulatory reforms aimed at addressing the too-big-to-fail problem, see the preamble to the TLAC proposal. *Id.* at 74926–74928.

<sup>4</sup> *See* “The Orderly Liquidation of Lehman Brothers Holdings Inc. under the Dodd-Frank Act” 3, FDIC Quarterly (2011) (“The Lehman bankruptcy had an immediate and negative effect on U.S. financial stability and has proven to be a disorderly, time-consuming, and expensive process.”), available at [https://www.fdic.gov/bank/analytical/quarterly/2011\\_vol5\\_2/lehman.pdf](https://www.fdic.gov/bank/analytical/quarterly/2011_vol5_2/lehman.pdf).

counter derivatives contracts.<sup>5</sup> When its holding company declared bankruptcy, Lehman's counterparties exercised their default rights.<sup>6</sup> Lehman's default "caused disruptions in the swaps and derivatives markets and a rapid, market-wide unwinding of trading positions."<sup>7</sup> Meanwhile, "out-of-the-money counterparties, which owed Lehman money, typically chose not to terminate their contracts" and instead suspended payment, reducing the liquidity available to the bankruptcy estate.<sup>8</sup> The complexity and disruption associated with Lehman's portfolios of financial contracts led to a disorderly resolution of Lehman.<sup>9</sup> This proposal is meant to help avoid a repeat of the systemic disruptions caused by the Lehman failure by preventing the exercise of default rights in financial contracts from leading to such disorderly and destabilizing failures in the future.

This proposal is intended to respond to the threat to financial stability posed by such default rights in two ways. First, the proposal reduces the risk that courts in foreign jurisdictions would disregard statutory provisions that would stay the rights of a failed firm's counterparties to

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<sup>5</sup> See Michael J. Fleming and Asani Sarkar, "The Failure Resolution of Lehman Brothers," FRBNY Economic Policy Review 185 (December 2014), available at <https://www.newyorkfed.org/medialibrary/media/research/epr/2014/1412flem.pdf>.

<sup>6</sup> See *id.*

<sup>7</sup> "The Orderly Liquidation of Lehman Brothers Holdings Inc. under the Dodd-Frank Act" 3, FDIC Quarterly (2011), available at [https://www.fdic.gov/bank/analytical/quarterly/2011\\_vol5\\_2/lehman.pdf](https://www.fdic.gov/bank/analytical/quarterly/2011_vol5_2/lehman.pdf).

<sup>8</sup> Michael J. Fleming and Asani Sarkar, "The Failure Resolution of Lehman Brothers," FRBNY Economic Policy Review 185 (December 2014), available at <https://www.newyorkfed.org/medialibrary/media/research/epr/2014/1412flem.pdf>.

<sup>9</sup> See Mark J. Roe and Stephen D. Adams, "Restructuring Failed Financial Firms in Bankruptcy: Selling Lehman's Derivatives Portfolio," Yale Journal on Regulation (2015) ("Lehman's failure exacerbated the financial crisis, especially after AIG's collapse in the days afterwards prompted counterparties to close out positions, sell collateral, and thereby depress and freeze markets. Many financial players stopped trading for fear that their counterparty would be the next Lehman or that their counterparty had large unseen exposures to Lehman that would make the counterparty itself fail. Such was the case with the Reserve Primary Fund, a money market fund that held too many defaulting obligations of Lehman. That reaction led to a further panic, a threat of a run on money market funds, and a government guarantee of all money market funds to stem the ongoing financial degradation throughout the economy.").

terminate their contracts when the firm enters a resolution proceeding under one of the special resolution frameworks for failed financial firms created by Congress under the Federal Deposit Insurance Act (FDI Act) and the Dodd-Frank Act. Second, the proposal would facilitate the resolution of a large financial entity under the U.S. Bankruptcy Code and other resolution frameworks by ensuring that the counterparties of solvent affiliates of the failed entity could not unravel their contracts with the solvent affiliate based solely on the failed entity's resolution.

**Qualified financial contracts, default rights, and financial stability.** In particular, this proposal pertains to several important classes of financial transactions that are collectively known as “qualified financial contracts” (QFCs).<sup>10</sup> QFCs include derivatives, repurchase agreements (also known as “repos”) and reverse repos, and securities lending and borrowing agreements.<sup>11</sup> GSIBs enter into QFCs for a variety of purposes, including to borrow money to finance their investments, to lend money, to manage risk, and to enable their clients and counterparties to hedge risks, make markets in securities and derivatives, and take positions in financial investments.

QFCs play a role in economically valuable financial intermediation when markets are functioning normally. But they are also a major source of financial interconnectedness, which can pose a threat to financial stability in times of market stress. This proposal focuses on a context in which that threat is especially great: the failure of a GSIB that is party to large volumes of QFCs, likely including QFCs with counterparties that are themselves systemically important.

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<sup>10</sup> The proposal would adopt the definition of “qualified financial contract” set out in section 210(c)(8)(D) of the Dodd-Frank Act, 12 U.S.C. 5390(c)(8)(D). See proposed rule § 252.81.

<sup>11</sup> The definition of “qualified financial contract” is broader than this list of examples, and the default rights discussed are not common to all types of QFC.



By contract, a party to a QFC generally has the right to take certain actions if its counterparty defaults on the QFC (that is, if it fails to meet certain contractual obligations). Common default rights include the right to suspend performance of the non-defaulting party's obligations, the right to terminate or accelerate the contract, the right to set off amounts owed between the parties, and the right to seize and liquidate the defaulting party's collateral. In general, default rights allow a party to a QFC to reduce the credit risk associated with the QFC by granting it the right to exit the QFC and thereby reduce its exposure to its counterparty upon the occurrence of a specified condition, such as its counterparty's entry into a resolution proceeding.

Where the defaulting party is a GSIB entity, the private benefit of allowing counterparties of GSIBs to take certain actions must be weighed against the harm that these actions cause by encouraging the disorderly failure of a GSIB and increasing the threat to the stability of the U.S. financial system as a whole. For example, if a significant number of QFC counterparties exercise their default rights precipitously and in a manner that would impede an orderly resolution of a GSIB, all QFC counterparties and the financial system may potentially be worse off and less stable.

This may occur through several channels. First, the exits may drain liquidity from a troubled GSIB, forcing the GSIB to rapidly sell off assets at depressed prices, both because the sales must be done within a short timeframe and because the elevated supply may push prices down. These asset firesales may cause or deepen balance-sheet insolvency at the GSIB, causing a GSIB to fail more suddenly and reducing the amount that its other creditors can recover, thereby imposing losses on those creditors and threatening their solvency. The GSIB may also respond to a QFC run by withdrawing liquidity that it had offered to other firms, forcing them to

engage in firesales. Alternatively, if the GSIB's QFC counterparty itself liquidates the QFC collateral at firesale prices, the effect will again be to weaken the GSIB's balance sheet.<sup>12</sup> The counterparty's rights to set off amounts owed, terminate the contract, and suspend payments may allow it to further drain the GSIB's capital and liquidity by withholding payments that it would otherwise owe to the GSIB. The GSIB may also have rehypothecated collateral that it received from QFC counterparties, for instance in repo or securities lending transactions that fund other client arrangements, in which case demands from those counterparties for the early return of their rehypothecated collateral could be especially disruptive.<sup>13</sup>

The asset firesales discussed above can also spread contagion throughout the financial system by increasing volatility and by lowering the value of similar assets held by other firms, potentially causing these firms to suffer mark-to-market losses, diminished market confidence in their own solvency, margin calls, and creditor runs (which could lead to further firesales, worsening the contagion). Finally, the early terminations of derivatives that the surviving entities of the failed GSIB relied on to hedge their risks could leave those entities with major risks unhedged, increasing the entities' potential losses going forward.

Where there are significant simultaneous terminations and these effects occur contemporaneously, such as upon the failure of a GSIB that is party to a large volume of QFCs, they may pose a substantial risk to financial stability. In short, QFC continuity is important for

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<sup>12</sup> See "The Orderly Liquidation of Lehman Brothers Holdings Inc. under the Dodd-Frank Act" 8, FDIC Quarterly (2011), available at [https://www.fdic.gov/bank/analytical/quarterly/2011\\_vol5\\_2/lehman.pdf](https://www.fdic.gov/bank/analytical/quarterly/2011_vol5_2/lehman.pdf) ("A disorderly unwinding of [qualified financial contracts] triggered by an event of insolvency, as each counterparty races to unwind and cover unhedged positions, can cause a tremendous loss of value, especially if lightly traded collateral covering a trade is sold into an artificially depressed, unstable market. Such disorderly unwinding can have severe negative consequences for the financial company, its creditors, its counterparties, and the financial stability of the United States.").

<sup>13</sup> See generally Adam Kirk, James McAndrews, Parinitha Sastry, and Phillip Weed, "Matching Collateral Supply and Financing Demands in Dealer Banks," FRBNY Economic Policy Review 127 (December 2014), available at <http://www.newyorkfed.org/medialibrary/media/research/epr/2014/1412kirk.pdf>.

the orderly resolution of a GSIB because it helps to ensure that the GSIB entities remain viable and to avoid instability caused by asset firesales.

Consequently, the Board and the Federal Deposit Insurance Corporation (FDIC) have identified the exercise of certain default rights in financial contracts as a potential obstacle to orderly resolution in the context of resolution plans filed pursuant to section 165(d) of the Dodd-Frank Act,<sup>14</sup> and have instructed the most systemically important firms to demonstrate that they are “amending, on an industry-wide and firm-specific basis, financial contracts to provide for a stay of certain early termination rights of external counterparties triggered by insolvency proceedings.”<sup>15</sup>

**Direct defaults and cross-defaults.** This proposal focuses on two distinct scenarios in which a non-defaulting party to a QFC is commonly able to exercise the rights described above. These two scenarios involve a default that occurs when either the GSIB legal entity that is a direct party<sup>16</sup> to the QFC or an affiliate of that legal entity enters a resolution proceeding.<sup>17</sup> The

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<sup>14</sup> 12 U.S.C. 5365(d).

<sup>15</sup> Board and FDIC, “Agencies Provide Feedback on Second Round Resolution Plans of ‘First-Wave’ Filers” (August 5, 2014), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20140805a.htm>. See also Board and FDIC, “Agencies Provide Feedback on Resolution Plans of Three Foreign Banking Organizations” (March 23, 2015), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20150323a.htm>; Board and FDIC, “Guidance for 2013 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012” 5–6 (April 15, 2013), available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20130415c2.pdf>.

<sup>16</sup> In general, a “direct party” refers to a party to a financial contract other than a credit enhancement (such as a guarantee). The definition of “direct party” and related definitions are discussed in more detail below on page 38.

<sup>17</sup> This preamble uses phrases such as “entering a resolution proceeding” and “going into resolution” to encompass the concept of “becoming subject to a receivership, insolvency, liquidation, resolution, or similar proceeding.” These phrases refer to proceedings established by law to deal with a failed legal entity. In the context of the failure of a systemically important banking organization, the most relevant types of resolution proceeding include the following: for most U.S.-based legal entities, the bankruptcy process established by the U.S. Bankruptcy Code (Title 11, United States Code); for U.S. insured depository institutions, a receivership administered by the Federal Deposit Insurance Corporation (FDIC) under the Federal Deposit Insurance Act (12 U.S.C. 1821); for companies whose “resolution under otherwise applicable Federal or State law would have serious adverse effects on the financial stability of the United States,” the Dodd-Frank Act’s Orderly Liquidation Authority (12 U.S.C. 5383(b)(2)); and, for entities based outside the United States, resolution proceedings created by foreign law.

first scenario occurs when a GSIB entity that is itself a direct party to the QFC enters a resolution proceeding; this preamble refers to such a scenario as a “direct default” and refers to the default rights that arise from a direct default as “direct default rights.” The second scenario occurs when an affiliate of the GSIB entity that is a direct party to the QFC (such as the direct party’s parent holding company) enters a resolution proceeding; this preamble refers to such a scenario as a “cross-default” and refers to default rights that arise from a cross-default as “cross-default rights.” For example, a GSIB parent entity might guarantee the derivatives transactions of its subsidiaries and those derivatives contracts could contain cross-default rights against a subsidiary of the GSIB that would be triggered by the bankruptcy filing of the GSIB parent entity even though the subsidiary continues to meet all of its financial obligations.<sup>18</sup>

Importantly, this proposal does not affect all types of default rights, and, where it affects a default right, the proposal does so only temporarily for the purpose of allowing the relevant resolution authority to take action to continue to provide for continued performance on the QFC. Moreover, the proposal is concerned only with default rights that run *against* a GSIB—that is, direct default rights and cross-default rights that arise from the entry into resolution of a GSIB entity. The proposal would not affect default rights that a GSIB entity (or any other entity) may have against a counterparty that is not a GSIB entity. This limited scope is appropriate because, as described above, the risk posed to financial stability by the exercise of QFC default rights is greatest when the defaulting counterparty is a GSIB entity.

**Single-point-of-entry resolution.** Cross-default rights are especially significant in the context of a GSIB failure because GSIBs typically enter into large volumes of QFCs through

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<sup>18</sup> See Michael J. Fleming and Asani Sarkar, “The Failure Resolution of Lehman Brothers,” FRBNY Economic Policy Review 185 (December 2014), available at <https://www.newyorkfed.org/medialibrary/media/research/epr/2014/1412flem.pdf>.

different entities controlled by the GSIB. For example, a U.S. GSIB is made up of a U.S. bank holding company and numerous operating subsidiaries that are owned, directly or indirectly, by the bank holding company. From the standpoint of financial stability, the most important of these operating subsidiaries are generally a U.S. insured depository institution, a U.S. broker-dealer, and similar entities organized in other countries.

Many complex GSIB have developed resolution strategies that rely on the single-point-of-entry (SPOE) resolution strategy. In an SPOE resolution of a GSIB, only a single legal entity—the GSIB’s top-tier bank holding company—would enter a resolution proceeding. The losses that led to the GSIB’s failure would be passed up from the operating subsidiaries that incurred the losses to the holding company and would then be imposed on the equity holders and unsecured creditors of the holding company through the resolution process.<sup>19</sup> This strategy is designed to help ensure that the GSIB subsidiaries remain adequately capitalized, and that operating subsidiaries of the GSIB are able to continue to meet their financial obligations without defaulting or entering resolution themselves. The expectation that the holding company’s equity holders and unsecured creditors would absorb the GSIB’s losses in the event of failure would help to maintain the confidence of the operating subsidiaries’ creditors and counterparties (including their QFC counterparties), reducing their incentive to engage in potentially destabilizing funding runs or margin calls and thus lowering the risk of asset firesales. A successful SPOE resolution would also avoid the need for separate resolution proceedings for

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<sup>19</sup> The Board’s TLAC proposal would address the need for adequate external loss-absorbing capacity at the holding company level by requiring the top-tier holding companies of the U.S. GSIBs and the U.S. intermediate holding companies of foreign GSIBs to maintain outstanding required levels of unsecured long-term debt and TLAC, which is defined to include both tier 1 capital and eligible long-term debt. See 80 FR 74926, 74931–74944. The TLAC proposal also discussed, but did not propose, a potential framework for internal loss-absorbing capacity that could be used to transfer losses from the operating subsidiaries that incur them to the top-tier holding company. See 80 FR 74926, 74948–74949.

separate legal entities run by separate authorities across multiple jurisdictions, which would be more complex and could therefore destabilize the resolution.

The Board's TLAC proposal is intended to help, though not exclusively, to lay the foundation necessary for the SPOE resolution of a GSIB by requiring the top-tier holding companies of U.S. GSIBs and the U.S. intermediate holding companies of foreign GSIBs to maintain loss-absorbing capacity that could be used for resolution and to adopt a "clean holding company" structure, under which certain financial activities that could pose obstacles to orderly resolution would be off-limits to the holding company and could only be conducted by its operating subsidiaries.<sup>20</sup>

**Other orderly resolution strategies.** This proposal would also yield benefits for other approaches to resolution. For example, preventing early terminations of QFCs would increase the prospects for an orderly resolution under a multiple-point-of-entry (MPOE) strategy involving a foreign GSIB's U.S. intermediate holding company going into resolution or a resolution plan that calls for a GSIB's U.S. insured depository institution to enter resolution under the Federal Deposit Insurance Act. As discussed above, this proposal would help support the continued operation of affiliates of an entity experiencing resolution to the extent the affiliate continues to perform on its QFCs.

**U.S. Bankruptcy Code.** When an entity goes into resolution under the Bankruptcy Code, attempts by the debtor entity's creditors to enforce their debts through any means other than participation in the bankruptcy proceeding (for instance, by suing in another court, seeking enforcement of a preexisting judgment, or seizing and liquidating collateral) are generally

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<sup>20</sup> See 80 FR 74926, 74944–74948.

blocked by the imposition of an automatic stay.<sup>21</sup> A key purpose of the automatic stay, and of bankruptcy law in general, is to maximize the value of the bankruptcy estate and the creditors' ultimate recoveries by facilitating an orderly liquidation or restructuring of the debtor. The automatic stay thus solves a collective action problem in which the creditors' individual incentives to become the first to recover as much from the debtor as possible, before other creditors can do so, collectively cause a value-destroying disorderly liquidation of the debtor.<sup>22</sup>

However, the Bankruptcy Code largely exempts QFC<sup>23</sup> counterparties from the automatic stay through special "safe harbor" provisions.<sup>24</sup> Under these provisions, any rights that a QFC counterparty has to terminate the contract, set off obligations, and liquidate collateral in response to a direct default are not subject to the stay and may be exercised against the debtor immediately upon default. (The Bankruptcy Code does not itself confer default rights upon QFC counterparties; it merely permits QFC counterparties to exercise certain rights created by other sources, such as contractual rights created by the terms of the QFC.)

The Bankruptcy Code's automatic stay also does not prevent the exercise of cross-default rights against an affiliate of the party entering resolution. The stay generally applies only to actions taken against the party entering resolution or the bankruptcy estate,<sup>25</sup> whereas a QFC counterparty exercising a cross-default right is instead acting against a distinct legal entity that is not itself in resolution: the debtor's affiliate.

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<sup>21</sup> See 11 U.S.C. 362.

<sup>22</sup> See, e.g., *Aiello v. Providian Financial Corp.*, 239 F.3d 876, 879 (7th Cir. 2001).

<sup>23</sup> The Bankruptcy Code does not use the term "qualified financial contract," but the set of transactions covered by its safe harbor provisions closely tracks the set of transactions that fall within the definition of "qualified financial contract" used in Title II of the Dodd-Frank Act and in this proposal.

<sup>24</sup> 11 U.S.C. 362(b)(6), (7), (17), (27), 362(o), 555, 556, 559, 560, 561. The Bankruptcy Code specifies the types of parties to which the safe harbor provisions apply, such as financial institutions and financial participants. *Id.*

<sup>25</sup> See 11 U.S.C. 362(a).

**Title II of the Dodd-Frank Act and the Orderly Liquidation Authority.** Title II of the Dodd-Frank Act imposes somewhat broader stay requirements on QFCs that enter resolution under that Title. In general, no financial firm (regardless of size) is too-big-to-fail and a U.S. bank holding company (such as the top-tier holding company of a U.S. GSIB) that fails would be resolved under the Bankruptcy Code. Congress recognized, however, that a financial company might fail under extraordinary circumstances in which an attempt to resolve it through the bankruptcy process would have serious adverse effects on financial stability in the United States. Title II of the Dodd-Frank Act establishes the Orderly Liquidation Authority (OLA), an alternative resolution framework intended to be used rarely to manage the failure of a firm that poses a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard.<sup>26</sup> Title II authorizes the Secretary of the Treasury, upon the recommendation of other government agencies and a determination that several preconditions are met, to place a financial company into a receivership conducted by the FDIC as an alternative to bankruptcy.<sup>27</sup>

Title II empowers the FDIC to transfer the QFCs to a bridge financial company or some other financial company that is not in a resolution proceeding and should therefore be capable of performing under the QFCs.<sup>28</sup> To give the FDIC time to effect this transfer, Title II temporarily stays QFC counterparties of the failed entity from exercising termination, netting, and collateral liquidation rights “solely by reason of or incidental to” the failed entity’s entry into OLA

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<sup>26</sup> Section 204(a) of the Dodd-Frank Act, 12 U.S.C. 5384(a).

<sup>27</sup> See section 203 of the Dodd-Frank Act, 12 U.S.C. 5383.

<sup>28</sup> See 12 U.S.C. 5390(c)(9).



resolution, its insolvency, or its financial condition.<sup>29</sup> Once the QFCs are transferred in accordance with the statute, Title II permanently stays the exercise of default rights for those reasons.<sup>30</sup>

Title II addresses cross-default rights through a similar procedure. It empowers the FDIC to enforce contracts of subsidiaries or affiliates of the failed covered financial company that are “guaranteed or otherwise supported by or linked to the covered financial company, notwithstanding any contractual right to cause the termination, liquidation, or acceleration of such contracts based solely on the insolvency, financial condition, or receivership of” the failed company, so long as the FDIC takes certain steps to protect the QFC counterparties’ interests by the end of the business day following the company’s entry into OLA resolution.<sup>31</sup>

These stay-and-transfer provisions of the Dodd-Frank Act are intended to mitigate the threat posed by QFC default rights. At the same time, the provisions allow for appropriate protections for QFC counterparties of the failed financial company. The provisions stay only the exercise of default rights based on the failed company’s entry into resolution, the fact of its insolvency, or its financial condition. And the stay period is brief, unless the FDIC transfers the QFCs to another financial company that is not in resolution (and should therefore be capable of performing under the QFCs) or, if applicable, provides adequate protection that the QFCs will be performed.

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<sup>29</sup> 12 U.S.C. 5390(c)(10)(B)(i)(I). This temporary stay generally lasts until 5:00 p.m. eastern time on the business day following the appointment of the FDIC as receiver.

<sup>30</sup> 12 U.S.C. 5390(c)(10)(B)(i)(II).

<sup>31</sup> 12 U.S.C. 5390(c)(16).

**The Federal Deposit Insurance Act.** Under the FDI Act, a failing insured depository institution would generally enter a receivership administered by the FDIC.<sup>32</sup> The FDI Act addresses direct default rights in the failed bank’s QFCs with stay-and-transfer provisions that are substantially similar to the provisions of Title II of the Dodd-Frank Act discussed above.<sup>33</sup> However, the FDI Act does not address cross-default rights, leaving the QFC counterparties of the failed depository institution’s affiliates free to exercise any contractual rights they may have to terminate, net, and liquidate collateral based on the depository institution’s entry into resolution. Moreover, as with Title II of the Dodd-Frank Act, there is a possibility that a court of a foreign jurisdiction might decline to enforce the FDI Act’s stay-and-transfer provisions under certain circumstances.

***B. Overview of the Proposal***

The Board invites comment on all aspects of this proposed rulemaking, which is intended to increase GSIB resolvability by addressing two QFC-related issues. First, the proposal seeks to address the risk that a court in a foreign jurisdiction may decline to enforce the QFC stay-and-transfer provisions of Title II and the FDI Act discussed above. Second, the proposal seeks to address the potential disruption that may occur if a counterparty to a QFC with an affiliate of a GSIB entity that goes into resolution under the Bankruptcy Code or the FDI Act is provided cross-default rights.

**Scope of application.** The proposal’s requirements would apply to all “covered entities.” “Covered entity” would include: any U.S. top-tier bank holding company identified as a GSIB under the Board’s rule establishing risk-based capital surcharges for GSIBs (GSIB surcharge

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<sup>32</sup> 12 U.S.C. 1821(c).

<sup>33</sup> See 12 U.S.C. 1821(e)(8)–(10).

rule);<sup>34</sup> any subsidiary of such a bank holding company; and any U.S. subsidiary, U.S. branch, or U.S. agency of a foreign GSIB. Covered entity would not include certain entities that are supervised by the Office of the Comptroller of the Currency (OCC) (covered bank). The OCC is expected to issue a proposed rule that would subject covered banks to requirements substantively identical to those proposed here for covered entities.

“Qualified financial contract” or “QFC” would be defined to have the same meaning as in section 210(c)(8)(D) of the Dodd-Frank Act,<sup>35</sup> and would include, among other things, derivatives, repos, and securities lending agreements. Subject to the exceptions discussed below, the proposal’s requirements would apply to any QFC to which a covered entity is party (covered QFC).

**Required contractual provisions related to the U.S. special resolution regimes.**

Covered entities would be required to ensure that covered QFCs include contractual terms explicitly providing that any default rights or restrictions on the transfer of the QFC are limited to the same extent as they would be pursuant to the U.S. special resolution regimes—that is, the OLA and the FDI Act.<sup>36</sup> The proposed requirements are not intended to imply that the statutory stay-and-transfer provisions would not in fact apply to a given QFC, but rather to help ensure that all covered QFCs—including QFCs that are governed by foreign law, entered into with a foreign party, or for which collateral is held outside the United States—would be treated the same way in the context of an FDIC receivership under the Dodd-Frank Act or the FDI Act. This provision would address the first issue listed above and would decrease the QFC-related threat to financial stability posed by the failure and resolution of an internationally active GSIB.

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<sup>34</sup> 12 CFR 217.402; 80 FR 49106 (August 14, 2015). See proposed rule § 252.81.

<sup>35</sup> 12 U.S.C. 5390(c)(8)(D). See proposed rule § 252.81.

<sup>36</sup> See proposed rule § 252.83.

This section of the proposal is also consistent with analogous legal requirements that have been imposed in other national jurisdictions<sup>37</sup> and with the Financial Stability Board’s “Principles for Cross-border Effectiveness of Resolution Actions.”<sup>38</sup>

**Prohibited cross-default rights.** A covered entity would be prohibited from entering into covered QFCs that would allow the exercise of cross-default rights—that is, default rights related, directly or indirectly, to the entry into resolution of an affiliate of the direct party—against it.<sup>39</sup> Covered entities would similarly be prohibited from entering into covered QFCs that would provide for a restriction on the transfer of a credit enhancement supporting the QFC from the covered entity’s affiliate to a transferee upon the entry into resolution of the affiliate.

The Board does not propose to prohibit covered entities from entering into QFCs that contain direct default rights. Under the proposal, a counterparty to a direct QFC with a covered entity also could, to the extent not inconsistent with Title II or the FDI Act, be granted and could exercise the right to terminate the QFC if the covered entity fails to perform its obligations under the QFC.

As an alternative to bringing their covered QFCs into compliance with the requirements set out in this section of the proposed rule, covered entities would be permitted to comply by

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<sup>37</sup> See, e.g., Bank of England Prudential Regulation Authority, Policy Statement, “Contractual stays in financial contracts governed by third-country law” (November 2015), available at <http://www.bankofengland.co.uk/pru/Documents/publications/ps/2015/ps2515.pdf>.

<sup>38</sup> Financial Stability Board, “Principles for Cross-border Effectiveness of Resolution Actions” (November 3, 2015), available at <http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf>.

The Financial Stability Board (FSB) was established in 2009 to coordinate the work of national financial authorities and international standard-setting bodies and to develop and promote the implementation of effective regulatory, supervisory, and other financial sector policies to advance financial stability. The FSB brings together national authorities responsible for financial stability in 24 countries and jurisdictions, as well as international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. See generally Financial Stability Board, available at <http://www.fsb.org>.

<sup>39</sup> See proposed rule § 252.83(b).

adhering to the ISDA 2015 Resolution Stay Protocol.<sup>40</sup> The Board views the ISDA 2015 Resolution Stay Protocol as consistent with the requirements of the proposed rule.

The purpose of this section of the proposal is to help ensure that, when a GSIB entity enters resolution under the Bankruptcy Code or the FDI Act<sup>41</sup>, its affiliates' covered QFCs will be protected from disruption to a similar extent as if the failed entity had entered resolution under the OLA. In particular, this section would facilitate resolution under the Bankruptcy Code by preventing the QFC counterparties of a GSIB's operating subsidiary from exercising default rights on the basis of the entry into bankruptcy by the GSIB's top-tier holding company or any other affiliate of the operating subsidiary. This section generally would not prevent covered QFCs from allowing the exercise of default rights upon a failure by the direct party to satisfy a payment or delivery obligation under the QFC, the direct party's entry into resolution, or the occurrence of any other default event that is not related to the entry into a resolution proceeding or the financial condition of an affiliate of the direct party.

**Process for approval of enhanced creditor protection conditions.** The proposal would allow the Board, at the request of a covered entity, to approve as compliant with the proposal covered QFCs with creditor protections other than those that would otherwise be permitted under section 252.84 of the proposal.<sup>42</sup> The Board could approve such a request if, in light of several enumerated considerations,<sup>43</sup> the alternative approach would mitigate risks to the financial stability of the United States presented by a GSIB's failure to at least the same extent as the proposed requirements.

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<sup>40</sup> See proposed rule § 252.85(a).

<sup>41</sup> The FDI Act does not stay cross-default rights against affiliates of an insured depository institution based on the entry of the insured depository institution into resolution proceedings under the FDI Act.

<sup>42</sup> See proposed rule § 252.85.

<sup>43</sup> See proposed rule § 252.85(c).

**Amendments to certain definitions in the Board’s capital and liquidity rules.** The proposal would also amend certain definitions in the Board’s capital and liquidity rules to help ensure that the regulatory capital and liquidity treatment of QFCs to which a covered entity is party is not affected by the proposed restrictions on such QFCs. Specifically, the proposal would amend the definition of “qualifying master netting agreement” in the Board’s regulatory capital and liquidity rules and would similarly amend the definitions of the terms “collateral agreement,” “eligible margin loan,” and “repo-style transaction” in the Board’s regulatory capital rules.

***C. Consultation with U.S Financial Regulators, the Council, and Foreign Authorities***

In developing this proposal, the Board consulted with the FDIC, the OCC, the Financial Stability Oversight Council (Council), and other U.S. financial regulators. The proposal reflects input that the Board received during this consultation process. The Board also intends to consult with the Council and other U.S. financial regulators after it reviews comments on the proposal. Furthermore, the Board has consulted with, and expects to continue to consult with, foreign financial regulatory authorities regarding this proposal and the establishment of other standards that would maximize the prospects for the cooperative and orderly cross-border resolution of a failed GSIB on an international basis.

The OCC is expected to issue for public comment a notice of proposed rulemaking that would subject covered banks, including the national bank subsidiaries of GSIBs, to requirements substantively identical to those proposed here for covered entities. The Board and the OCC coordinated the development of their respective proposals in order to avoid redundancy.

***D. Overview of Statutory Authority***

The Board is issuing this proposal under the authority provided by section 165 of the Dodd-Frank Act.<sup>44</sup> Section 165 instructs the Board to impose enhanced prudential standards on bank holding companies with total consolidated assets of \$50 billion or more “[i]n order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions.”<sup>45</sup> These enhanced prudential standards must increase in stringency based on the systemic footprint and risk characteristics of covered firms.<sup>46</sup> Section 165 requires the Board to impose enhanced prudential standards of several specified types and also authorizes the Board to establish “such other prudential standards as the Board of Governors, on its own or pursuant to a recommendation made by the Council, determines are appropriate.”<sup>47</sup>

Enhanced prudential standards in the proposal are intended to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure of a GSIB. In particular, the proposed requirements would improve the resolvability of U.S. GSIBs under the Bankruptcy Code, Title II of the Dodd-Frank Act, or, with reference to insured depository institutions that are GSIB subsidiaries, the FDI Act, and reduce the potential that resolution of the firm will be disorderly and lead to disruptive asset sales and liquidations.

The proposal would also improve the resilience of the U.S. operations of foreign GSIBs, and thereby increase the likelihood that a failed foreign GSIB with U.S. operations would be successfully resolved by its home jurisdiction authorities without the failure of the foreign

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<sup>44</sup> 12 U.S.C. 5365.

<sup>45</sup> 12 U.S.C. 5365(a)(1).

<sup>46</sup> 12 U.S.C. 5365(a)(1)(B), (b)(3)(A)–(D).

<sup>47</sup> 12 U.S.C. 5365(b)(1)(B)(iv).

GSIB's U.S. operating entities and with limited effect on the financial stability of the United States.

The Board has tailored this proposal to apply only to those banking organizations whose disorderly failure would likely pose the greatest risk to U.S. financial stability: the U.S. GSIBs and the U.S. operations of foreign GSIBs.

*Question 1: The Board invites comment on all aspects of this section.*

## **II. Proposed Restrictions on QFCs of GSIBs**

### ***A. Covered Entities (Section 252.82(a) of the Proposed Rule)***

The proposed rule would apply to “covered entities,” which include (a) any U.S. GSIB top-tier bank holding company, (b) any subsidiary of such a bank holding company that is not a “covered bank,” and (c) the U.S. operations of any foreign GSIB with the exception of any “covered bank.” The term “covered bank” would be defined to include certain entities, such as certain national banks, that are supervised by the OCC. While covered banks would be exempt from the requirements of this proposal, the OCC is expected to issue a proposed rule that would impose substantively identical requirements for covered banks in the near future.<sup>48</sup>

**U.S. GSIB bank holding companies.** Covered entities would include the entities identified as U.S. GSIB top-tier holding companies under the Board's GSIB surcharge rule.<sup>49</sup> Under the GSIB surcharge rule, a U.S. top-tier bank holding company subject to the advanced approaches rule must determine whether it is a GSIB by applying a multifactor methodology

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<sup>48</sup> Section 252.88 of the Board's proposal also clarifies that covered entities are not required to conform covered QFCs with respect to a part of a covered QFC that a covered bank also would be required to conform under the proposed rule that the OCC is expected to issue. Such overlap could occur, for example, where a bank holding company that is a covered entity guarantees a swap between a subsidiary that is a covered bank and the covered bank's counterparty.

<sup>49</sup> 12 CFR 217.402; 80 FR 49106 (August 14, 2015). See proposed rule § 252.82(a)(1).



established by the Board.<sup>50</sup> The methodology evaluates a banking organization's systemic importance on the basis of its attributes in five broad categories: size, interconnectedness, cross-jurisdictional activity, substitutability, and complexity.

Accordingly, the methodology provides a tool for identifying those banking organizations whose failure or material distress would pose especially large risks to the financial stability of the United States. Improving the orderly resolution and resolvability of such firms, including by reducing risks associated with their QFCs, would be an important step toward achieving the goals of the Dodd-Frank Act. The proposal's focus on GSIBs is also in keeping with the Dodd-Frank Act's mandate that more stringent prudential standards be applied to the most systemically important bank holding companies.<sup>51</sup> Moreover, several of the attributes that feed into the determination of whether a given firm is a GSIB incorporate aspects of the firm's QFC activity. These attributes include the firm's total exposures, its intra-financial system assets and liabilities, its notional amount of over-the-counter derivatives, and its cross-jurisdictional claims and liabilities.

Under the GSIB surcharge rule's methodology, there are currently eight U.S. GSIBs: Bank of America Corporation, The Bank of New York Mellon Corporation, Citigroup Inc., Goldman Sachs Group, Inc., JPMorgan Chase & Co., Morgan Stanley Inc., State Street Corporation, and Wells Fargo & Company. This list may change in the future in light of changes to the relevant attributes of the current U.S. GSIBs and of other large U.S. bank holding companies.

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<sup>50</sup> Id.; 12 CFR part 217, subpart E.

<sup>51</sup> 12 U.S.C. 5365(a)(1)(B).

**U.S. GSIB subsidiaries.** Covered entities would also include all subsidiaries of the U.S. GSIBs (other than covered banks).<sup>52</sup> U.S. GSIBs generally enter into QFCs through subsidiary legal entities rather than through the top-tier holding company.<sup>53</sup> Therefore, in order to increase GSIB resolvability by addressing the potential obstacles to orderly resolution posed by QFCs, it is necessary to apply the proposed restrictions to the U.S. GSIBs' subsidiaries.

In particular, to facilitate the resolution of a GSIB under an SPOE strategy, in which only the top-tier holding company would enter a resolution proceeding while its subsidiaries would continue to meet their financial obligations, or an MPOE strategy where an affiliate of an entity that is otherwise performing under a QFC enters resolution, it is necessary to ensure that those subsidiaries or affiliates do not enter into QFCs that contain cross-default rights that the counterparty could exercise based on the holding company's or affiliate's entry into resolution (or that any such cross-default rights are stayed when the holding company enters resolution). Moreover, including U.S. and non-U.S. entities of a U.S. GSIB as covered entities should help ensure that such cross-default rights do not affect the ability of performing and solvent entities of a GSIB—regardless of jurisdiction—to remain outside of resolution proceedings.

**U.S. operations of foreign GSIBs.** Finally, covered entities would include all U.S. operations of foreign GSIBs that are not covered banks, including U.S. subsidiaries, U.S. branches, and U.S. agencies. Under the proposal, the term “global systemically important foreign banking organization” (which this preamble will shorten to “foreign GSIB”) would be defined to include any foreign banking organization that (a) would be designated as a GSIB

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<sup>52</sup> See proposed rule § 252.82(a).

<sup>53</sup> Under the clean holding company component of the Board's recent TLAC proposal, the top-tier holding companies of U.S. GSIBs would be prohibited from entering into direct QFCs with third parties. See 80 FR 74926, 74945.

under the Board’s GSIB surcharge rule if it were subject to that rule on a consolidated basis or (b) would be designated as a GSIB under the methodology for identifying GSIBs adopted by the Basel Committee on Banking Supervision (global methodology).<sup>54</sup>

As discussed above, the Board’s GSIB surcharge rule identifies the most systemically important banking organizations on the basis of their attributes in the categories of size, interconnectedness, cross-jurisdictional activity, substitutability, and complexity. While the GSIB surcharge rule applies only to U.S. bank holding companies, its methodology is equally well-suited to evaluating the systemic importance of foreign banking organizations. The global methodology generally evaluates the same attributes and would identify the same set of GSIBs as the Board’s methodology.

As with U.S. GSIBs, the proposal’s focus on those foreign banking organizations that qualify as GSIBs is in keeping with the Dodd-Frank Act’s mandate that more stringent prudential standards be applied to the most systemically important banking organizations.<sup>55</sup> Moreover, the

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<sup>54</sup> See proposed rule § 252.87. The Basel Committee on Banking Supervision (BCBS) is a committee of bank supervisory authorities established by the central bank governors of the Group of Ten countries in 1975. The committee’s membership consists of senior representatives of bank supervisory authorities and central banks from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. In 2011, the BCBS adopted the global methodology to identify global systemically important banking organizations and assess their systemic importance. See “Global systemically important banks: Assessment methodology and the additional loss absorbency requirement,” available at <http://www.bis.org/publ/bcbs207.htm>. In 2013, the BCBS published a revised document, which provides certain revisions and clarifications to the global methodology. See “Global systemically important banks: Updated assessment methodology and the higher loss absorbency requirement,” available at <http://www.bis.org/publ/bcbs255.htm>.

In November 2015, the FSB and the BCBS published an updated list of banking organizations that are GSIBs under the assessment methodology. The list includes the eight U.S. GSIBs and the following 22 foreign banking organizations: Agricultural Bank of China, Bank of China, Barclays, BNP Paribas, China Construction Bank, Credit Suisse, Deutsche Bank, Groupe BPCE, Groupe Crédit Agricole, Industrial and Commercial Bank of China Limited, HSBC, ING Bank, Mitsubishi UFJ FG, Mizuho FG, Nordea, Royal Bank of Scotland, Santander, Société Générale, Standard Chartered, Sumitomo Mitsui FG, UBS, and Unicredit Group. See FSB, “2015 update of list of global systemically important banks” (November 3, 2015), available at <http://www.fsb.org/wp-content/uploads/2015-update-of-list-of-global-systemically-important-banks-G-SIBs.pdf>.

<sup>55</sup> 12 U.S.C. 5365(a)(1)(B).

use of the GSIB surcharge rule to identify foreign GSIBs as well as U.S. GSIBs promotes a level playing field between U.S. and foreign banking organizations.

The proposal would cover only the U.S. operations of foreign GSIBs. As with the coverage of subsidiaries of U.S. GSIBs, coverage of the U.S. operations of foreign banks will enhance the orderly resolution of the foreign bank and its U.S. operations. In particular, covering QFCs that involve any U.S. subsidiary, U.S. branch, or U.S. agency of a foreign GSIB will reduce the potentially disruptive cancellation of those QFCs if the foreign bank or any of its subsidiaries enters resolution.<sup>56</sup>

*Question 2: The Board invites comment on the proposed definition of the term “covered entity.”*

*Question 3: The Board invites comment on alternative approaches for determining the scope of application of the proposed restrictions.*

*Question 4: The Board invites comment on whether the proposal should be expanded to cover banking organizations that are not GSIBs but that engage in especially high levels of QFC activity. If so, what specific metrics should be used to identify such banking organizations?*

### ***B. Covered QFCs***

**General definition.** The proposal would apply to any “covered QFC,” generally defined as any QFC that a covered entity enters into, executes, or otherwise becomes party to.<sup>57</sup>

“Qualified financial contract” or “QFC” would be defined as in section 210(c)(8)(D) of Title II

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<sup>56</sup> Under the clean holding company component of the Board’s recent TLAC proposal, the U.S. intermediate holding companies of foreign GSIBs would be prohibited from entering into QFCs with third parties. See 80 FR 74926, 74945.

<sup>57</sup> See proposed rule § 252.83(a). For convenience, this preamble generally refers to “a covered entity’s QFCs” or “QFCs to which a covered entity is party” as shorthand to encompass this definition.

of the Dodd-Frank Act and would include swaps, repo and reverse repo transactions, securities lending and borrowing transactions, commodity contracts, and forward agreements.<sup>58</sup>

The proposed definition of “covered QFC” is intended to limit the proposed restrictions to those financial transactions whose disorderly unwind has substantial potential to frustrate the orderly resolution of a GSIB, as discussed above. By adopting the Dodd-Frank Act’s definition, the proposed rule would extend the benefits of the stay and transfer protections to the same types of transactions in the event the covered entity enters bankruptcy. In this way, the proposal enhances the prospects for an orderly resolution in bankruptcy (as opposed to resolution under Title II of the Dodd-Frank Act) of a covered entity.

*Question 5: The Board invites comment on the proposed definitions of “QFC” and “covered QFC.” Are there financial transactions that could pose a similar risk to U.S. financial stability if a GSIB were to fail but that would not be included within the proposed definitions of QFC and covered QFC? Are there transactions that would be included within the proposed definitions but that would not present risks justifying the application of this proposal? Please explain.*

**Exclusion of cleared QFCs.** The proposal would exclude from the definition of “covered QFC” all QFCs that are cleared through a central counterparty.<sup>59</sup> The issues that the proposal is intended to address with respect to non-cleared QFCs may also exist in the context of centrally cleared QFCs. However, clearing through a central counterparty also provides unique benefits to the financial system as well as unique issues related to the cancellation of cleared contracts. Accordingly, the Board continues to consider the appropriate treatment of centrally

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<sup>58</sup> See proposed rule § 252.81; 12 U.S.C. 5390(c)(8)(D).

<sup>59</sup> See proposed rule § 252.82(b).

cleared QFCs, in light of differences between cleared and non-cleared QFCs with respect to contractual arrangements, counterparty credit risk, default management, and supervision. The Board is also considering whether to propose a regulatory regime that would address the continuity of cleared QFCs during the resolution of a GSIB within the broader context of safeguarding GSIB access to financial market utilities, including central counterparties, during the orderly resolution of the GSIB.

*Question 6: The Board invites comment on the proposed exclusion of cleared QFCs, including the potential effects on the financial stability of the United States of excluding cleared QFCs as well as the potential effects on U.S. financial stability of subjecting covered entities' relationships with central counterparties to restrictions analogous to this proposal's restrictions on covered entities' non-cleared QFCs.*

**Exclusion of certain QFCs under multi-branch master agreements of foreign banking organizations.** To avoid imposing unnecessary restrictions on QFCs that are not closely connected to the United States, the proposal would exclude from the definition of “covered QFC” certain QFCs of foreign GSIBs that lack a close connection to the foreign GSIB’s U.S. operations.<sup>60</sup> The proposed definition of “QFC” includes master agreements that apply to QFCs.<sup>61</sup> Master agreements are contracts that contain general terms that the parties wish to apply to multiple transactions between them; having executed the master agreement, the parties can then include those terms in future contracts through reference to the master agreement. Moreover, the Dodd-Frank Act’s definition of “qualified financial contract,” which

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<sup>60</sup> See proposed rule § 252.86.

<sup>61</sup> See proposed rule § 252.81.

the proposal would adopt, treats master agreements for QFCs together with all supplements to the master agreement (including underlying transactions) as a single QFC.<sup>62</sup>

Foreign banks have master agreements that permit transactions to be entered into both at a U.S. branch or U.S. agency of the foreign bank and at a non-U.S. location of the foreign bank (such as a foreign branch). Notwithstanding the proposal's general treatment of a master agreement and all QFCs thereunder as a single QFC, the proposal would exclude QFCs under such a "multi-branch master agreement" that are not booked at a covered entity and for which no payment or delivery may be made at a covered entity.<sup>63</sup> The multi-branch master agreement would still be a covered QFC with respect to QFC transactions that are booked at a covered entity or for which payment or delivery may be made at a covered entity.

The purpose of this exclusion is to help ensure that, where a foreign GSIB has a multi-branch master agreement, the foreign GSIB will only have to conform those QFCs entered into under the multi-branch master agreement that could directly affect the obligations of the covered U.S. branch or U.S. agency of the foreign GSIB and that could therefore have the most direct effect on the financial stability of the United States.

*Question 7: The Board invites comment on the proposed exclusion, including the potential benefits and detriments to U.S. financial stability of eliminating the proposed exclusion,*

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<sup>62</sup> 12 U.S.C. 5390(c)(8)(D)(viii); see also 12 U.S.C. 1821(e)(8)(D)(vii); 109 H. Rpt. 31, Part. 1 (April 8, 2005) (explaining that a "master agreement for one or more securities contracts, commodity contracts, forward contracts, repurchase agreements or swap agreements will be treated as a single QFC under the FDIA or the FCUA (but only with respect to the underlying agreements are themselves QFCs)").

<sup>63</sup> See proposed rule § 252.86(a). With respect to a U.S. branch or U.S. agency of a foreign GSIB, a multi-branch master agreement that is a covered QFC solely because the master agreement permits agreements or transactions that are QFCs to be entered into at one or more U.S. branches or U.S. agencies of the foreign GSIB will be considered a covered QFC for purposes of this proposal only with respect to such agreements or transactions booked at such U.S. branches and U.S. agencies or for which a payment or delivery may be made at such U.S. branches or U.S. agencies.

*the reduction in compliance burden that would be produced by the proposed exclusion, and the proposed exclusion's effect on netting under multi-branch master agreements.*

### ***C. Definition of “Default Right”***

As discussed above, a party to a QFC generally has a number of rights that it can exercise if its counterparty defaults on the QFC by failing to meet certain contractual obligations. These rights are generally, but not always, contractual in nature. One common default right is a setoff right: the right to reduce the total amount that the non-defaulting party must pay by the amount that its defaulting counterparty owes. A second common default right is the right to liquidate pledged collateral and use the proceeds to pay the defaulting party's net obligation to the non-defaulting party. Other common rights include the ability to suspend or delay the non-defaulting party's performance under the contract or to accelerate the obligations of the defaulting party. Finally, the non-defaulting party typically has the right to terminate the QFC, meaning that the parties would not make payments that would have been required under the QFC in the future. The phrase “default right” in the proposed rule is broadly defined to include these common rights as well as “any similar rights.”<sup>64</sup> Additionally, the definition includes all such rights regardless of source, including rights existing under contract, statute, or common law.

However, the proposed definition excludes two rights that are typically associated with the business-as-usual functioning of a QFC. First, same-day netting that occurs during the life of the QFC in order to reduce the number and amount of payments each party owes the other is excluded from the definition of “default right.”<sup>65</sup> Second, contractual margin requirements that arise solely from the change in the value of the collateral or the amount of an economic exposure

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<sup>64</sup> See proposed rule § 252.81.

<sup>65</sup> See *id.*



are also excluded from the definition.<sup>66</sup> The function of these exclusions is to leave such rights unaffected by the proposed rule. The exclusions are appropriate because the proposal is intended to improve resolvability by addressing default rights that could disrupt an orderly resolution, not to interrupt the parties' business-as-usual interactions under a QFC.

However, certain QFCs are also commonly subject to rights that would increase the amount of collateral or margin that the defaulting party (or a guarantor) must provide upon an event of default. The financial impact of such default rights on a covered entity could be similar to the impact of the liquidation and acceleration rights discussed above. Therefore, the proposed definition of "default right" includes such rights (with the exception discussed in the previous paragraph for margin requirements that depend solely on the value of collateral or the amount of an economic exposure).<sup>67</sup>

Finally, contractual rights to terminate without the need to show cause, including rights to terminate on demand and rights to terminate at contractually specified intervals, are excluded from the definition of "default right" for purposes the proposed rule's restrictions on cross-default rights (section 252.84 of the proposed rule).<sup>68</sup> This is consistent with the proposal's objective of restricting only default rights that are related, directly or indirectly, to the entry into resolution of an affiliate of the covered entity, while leaving other default rights unrestricted.

*Question 8: The Board invites comment on all aspects of the proposed definition of "default right." In particular, are the proposed exclusions appropriate in light of the objectives of the proposal? To what extent does the exclusion of rights that allow a party to terminate the contract "on demand or at its option at a specified time, or from time to time, without the need to*

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<sup>66</sup> See id.

<sup>67</sup> See id.

<sup>68</sup> See proposed rule §§ 252.81, 252.84.

*show cause” create an incentive for firms to include these rights in future contracts to evade the proposed restrictions? To what extent should other regulatory requirements (e.g., liquidity coverage ratio or the short-term wholesale funding components of the GSIB surcharge rule) be revised to create a counterincentive? Would additional exclusions be appropriate? To what extent should it be clarified that the “need to show cause” includes the need to negotiate alternative terms with the other party prior to termination or similar requirements (e.g., Master Securities Loan Agreement, Annex III - Term Loans)?*

***D. Required Contractual Provisions Related to the U.S. Special Resolution Regimes (Section 252.83 of the Proposed Rule)***

Under the proposal, a covered QFC would be required to explicitly provide both (a) that the transfer of the QFC (and any interest or obligation in or under it and any property securing it) from the covered entity to a transferee would be effective to the same extent as it would be under the U.S. special resolution regimes if the covered QFC were governed by the laws of the United States or of a state of the United States and (b) that default rights with respect to the covered QFC that could be exercised against a covered entity could be exercised to no greater extent than they could be exercised under the U.S. special resolution regimes if the covered QFC were governed by the laws of the United States or of a state of the United States.<sup>69</sup> The proposal would define the term “U.S. special resolution regimes” to mean the FDI Act<sup>70</sup> and Title II of the Dodd-Frank Act,<sup>71</sup> along with regulations issued under those statutes.<sup>72</sup>

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<sup>69</sup> See proposed rule § 252.83.

<sup>70</sup> 12 U.S.C. 1811–1835a.

<sup>71</sup> 12 U.S.C. 5381–5394.

<sup>72</sup> See proposed rule § 252.81.

The proposed requirements are not intended to imply that a given covered QFC is not governed by the laws of the United States or of a state of the United States, or that the statutory stay-and-transfer provisions would not in fact apply to a given covered QFC. Rather, the requirements are intended to provide certainty that all covered QFCs would be treated the same way in the context of a receivership of a covered entity under the Dodd-Frank Act or the FDI Act. The stay-and-transfer provisions of the U.S. special resolution regimes should be enforced with respect to all contracts of any U.S. GSIB entity that enters resolution under a U.S. special resolution regime as well as all transactions of the subsidiaries of such an entity. Nonetheless, it is possible that a court in a foreign jurisdiction would decline to enforce those provisions in cases brought before it (such as a case regarding a covered QFC between a covered entity and a non-U.S. entity that is governed by non-U.S. law and secured by collateral located outside the United States). By requiring that the effect of the statutory stay-and-transfer provisions be incorporated directly into the QFC contractually, the proposed requirement would help ensure that a court in a foreign jurisdiction would enforce the effect of those provisions, regardless of whether the court would otherwise have decided to enforce the U.S. statutory provisions themselves.<sup>73</sup> For example, the proposed provisions should prevent a U.K. counterparty of a U.S. GSIB from persuading a U.K. court that it should be permitted to seize and liquidate collateral located in the United Kingdom in response to the U.S. GSIB's entry into OLA resolution. And the knowledge that a court in a foreign jurisdiction would reject the purported exercise of default rights in violation of the required provisions would deter covered entities' counterparties from attempting to exercise such rights.

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<sup>73</sup> See generally Financial Stability Board, "Principles for Cross-border Effectiveness of Resolution Actions" (November 3, 2015), available at <http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf>.

This requirement would advance the proposal's goal of removing QFC-related obstacles to the orderly resolution of a GSIB. As discussed above, restrictions on the exercise of QFC default rights are an important prerequisite for an orderly GSIB resolution. Congress recognized the importance of such restrictions when it enacted the stay-and-transfer provisions of the U.S. special resolution regimes. As demonstrated by the 2007–2009 financial crisis, the modern financial system is global in scope, and covered entities are party to large volumes of QFCs with connections to foreign jurisdictions. The stay-and-transfer provisions of the U.S. special resolution regimes would not achieve their purpose of facilitating orderly resolution in the context of the failure of a GSIB with large volumes of such QFCs if QFCs could escape the effect of those provisions. To remove any doubt about the scope of coverage of these provisions, the proposed requirement would ensure that the stay-and-transfer provisions apply as a matter of contract to all covered QFCs, wherever the transaction. This will advance the resolvability goals of the Dodd-Frank Act and the FDI Act.

This section of the proposal is consistent with efforts by regulators in other jurisdictions to address similar risks by requiring that financial firms within their jurisdictions ensure that the effect of the similar provisions under these foreign jurisdictions' respective special resolution regimes would be enforced by courts in other jurisdictions, including the United States. For example, the United Kingdom's Prudential Regulation Authority (PRA) recently required certain financial firms to ensure that their counterparties to newly created obligations agree to be subject to stays on early termination that are similar to those that would apply upon a U.K. firm's entry into resolution if the financial arrangements were governed by U.K. law.<sup>74</sup> Similarly, the

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<sup>74</sup> See PRA Rulebook: CRR Firms and Non-Authorised Persons: Stay in Resolution Instrument 2015, available at <http://www.bankofengland.co.uk/pru/Documents/publications/ps/2015/ps2515app1.pdf>; see also Bank of England, Prudential Regulation Authority, "Contractual stays in financial contracts governed by third-country law" (PS25/15)

German parliament passed a law in November 2015 requiring German financial institutions to have provisions in financial contracts that are subject to the law of a country outside of the European Union that acknowledge the provisions regarding the temporary suspension of termination rights and accept the exercise of the powers regarding such temporary suspension under the German special resolution regime.<sup>75</sup> Additionally, the Swiss Federal Council requires that banks “ensure at both the individual institution and group level that new agreements or amendments to existing agreements which are subject to foreign law or envisage a foreign jurisdiction are agreed only if the counterparty recognises a postponement of the termination of agreements in accordance with” the Swiss special resolution regime.<sup>76</sup>

*Question 9: The Board invites comment on all aspects of this section of the proposal.*

***E. Prohibited Cross-Default Rights (Section 252.84 of the Proposed Rule)***

**Definitions.** Section 252.84 of the proposal pertains to cross-default rights in QFCs between covered entities and their counterparties, many of which are subject to credit enhancements (such as a guarantee) provided by an affiliate of the covered entity. Because credit enhancements on QFCs are themselves “qualified financial contracts” under the Dodd-Frank Act’s definition of that term (which this proposal would adopt), the proposal includes the

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(November 2015), available at <http://www.bankofengland.co.uk/prd/Documents/publications/ps/2015/ps2515.pdf>. These PRA rules apply to PRA-authorized banks, building societies, PRA-designated investment firms, and their qualifying parent undertakings, including U.K. financial holding companies and U.K. mixed financial holding companies.

<sup>75</sup> See Gesetz zur Sanierung und Abwicklung von Instituten und Finanzgruppen, Sanierungs- und Abwicklungsgesetz [SAG] [German Act on the Reorganisation and Liquidation of Credit Institutions], Dec. 10, 2014, § 60a, <https://www.gesetze-im-internet.de/bundesrecht/sag/gesamt.pdf>.

<sup>76</sup> See Verordnung über die Finanzmarktinfrastrukturen und das Marktverhalten im Effekten- und Derivatehandel [FinfraV] [Ordinance on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading] Nov. 25, 2015, amending Bankenverordnung vom 30. April 2014 [BankV] [Banking Ordinance of 30 April 2014] Apr. 30, 2014, SR 952.02, art. 12 paragraph 2<sup>bis</sup>, [translation at http://www.news.admin.ch/NSBSubscriber/message/attachments/42659.pdf](http://www.news.admin.ch/NSBSubscriber/message/attachments/42659.pdf); see also Erläuterungsbericht zur Verordnung über die Finanzmarktinfrastrukturen und das Marktverhalten im Effekten- und Derivatehandel (Nov. 25, 2015) (providing commentary).

following additional definitions in order to facilitate a precise description of the relationships to which it would apply.

First, the proposal distinguishes between a credit enhancement and a “direct QFC,” defined as any QFC that is not a credit enhancement.<sup>77</sup> The proposal also defines “direct party” to mean a covered entity that is itself a party to the direct QFC, as distinct from an entity that provides a credit enhancement.<sup>78</sup> In addition, the proposal defines “affiliate credit enhancement” to mean “a credit enhancement that is provided by an affiliate of the party to the direct QFC that the credit enhancement supports,” as distinct from a credit enhancement provided by either the direct party itself or by an unaffiliated party.<sup>79</sup> Moreover, the proposal defines “covered affiliate credit enhancement” to mean an affiliate credit enhancement provided by a covered entity and defines “covered affiliate support provider” to mean the covered entity that provides the covered affiliate credit enhancement.<sup>80</sup> Finally, the proposal defines the term “supported party” to mean any party that is the beneficiary of a covered affiliate credit enhancement (that is, the QFC counterparty of a direct party, assuming that the direct QFC is subject to a covered affiliate credit enhancement).<sup>81</sup>

**General prohibitions.** Subject to the substantial exceptions discussed below, the proposal would prohibit a covered entity from being party to a covered QFC that allows for the exercise of any default right that is related, directly or indirectly, to the entry into resolution of an

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<sup>77</sup> See proposed rule § 252.84(c)(2).

<sup>78</sup> See proposed rule § 252.84(c)(1).

<sup>79</sup> See proposed rule § 252.84(c)(3).

<sup>80</sup> See proposed rule § 252.84(f)(2).

<sup>81</sup> See proposed rule § 252.84(f)(4).

affiliate of the covered entity.<sup>82</sup> The proposal also would generally prohibit a covered entity from being party to a covered QFC that would prohibit the transfer of any credit enhancement applicable to the QFC (such as another entity's guarantee of the covered entity's obligations under the QFC), along with associated obligations or collateral, upon the entry into resolution of an affiliate of the covered entity.<sup>83</sup>

A primary purpose of the proposed restrictions is to facilitate the resolution of a GSIB outside of Title II, including under the Bankruptcy Code. As discussed above, the potential for mass exercises of QFC default rights is one reason why a GSIB's failure could do severe damage to financial stability. In the context of an SPOE resolution, if the GSIB parent's entry into resolution led to the mass exercise of cross-default rights by the subsidiaries' QFC counterparties, then the subsidiaries could themselves fail or experience financial distress. Moreover, the mass exercise of QFC default rights could entail asset firesales, which likely would affect other financial companies and undermine financial stability. Similar disruptive results can occur with an MPOE resolution of an affiliate of an otherwise performing entity triggers default rights on QFCs involving the performing entity.

In an SPOE resolution, this damage can be avoided if actions of the following two types are prevented: the exercise of direct default rights against the top-tier holding company that has entered resolution, and the exercise of cross-default rights against the operating subsidiaries based on their parent's entry into resolution. (Direct default rights against the subsidiaries would

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<sup>82</sup> See proposed rule § 252.84(b)(1).

<sup>83</sup> See proposed rule § 252.84(b)(2). This prohibition would be subject to an exception that would allow supported parties to exercise default rights with respect to a QFC if the supported party would be prohibited from being the beneficiary of a credit enhancement provided by the transferee under any applicable law, including the Employee Retirement Income Security Act of 1974 and the Investment Company Act of 1940. This exception is substantially similar to an exception to the transfer restrictions in section 2(f) of the ISDA 2014 Resolution Stay Protocol (2014 Protocol) and the ISDA 2015 Universal Resolution Stay Protocol, which was added to address concerns expressed by asset managers during the drafting of the 2014 Protocol.

not be exercisable, because the subsidiaries would not enter resolution.) In an MPOE resolution, this damage occurs from exercise of default rights against a performing entity based on the failure of an affiliate.

Under the OLA, the Dodd-Frank Act's stay-and-transfer provisions would address both direct default rights and cross-default rights. But, as explained above, no similar statutory provisions would apply to a resolution under the Bankruptcy Code. This proposal attempts to address these obstacles to orderly resolution under the Bankruptcy Code by extending the stay-and-transfer provisions to any type of resolution of a covered entity. Similarly, the proposal would facilitate a transfer of the GSIB parent's interests in its subsidiaries, along with any credit enhancements it provides for those subsidiaries, to a solvent financial company by prohibiting covered entities from having QFCs that would allow the QFC counterparty to prevent such a transfer or to use it as a ground for exercising default rights.<sup>84</sup>

The proposal also is intended to facilitate other approaches to GSIB resolution. For example, it would facilitate a similar resolution strategy in which a U.S. depository institution subsidiary of a GSIB enters resolution under the FDI Act while its subsidiaries continue to meet their financial obligations outside of resolution.<sup>85</sup> Similarly, the proposal would facilitate the orderly resolution of a foreign GSIB under its home jurisdiction resolution regime by preventing the exercise of cross-default rights against the foreign GSIB's U.S. operations. The proposal would also facilitate the resolution of the U.S. intermediate holding company of a foreign GSIB, and the recapitalization of its U.S. operating subsidiaries, as part of a broader MPOE resolution

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<sup>84</sup> See proposed rule § 252.84(b).

<sup>85</sup> As discussed above, the FDI Act would prevent the exercise of direct default rights against the depository institution, but it does not address the threat posed to orderly resolution by cross-default rights in the QFCs of the depository institution's subsidiaries. This proposal would facilitate orderly resolution under the FDI Act by filling that gap.



strategy under which the foreign GSIB's operations in other regions would enter separate resolution proceedings. Finally, the proposal would broadly prevent the unanticipated failure of any one GSIB entity from bringing about the disorderly failures of its affiliates by preventing the affiliates' QFC counterparties from using the first entity's failure as a ground for exercising default rights against those affiliates that continue meet to their obligations.

The proposal is intended to enhance the potential for orderly resolution of a GSIB under the Bankruptcy Code, the FDI Act, or a similar resolution regime. By doing so, the proposal would advance the Dodd-Frank Act's goal of making orderly GSIB resolution workable under the Bankruptcy Code.<sup>86</sup>

The proposal could also benefit the counterparties of a subsidiary of a failed GSIB, by preventing the disorderly failure of the subsidiary and allowing it to continue to meet its obligations. While it may be in the individual interest of any given counterparty to exercise any available rights to run on a subsidiary of a failed GSIB, the mass exercise of such rights could harm the counterparties' collective interest by causing an otherwise-solvent subsidiary to fail. Therefore, like the automatic stay in bankruptcy, which serves to maximize creditors' ultimate recoveries by preventing a disorderly liquidation of the debtor, the proposal would mitigate this collective action problem to the benefit of the failed firm's creditors and counterparties by preventing a disorderly resolution. And because many creditors and counterparties of GSIBs are themselves systemically important financial firms, improving outcomes for those creditors and counterparties would further protect the financial stability of the United States.

**General creditor protections.** While the proposed restrictions would facilitate orderly resolution, they would also diminish the ability of covered entities' QFC counterparties to

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<sup>86</sup> See 12 U.S.C. 5365(d).

include certain protections for themselves in covered QFCs. In order to reduce this effect, the proposal includes several substantial exceptions to the proposed restrictions.<sup>87</sup> These permitted creditor protections are intended to allow creditors to exercise cross-default rights outside of an orderly resolution of a GSIB (as described above) and therefore would not be expected to undermine such a resolution.

First, in order to ensure that the proposed prohibitions would apply only to cross-default rights (and not direct default rights), the proposal would provide that a covered QFC may permit the exercise of default rights based on the direct party's entry into a resolution proceeding, other than a proceeding under a U.S. or foreign special resolution regime.<sup>88</sup> This provision would help ensure that, if the direct party to a QFC were to enter bankruptcy, its QFC counterparties could exercise any relevant direct default rights. Thus, a covered entity's direct QFC counterparties would not risk the delay and expense associated with becoming involved in a bankruptcy proceeding, and would be able to take advantage of default rights that would fall within the Bankruptcy Code's safe harbor provisions.

The proposal would also allow covered QFCs to permit the exercise of default rights based on the failure of the direct party, a covered affiliate support provider, or a transferee that assumes a credit enhancement to satisfy its payment or delivery obligations under the direct QFC or credit enhancement.<sup>89</sup> Moreover, the proposal would allow covered QFCs to permit the exercise of a default right in one QFC that is triggered by the direct party's failure to satisfy its

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<sup>87</sup> See proposed rule § 252.84(e).

<sup>88</sup> See proposed rule § 252.84(e)(1). Special resolution regimes typically stay direct default rights, but may not stay cross-default rights. For example, as discussed above, the FDI Act stays direct default rights, see 12 U.S.C. 1821(e)(10)(B), but does not stay cross-default rights, whereas the Dodd-Frank Act's OLA stays direct default rights and cross-defaults arising from a parent's receivership, see 12 U.S.C. 5390(c)(10)(B), 5390(c)(16).

<sup>89</sup> See proposed rule § 252.84(e)(2)–(3).

payment or delivery obligations under another contract between the same parties. This exception takes appropriate account of the interdependence that exists among the contracts in effect between the same counterparties.

The proposed exceptions for the creditor protections described above are intended to help ensure that the proposal permits a covered entity's QFC counterparties to protect themselves from imminent financial loss and does not create a risk of delivery gridlocks or daisy-chain effects, in which a covered entity's failure to make a payment or delivery when due leaves its counterparty unable to meet its own payment and delivery obligations (the daisy-chain effect would be prevented because the covered entity's counterparty would be permitted to exercise its default rights, such as by liquidating collateral). These exceptions are generally consistent with the treatment of payment and delivery obligations under the U.S. special resolution regimes.<sup>90</sup>

These exceptions also help to ensure that a covered entity's QFC counterparty would not risk the delay and expense associated with becoming involved in a bankruptcy proceeding, since, unlike a typical creditor of an entity that enters bankruptcy, the QFC counterparty would retain its ability under the Bankruptcy Code's safe harbors to exercise direct default rights. This should further reduce the counterparty's incentive to run. Reducing incentives to run in the lead up to resolution promotes orderly resolution, since a QFC creditor run (such as a mass withdrawal of repo funding) could lead to a disorderly resolution and pose a threat to financial stability.

**Additional creditor protections for supported QFCs.** The proposal would allow additional creditor protections for a non-defaulting counterparty that is the beneficiary of a credit enhancement from an affiliate of the covered entity that is also a covered entity under the

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<sup>90</sup> See 12 U.S.C. 1821(e)(8)(G)(ii), 5390(c)(8)(F)(ii) (suspending payment and delivery obligations for one business day or less).

proposal.<sup>91</sup> The proposal would allow these creditor protections in recognition of the supported party's interest in receiving the benefit of its credit enhancement. These creditor protections would not undermine an SPOE resolution of a GSIB.

Where a covered QFC is supported by a covered affiliate credit enhancement,<sup>92</sup> the covered QFC and the credit enhancement would be permitted to allow the exercise of default rights under the circumstances discussed below after the expiration of a stay period. Under the proposal, the applicable stay period would begin when the credit support provider enters resolution and would end at the later of 5:00 p.m. (eastern time) on the next business day and 48 hours after the entry into resolution.<sup>93</sup> This portion of the proposal is similar to the stay treatment provided in a resolution under the OLA or the FDI Act.<sup>94</sup>

Under the proposal, default rights could be exercised at the end of the stay period if the covered affiliate credit enhancement has not been transferred away from the covered affiliate support provider and that support provider becomes subject to a resolution proceeding other than a proceeding under Chapter 11 of the Bankruptcy Code.<sup>95</sup> Default rights could also be exercised at the end of the stay period if the transferee (if any) of the credit enhancement enters a

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<sup>91</sup> See proposed rule § 252.84(g).

<sup>92</sup> Note that the exception in § 252.84(g) of the proposed rule would not apply with respect to credit enhancements that are not covered affiliate credit enhancements. In particular, it would not apply with respect to a credit enhancement provided by a non-U.S. entity of a foreign GSIB, which would not be a covered entity under the proposal. Such credit enhancements would be excluded in order to help ensure that the resolution of a non-U.S. entity would not negatively affect the financial stability of the United States by allowing for the exercise of default rights against a covered entity.

<sup>93</sup> See proposed rule § 252.84(h)(1).

<sup>94</sup> See 12 U.S.C. 1821(e)(10)(B)(I), 5390(c)(10)(B)(i), 5390(c)(16)(A). While the proposed stay period is similar to the stay periods that would be imposed by the U.S. special resolution regimes, it could run longer than those stay periods under some circumstances.

<sup>95</sup> See proposed rule § 252.84(g)(1). Chapter 11 (11 U.S.C. 1101–1174) is the portion of the Bankruptcy Code that provides for the reorganization of the failed company, as opposed to its liquidation, and, relative to special resolution regimes, is generally well-understood by market participants.

resolution proceeding, protecting the supported party from a transfer of the credit enhancement to a transferee that is unable to meet its financial obligations.

Default rights could also be exercised at the end of the stay period if the original credit support provider does not remain, and no transferee becomes, obligated to the same (or substantially similar) extent as the original credit support provider was obligated immediately prior to entering a resolution proceeding (including a Chapter 11 proceeding) with respect to (a) the credit enhancement applicable to the covered QFC, (b) all other credit enhancements provided by the credit support provider on any other QFCs between the same parties, and (c) all credit enhancements provided by the credit support provider between the direct party and affiliates of the direct party's QFC counterparty.<sup>96</sup> Such creditor protections would be permitted in order to prevent the support provider or the transferee from "cherry picking" by assuming only those QFCs of a given counterparty that are favorable to the support provider or transferee. Title II and the FDI Act contain similar provisions to prevent cherry picking.

Finally, if the covered affiliate credit enhancement is transferred to a transferee, then the non-defaulting counterparty could exercise default rights at the end of the stay period unless either (a) all of the support provider's ownership interests in the direct party are also transferred to the transferee or (b) reasonable assurance is provided that substantially all of the support provider's assets (or the net proceeds from the sale of those assets) will be transferred to the transferee in a timely manner. These conditions would help to assure the supported party that the transferee would be at least roughly as financially capable of providing the credit enhancement

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<sup>96</sup> See proposed rule § 252.84(g)(3).

as the covered affiliate support provider. Title II contains a similar provision regarding affiliate credit enhancements.<sup>97</sup>

**Creditor protections related to FDI Act proceedings.** Moreover, in the case of a covered QFC that is supported by a covered affiliate credit enhancement, both the covered QFC and the credit enhancement would be permitted to allow the exercise of default rights related to the credit support provider's entry into resolution proceedings under the FDI Act<sup>98</sup> under the following circumstances: (a) after the FDI Act stay period,<sup>99</sup> if the credit enhancement is not transferred under the relevant provisions of the FDI Act<sup>100</sup> and associated regulations, and (b) during the FDI Act stay period, to the extent that the default right permits the supported party to suspend performance under the covered QFC to the same extent as that party would be entitled to do if the covered QFC were with the credit support provider itself and were treated in the same manner as the credit enhancement.<sup>101</sup> This provision is intended to ensure that a QFC counterparty of a subsidiary of a bank that goes into FDI Act receivership can receive the same level of protection that the FDI Act provides to QFC counterparties of the bank itself.

**Prohibited terminations.** In case of a legal dispute as to a party's right to exercise a default right under a covered QFC, the proposal would require that a covered QFC must provide that, after an affiliate of the direct party has entered a resolution proceeding, (a) the party seeking to exercise the default right bears the burden of proof that the exercise of that right is indeed

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<sup>97</sup> 12 U.S.C. 5390(c)(16)(A).

<sup>98</sup> As discussed above, the FDI Act stays direct default rights against the failed depository institution but does not stay the exercise of cross-default rights against its affiliates.

<sup>99</sup> Under the FDI Act, the relevant stay period runs until 5:00 p.m. (eastern time) on the business day following the appointment of the FDIC as receiver. 12 U.S.C. 1821(e)(10)(B)(I).

<sup>100</sup> 12 U.S.C. 1821(e)(9)–(10).

<sup>101</sup> See proposed rule § 252.84(i).

permitted by the covered QFC and (b) the party seeking to exercise the default right must meet a “clear and convincing evidence” standard, a similar standard,<sup>102</sup> or a more demanding standard.

The purpose of this proposed requirement is to deter the QFC counterparty of a covered entity from thwarting the purpose of this proposal by exercising a default right because of an affiliate’s entry into resolution under the guise of other default rights that are unrelated to the affiliate’s entry into resolution.

**Agency transactions.** In addition to entering into QFCs as principals, GSIBs may engage in QFCs as agent for other principals. For example, a GSIB subsidiary may enter into a master securities lending arrangement with a foreign bank as agent for a U.S.-based pension fund. The GSIB would document its role as agent for the pension fund, often through an annex to the master agreement, and would generally provide to its customer (the principal party) a securities replacement guarantee or indemnification for any shortfall in collateral in the event of the default of the foreign bank.<sup>103</sup> A covered entity may also enter into a QFC as principal where there is an agent acting on its behalf or on behalf of its counterparty.

This proposal would apply to a covered QFC regardless of whether the covered entity or the covered entity’s direct counterparty is acting as a principal or as an agent. Section 252.83 and section 252.84 do not distinguish between agents and principals with respect to default rights or transfer restrictions applicable to covered QFCs. Section 252.83 would limit default rights and transfer restrictions that the principal and its agent may have against a covered entity

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<sup>102</sup> The reference to a “similar” burden of proof is intended to allow covered QFCs to provide for the application of a standard that is analogous to clear and convincing evidence in jurisdictions that do not recognize that particular standard. A covered QFC would not be permitted to provide for a lower standard.

<sup>103</sup> The definition of QFC under Title II of the Dodd-Frank Act includes security agreements and other credit enhancements as well as master agreements (including supplements). 12 U.S.C. 5390(c)(8)(D).

consistent with the U.S. special resolution regimes.<sup>104</sup> Section 252.84 would ensure that, subject to the enumerated creditor protections, neither the agent nor the principal could exercise cross-default rights under the covered QFC against the covered entity based on the resolution of an affiliate of the covered entity.<sup>105</sup>

**Compliance with the ISDA 2015 Resolution Stay Protocol.** As an alternative to compliance with the requirements of section 252.84 that are described above, a covered entity would comply with the proposed rule to the extent its QFCs are amended by to the current ISDA 2015 Universal Resolution Stay Protocol, including the Securities Financing Transaction Annex and the Other Agreements Annex, as well as subsequent, immaterial amendments to the Protocol.<sup>106</sup> The Protocol “enables parties to amend the terms of their [contracts] to contractually recognize the cross-border application of special resolution regimes applicable to certain financial companies and support the resolution of certain financial companies under the United States Bankruptcy Code.”<sup>107</sup> The Protocol amends ISDA Master Agreements, which are used for derivatives transactions. Market participants that adhere to the Protocol would amend

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<sup>104</sup> See proposed rule § 252.83(a)(3).

<sup>105</sup> See proposed rule § 252.84(d). If a covered entity (acting as agent) is a direct party to a covered QFC, then the general prohibitions of section 252.84(d) would only affect the substantive rights of the agent’s principal(s) to the extent that the covered QFC provides default rights based directly or indirectly on the entry into resolution of an affiliate of the covered entity (acting as agent). See also proposed rule § 252.84(a)(3).

<sup>106</sup> International Swaps and Derivatives Association, Inc., “ISDA 2015 Universal Resolution Stay Protocol” (November 4, 2015), available at <http://assets.isda.org/media/ac6b533f-3/5a7c32f8-pdf/>. The Protocol was developed by a working group of member institutions of the International Swaps and Derivatives Association, Inc. (ISDA), in coordination with the Board, the FDIC, the OCC, and foreign regulatory agencies. The Securities Financing Transaction Annex was developed by the International Capital Markets Association, the International Securities Lending Association, and the Securities Industry and Financial Markets Association, in coordination with ISDA. ISDA is expected to supplement the Protocol with ISDA Resolution Stay Jurisdictional Modular Protocols for the United States and other jurisdictions. A jurisdictional module for the United States that is substantively identical to the Protocol in all respects aside from exempting QFCs between adherents that are not covered entities or covered banks would be consistent with the current proposal.

<sup>107</sup> Protocol Press Release at <http://www2.isda.org/functional-areas/protocol-management/protocol/22>.



their master agreements for securities financing transactions pursuant to the Securities Financing Transaction Annex to the Protocol and would amend all other QFCs pursuant to the Other Agreements Annex. Thus, a covered entity would comply with the proposed rule with respect to all of its covered QFCs through adherence to the Protocol and the annexes.

The Protocol has the same general objective as the proposed rule: to make GSIBs more resolvable by amending their contracts to, in effect, contractually recognize the applicability of U.S. special resolution regimes<sup>108</sup> and to restrict cross-default provisions to facilitate orderly resolution under the U.S. Bankruptcy Code. Moreover, the provisions of the Protocol largely track the requirements of the proposed rule.<sup>109</sup>

The scope of the stay and transfer provisions in the Protocol are narrower than the stay and transfer provisions required under the proposal.<sup>110</sup> The Protocol also allows any non-defaulting counterparty to exercise its related default rights<sup>111</sup> under the agreement if an affiliate

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<sup>108</sup> The Protocol also includes other special resolution regimes. Currently, the Protocol includes special resolution regimes in place in France, Germany, Japan, Switzerland, and the United Kingdom. Other special resolution regimes that meet the definition of “Protocol-eligible Regime” may be added to the Protocol.

<sup>109</sup> Sections 2(a) and (b) of the Protocol provide the stays required under paragraph (b)(1) of proposed rule § 252.84 for the most common U.S. insolvency regimes. Section 2(f) of the Protocol overrides transfer restrictions as required under paragraph (b)(2) of proposed rule § 252.84 for transfers that are consistent with the Protocol. The Protocol’s exemptions from the stay for “Performance Default Rights” and the “Unrelated Default Rights” described in paragraph (a) of the definition are consistent with the proposal’s general creditor protections permitted under paragraph (b) of proposed rule § 252.84. The Protocol’s burden of proof provisions (see section 2(i) of the Protocol and the definition of Unrelated Default Rights) and creditor protections for credit enhancement providers in FDI Act proceedings (see Section 2(d) of the Protocol) are also consistent with the paragraphs (j) and (i), respectively, of proposed rule § 252.84. Note also that, although exercise of Performance Default Rights under the Protocol does not require a showing of clear and convincing evidence while these same rights under the proposal (proposed rule § 225.84(e)) would require such a showing, this difference between the Protocol and the proposal does not appear to be meaningful because clearly documented evidence for such default rights (i.e., payment and performance failures, entry into resolution proceedings) should exist.

<sup>110</sup> The Protocol only stays default rights arising from proceedings under Chapters 7 and 11 of the Bankruptcy Code, the FDI Act, and the Securities Investor Protection Act (U.S. Federal insolvency proceedings). The stay required under proposed rule § 252.84 is broader; it requires a stay to apply under any receivership, insolvency, liquidation, resolution, or similar proceeding, and therefore includes applicable state and foreign insolvency proceedings.

<sup>111</sup> Related default rights refer to default rights based solely on such insolvency or receivership of the affiliate. See paragraph (b) of the definition of Unrelated Default Rights in the Protocol.

of its direct party enters resolution proceedings (other than U.S. Federal insolvency proceedings) while the top-tier U.S. parent of the counterparty's direct party remains outside of resolution proceedings.

The Protocol also provides a number of protections to supported parties that are additional to, or stronger versions of, the creditor protections the proposal otherwise permits for supported parties.<sup>112</sup> Specifically, the Protocol's protections require that the covered affiliate support provider or transferee to remain obligated to the "same extent" for its stay to remain effective,<sup>113</sup> and that the direct party remain duly registered and licensed by relevant regulatory bodies.<sup>114</sup> In addition, the Protocol is more specific than the proposal as to the form and timing of the assurance that the covered affiliate support provider's assets (or net proceeds therefrom) would be transferred to the transferee.<sup>115</sup>

A number of the additional creditor protections of the Protocol depend on whether credit enhancements have been transferred to another entity. Additional protections for situations in which the credit enhancements are transferred include the transferee satisfying all material payment and delivery obligations to each of its creditors during the stay period;<sup>116</sup> the transferee

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<sup>112</sup> The Protocol is consistent with the creditor protections of paragraphs (e)(1) and (e)(2) of § 252.84. Section 2(b) of the Protocol requires the support provider to have entered only a Chapter 11 resolution proceeding. Section 2(b)(ii)(A)(II) requires the transferee to remain outside of resolution proceedings.

<sup>113</sup> See paragraph (a) of the definition of DIP Stay Conditions and paragraphs (b) and (c) of the definition of Transfer Stay Conditions in the Protocol. In contrast, the proposal would not permit a covered QFC to exempt the non-defaulting party from the stay and transfer requirements of proposed rule § 252.84 if the covered affiliate support provider or transferee remains obligated to the same *or substantially similar extent* as the covered affiliate support provider was immediately prior to entering the resolution proceeding. See proposed rule § 252.84(g)(3).

<sup>114</sup> See section 2(b)(ii)(C)(I) and 2(b)(iii)(C) of the Protocol.

<sup>115</sup> The proposal would not otherwise permit a QFC to be relieved from § 252.84's general prohibitions as long as the non-defaulting counterparty to receives "reasonable assurance" that the covered affiliate support provider's assets (or net proceeds therefrom) would be transferred to the transferee, as described above. See proposed rule § 252.84(g)(4). The Protocol requires that the bankruptcy court issue order to that effect at the end of the stay period. Section 2(b)(ii) of the Protocol.

<sup>116</sup> Section 2(b)(ii)(A)(II) of the Protocol.

continuing to satisfy all financial covenants and other terms applicable to the credit enhancement provider under the agreement after the stay period;<sup>117</sup> and the transferee continuing to satisfy all provisions and covenants regarding the attachment, enforceability, perfection, or priority of property securing the obligations of the credit enhancement after the stay period.<sup>118</sup> Additional protections for situations in which the affiliate credit support provider remains obligated after the resolution proceeding include the bankruptcy court's issuance of an order by the end of the stay period providing supported parties with increased creditor priority in bankruptcy.<sup>119</sup>

As compared to the creditor protections provided in the proposal, the Protocol's additional creditor protections appear to meaningfully increase a supported party's assurance that material payment and delivery obligations under its covered QFCs will continue to be performed and should meaningfully decrease the supported party's credit risk to its direct parties.<sup>120</sup>

Moreover, the additional creditor protections do not appear to materially diminish the prospects for the orderly resolution of a GSIB entity because the Protocol includes a number of desirable features that the proposal lacks. First, when an entity (whether or not it is a covered

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<sup>117</sup> Section 2(b)(ii)(C)(II) of the Protocol. This requirement only applies with respect to transfers to transferees that are not affiliated with the credit support provider. See id.; definition of Bankruptcy Bridge Company of the Protocol.

<sup>118</sup> Section 2(b)(ii)(C)(III) of the Protocol.

<sup>119</sup> Section 2(b)(iii)(B) and the definition of DIP Stay Conditions of the Protocol. The Protocol permits such closeout pursuant to section 2(c). The order would (1) include the grant of administrative expense status to the non-defaulting counterparty's claims against the credit enhancements the affiliate support provider has provided the counterparty; (2) allow the non-defaulting counterparty to exercise its default rights with respect to a direct QFCs supported by the affiliate support provider without further involvement from the bankruptcy court if the direct party or affiliate support provider fail to meet any material obligations to the counterparty under the agreement; and (3) allow the counterparty to exercise its default rights against the direct party and affiliate support provider without further involvement from the bankruptcy court if the direct party failed to pay or deliver to another party any close-out amount when due and the affiliate support provider does not satisfy its obligations under a credit enhancement that supports the direct QFC with the other party. Paragraphs (a)-(c) of the definition of Creditor Protection Order of the Protocol.

<sup>120</sup> See proposed rule § 252.85(d)(7), (9).

entity) adheres to the Protocol, it necessarily adheres to the Protocol with respect to all covered entities that have also adhered to the Protocol rather than one or a subset of covered entities (as the proposal may otherwise permit).<sup>121</sup> Since many covered entities have already adhered to the Protocol, any other entity that chooses to adhere will simultaneously adhere with respect to all covered entities.<sup>122</sup> This feature appears to allow the Protocol to address impediments to resolution on an industry-wide basis and increase market certainty, transparency, and equitable treatment with respect to default rights of non-defaulting parties.<sup>123</sup> Other features of the Protocol that the proposal otherwise lacks also reflect positively toward other proposed factors relevant to proposals for enhanced creditor protections: The Protocol amends all existing transactions of adhering parties;<sup>124</sup> does not provide the counterparty with default rights in addition to those provided under the underlying QFC,<sup>125</sup> and, as noted, applies to all QFCs.<sup>126</sup> These features also increase the chances that all or most of the QFC counterparties to a GSIB will be stayed to the same extent in the resolution of the GSIB and improve the chances that a GSIB could be resolved in an orderly manner. Finally, the Protocol is not limited to resolution under the U.S. Bankruptcy Code but also includes U.S. special resolution regimes and certain

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<sup>121</sup> Under section 4(a) of the Protocol, the Protocol is generally effective as between any two adhering parties, once the relevant effective date has arrived. Under section 4(b)(ii), an adhering party that is not a covered entity may choose to opt out of section 2 of the Protocol with respect to its contracts with any other adhering party that is also not a covered entity. However, the Protocol will apply to relationships between any covered entity that adheres and any other adhering party.

<sup>122</sup> See proposed rule § 252.85(d)(3), (6).

<sup>123</sup> See proposed rule § 252.85(d)(3).

<sup>124</sup> See proposed rule § 252.85(d)(4). If a covered entity intends to continue to comply with the requirements of the proposal through the Protocol alternative after its initial adherence, the covered entity should ensure that future master agreements and credit enhancements also become subject to the terms of the Protocol.

<sup>125</sup> See proposed rule § 252.85(d)(10). Moreover, the Protocol overrides unexercised default rights in certain circumstances. Section 2(e) of the Protocol.

<sup>126</sup> See proposed rule § 252.85(d)(5).

non-U.S. special resolution regimes, which should help facilitate the resolution of a GSIB across a broader range of scenarios.

The features, considered together, appear to advance the proposal’s objective of increasing the likelihood that a resolution of a GSIB under a range of scenarios could be carried out in an orderly manner.<sup>127</sup> For these reasons, and consistent with the Board’s objective of increasing GSIB resolvability, the proposed rule would allow a covered entity to bring its covered QFCs into compliance by amending them through adherence to the Protocol.

*Question 10: The Board invites comment on the proposed restrictions on cross-default rights in covered entities’ QFCs. Is the proposal sufficiently clear, such that parties to a conforming QFC will understand what default rights are and are not exercisable in the context of a GSIB resolution? How could the proposed restrictions be made clearer?*

*Question 11: Are the proposed restrictions on cross-default rights under-inclusive, such that the proposed restrictions would permit default rights that would have the same or similar potential to undermine an orderly GSIB resolution and should therefore be subjected to similar restrictions?*

*Question 12: In particular, would it be appropriate for the prohibition to explicitly cover default rights that are based on or related to the “financial condition” of an affiliate of the direct party (for example, rights based on an affiliate’s credit rating, stock price, or regulatory capital level)?<sup>128</sup>*

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<sup>127</sup> See proposed rule § 252.85(d)(1)–(2).

<sup>128</sup> Cf. 12 U.S.C. 5390(c)(16) (staying “any contractual right to cause the termination, liquidation, or acceleration of such contracts based solely on the insolvency, financial condition, or receivership of the covered financial company”).

*Question 13: The Board invites comment on whether the proposed restrictions should be expanded to cover contractual rights that a QFC counterparty may have to terminate the QFC at will or without cause, including rights that arise on a periodic basis. Could such rights be used to circumvent the proposed restrictions on cross-default rights? If so, how, if at all, should the proposed rule regulate such contractual rights?*

*Question 14: The Board invites comment on the proposed provisions permitting specific creditor protections in covered entities' QFCs. Does the proposal draw an appropriate balance between protecting financial stability from risks associated with QFC unwinds and maintaining important creditor protections? Should the proposed set of permitted creditor protections be expanded to allow for other creditor protections that would fall within the proposed restrictions? Is the proposed set of permitted creditor protections sufficiently clear?*

*Question 15: The Board invites comment on its proposal to treat as compliant with section 252.84 of the proposal any covered QFC that has been amended by the Protocol. Does adherence to the Protocol suffice to meet the goals of this proposal and appropriately safeguard U.S. financial stability?*

*Question 16: The Board invites comment on the proposed requirement for burden-of-proof provisions in covered QFCs. Is the proposed requirement drafted appropriately to advance the goals of this proposal? Would those goals be better advanced by alternative or complementary provisions?*

*Question 17: The Board invites comment on all aspects of the proposed treatment of agency transactions, including whether creditor protections should apply to QFCs where the direct party is acting as agent under the QFC.*

*F. Process for Approval of Enhanced Creditor Protections (Section 252.85 of the Proposed Rule)*

As discussed above, the proposed restrictions would leave many creditor protections that are commonly included in QFCs unaffected. The proposal would also allow any covered entity to submit to the Board a request to approve as compliant with the rule one or more QFCs that contain additional creditor protections—that is, creditor protections that would be impermissible under the restrictions set forth above. A covered entity making such a request would be required to provide an analysis of the contractual terms for which approval is requested in light of a range of factors that are set forth in the proposed rule and intended to facilitate the Board’s consideration of whether permitting the contractual terms would be consistent with the proposed restrictions.<sup>129</sup> The Board also expects to consult with the FDIC and OCC during its consideration of such a request.

The first two factors concern the potential impact of the requested creditor protections on GSIB resilience and resolvability. The next four concern the potential scope of the proposal: adoption on an industry-wide basis, coverage of existing and future transactions, coverage of one or multiple QFCs, and coverage of some or all covered entities. Creditor protections that may be applied on an industry-wide basis may help to ensure that impediments to resolution are addressed on a uniform basis, which could increase market certainty, transparency, and equitable treatment. Creditor protections that apply broadly to a range of QFCs and covered entities would increase the chance that all of a GSIB’s QFC counterparties would be treated the same way during a resolution of that GSIB and may improve the prospects for an orderly resolution of that GSIB. By contrast, proposals that would expand counterparties’ rights beyond those afforded

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<sup>129</sup> Proposed rule § 252.85(d)(1)–(10).

under existing QFCs would conflict with the proposal's goal of reducing the risk of mass unwinds of GSIB QFCs. The proposal also includes three factors that focus on the creditor protections specific to supported parties. The Board may weigh the appropriateness of additional protections for supported QFCs against the potential impact of such provisions on the orderly resolution of a GSIB.

In addition to analyzing the request under the enumerated factors, a covered entity requesting that the Board approve enhanced creditor protections would be required to submit a legal opinion stating that the requested terms would be valid and enforceable under the applicable law of the relevant jurisdictions, along with any additional relevant information requested by the Board.

Under the proposal, the Board could approve a request for an alternative set of creditor protections if the terms of the QFC, as compared to a covered QFC containing only the limited exceptions permitted by the proposed rule, would prevent or mitigate risks to the financial stability of the United States that could arise from the failure of a GSIB and would protect the safety and soundness of bank holding companies and state member banks to at least the same extent. Once approved by the Board, enhanced creditor protections could be used by other covered entities (in addition to the covered entity that submitted the request for Board approval) as appropriate. The proposed request-and-approval process would improve flexibility by allowing for an industry-proposed alternative to the set of creditor protections permitted by the proposed rule while ensuring that any approved alternative would serve the proposal's policy goals to at least the same extent as a covered QFC that complies fully with the proposed rule.

*Question 18: The Board invites comment on all aspects of the proposed process for approval of enhanced creditor protections. Are the proposed considerations the appropriate*



*factors for the Board to take into account in deciding whether to grant a request for approval?*

*What other considerations are potentially relevant to such a decision?*

### **III. Transition Periods**

Under the proposal, the rule would take effect on the first day of the first calendar quarter that begins at least one year after the issuance of the final rule (effective date).<sup>130</sup> Entities that are covered entities when the final rule is issued would be required to comply with the proposed requirements beginning on the effective date. Thus, a covered entity would be required to ensure that covered QFCs entered into on or after the effective date comply with the rule's requirements.<sup>131</sup> Moreover, a covered entity would be required to bring a preexisting covered QFC entered into prior to the effective date into compliance with the rule no later than the first date on or after the effective date on which the covered entity or an affiliate (that is also a covered entity or covered bank) enters into a new covered QFC with the counterparty to the preexisting covered QFC or an affiliate of the counterparty.<sup>132</sup> (Thus, a covered entity would not be required to conform a preexisting QFC if that covered entity and its affiliates do not enter into any new QFCs with the same counterparty or its affiliates on or after the effective date.) Finally, an entity that becomes a covered entity after the final rule is issued would be required to comply by the first day of the first calendar quarter that begins at least one year after the entity becomes a covered entity.<sup>133</sup>

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<sup>130</sup> Under section 302(b) of the Riegle Community Development and Regulatory Improvement Act of 1994, new Board regulations that impose requirements on insured depository institutions generally must "take effect on the first day of a calendar quarter which begins on or after the date on which the regulations are published in final form." 12 U.S.C. 4802(b).

<sup>131</sup> See proposed rule §§ 252.83(a)(2)(i); 252.84(a)(2)(i).

<sup>132</sup> See proposed rule §§ 252.83(a)(2)(ii), 252.84(a)(2)(ii).

<sup>133</sup> See proposed rule § 252.82(c)(1).

By permitting a covered entity to remain party to noncompliant QFCs entered into before the effective date unless the covered entity or any affiliate (that is also a covered entity or covered bank) enters into new QFCs with the same counterparty or its affiliates, the proposal strikes a balance between ensuring QFC continuity if the GSIB were to fail and ensuring that covered entities and their existing counterparties can avoid any compliance costs and disruptions associated with conforming existing QFCs by refraining from entering into new QFCs. The requirement that a covered entity ensure that all existing QFCs with a particular counterparty and its affiliates are compliant before it or any affiliate of the covered entity (that is also a covered entity or covered bank) enters into a new QFC with the same counterparty or its affiliates after the effective date will provide covered entities with an incentive to seek the modifications necessary to ensure that their QFCs with their most important counterparties are compliant. Moreover, the volume of preexisting, noncompliant covered QFCs outstanding can be expected to decrease over time and eventually to reach zero. In light of these considerations, and to avoid creating potentially inappropriate compliance costs with respect to existing QFCs with counterparties that, together with their affiliates, do not enter new covered QFCs with the GSIB on or after the effective date, it would be appropriate to permit a limited number of noncompliant QFCs to remain outstanding, in keeping with the terms described above. That said, the Board will monitor covered entities' levels of noncompliant QFCs and evaluate the risk, if any, that they pose to the safety and soundness of the GSIBs or to U.S. financial stability.

*Question 19: The Board invites comment on the proposed transition periods and the proposed treatment of preexisting QFCs.*

*Question 20: Would it be appropriate to impose different compliance deadlines with respect to different classes of QFCs? If so, how should those classes be distinguished, and which should be required to be brought into compliance first?*

#### **IV. Costs and Benefits**

The proposed rule is intended to yield substantial net benefits for the financial stability of the United States by reducing the potential that resolution of a GSIB, particularly a resolution in bankruptcy, will be disorderly and disruptive to financial stability. These benefits are expected to substantially outweigh the costs associated with the proposal.

The primary costs to covered entities associated with the proposed requirements for covered entities' QFCs would be costs associated with drafting and negotiating compliant contracts with potential QFC counterparties. These costs would be small relative to the revenue of covered entities and to the costs of doing business in the financial sector generally.

The proposal could also impose costs on covered entities to the extent that they may need to provide their QFC counterparties with better contractual terms in order to compensate those parties for the loss of their ability to exercise default rights that would be restricted by the proposal. These costs may be higher than the drafting and negotiating costs. However, they are also expected to be relatively small because of the limited nature of the rights counterparties are required to reduce, the unlikelihood that the counterparty will have to exercise these rights and the availability of other forms of protection for counterparties.

The proposal could also create economic costs by causing a marginal reduction in QFC-related economic activity. This could mean that a QFC that would have been entered into in the absence of the proposed rule would not be entered into, and it could also mean that economic activity that would have been associated with that QFC would not occur (such as economic

activity that would have otherwise been hedged with a derivatives contract or funded through a repo transaction).

While uncertainty surrounding the future negotiations of economic actors makes a reliable quantification of any such costs difficult, costs from reduced QFC activity are expected to be very low. The proposed restrictions on default rights in covered QFCs are relatively narrow and would not affect a counterparty's rights in the event a GSIB fails to make payment on a QFC, or in response to its direct counterparty's entry into a bankruptcy proceeding (that is, the default rights covered by the Bankruptcy Code's "safe harbor" provisions). Counterparties are also able to prudently manage risk through other means, including entering into QFCs with entities that are not GSIB entities and therefore would not be subject to the proposed rule.

Additionally, the stay-and-transfer provisions of the Dodd-Frank Act and the FDI Act are already in force, and the ISDA Protocol is already partially effective. To staff's knowledge, no material economic costs have arisen as a result. This observation provides further support for the view that any marginal costs created by the proposal—which is intended to extend the effects of the stay-and-transfer provisions and the ISDA Protocol—are unlikely to be material.

Thus, the costs of the proposal are likely to be relatively small. These relatively small costs appear to be significantly outweighed by the substantial benefits that the rule would produce for the U.S. economy. Financial crises impose enormous costs on the real economy, so even small reductions in the probability or severity future financial crises create substantial economic benefits. The proposal would materially reduce the risk to the financial stability of the United States that could arise from the failure of a GSIB by enhancing the prospects for the orderly resolution of such a firm and would thereby materially reduce the probability and severity of financial crises in the future.

Moreover, the proposal would likely benefit the counterparties of a subsidiary of a failed GSIB by preventing the disorderly failure of the subsidiary and allowing it to continue to meet its obligations. Preventing the mass exercise of QFC default rights at the time the parent or other affiliate enters resolution proceedings makes it more likely that the subsidiaries or other affiliates will be able to meet their obligations to QFC counterparties. Moreover, the creditor protections permitted under the proposal would allow any counterparty that does not continue to receive payment under the QFC to exercise its default rights.

As discussed in detail above, this proposed rule would materially reduce the risk to the financial stability of the United States that could arise from the failure of a GSIB by enhancing the prospects for the orderly resolution of such a firm. By further safeguarding U.S. financial stability, the proposed rule would materially reduce the probability and severity of financial crises in the future. The proposed rule would therefore advance a key objective of the Dodd-Frank Act and help protect the American economy from the substantial costs associated with more frequent and severe financial crises.

*Question 21: The Board invites comment on all aspects of this evaluation of costs and benefits.*

#### **V. Revisions to Certain Definitions in the Board's Capital and Liquidity Rules**

The proposal would also amend several definitions in the Board's capital and liquidity rules to help ensure that the proposal would not have unintended effects for the treatment of covered entities' netting sets under those rules. The proposed amendments are similar to revisions that the Board and the OCC made in a 2014 interim final rule to prevent similar effects

from foreign jurisdictions' special resolution regimes and firms' adherence to the 2014 ISDA Protocol.<sup>134</sup>

The Board's regulatory capital rules permit a banking organization to measure exposure from certain types of financial contracts on a net basis and recognize the risk-mitigating effect of financial collateral for other types of exposures, provided that the contracts are subject to a "qualifying master netting agreement" or agreement that provides for certain rights upon the default of a counterparty.<sup>135</sup> The Board has defined "qualifying master netting agreement" to mean a netting agreement that permits a banking organization to terminate, apply close-out netting, and promptly liquidate or set-off collateral upon an event of default of the counterparty, thereby reducing its counterparty exposure and market risks.<sup>136</sup> On the whole, measuring the amount of exposure of these contracts on a net basis, rather than on a gross basis, results in a lower measure of exposure and thus a lower capital requirement.

The current definition of "qualifying master netting agreement" recognizes that default rights may be stayed if the financial company is in resolution under the Dodd-Frank Act, the FDI Act, a substantially similar law applicable to government-sponsored enterprises, or a substantially similar foreign law, or where the agreement is subject by its terms to any of those laws. Accordingly, transactions conducted under netting agreements where default rights may be stayed in those circumstances may qualify for the favorable capital treatment described above. However, the current definition of "qualifying master netting agreement" does not recognize the restrictions that the proposal would impose on the QFCs of covered entities. Thus, a master netting agreement that is compliant with this proposal would not qualify as a qualifying master

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<sup>134</sup> See 12 CFR part 217.

<sup>135</sup> See 12 CFR part 217.

<sup>136</sup> See section 2 of the regulatory capital rules.

netting agreement. This would result in considerably higher capital and liquidity requirements for QFC counterparties of covered entities, which is not an intended effect of this proposal.

Accordingly, the proposal would amend the definition of “qualifying master netting agreement” so that a master netting agreement could qualify where the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty is consistent with the requirements of this proposal. This revision would maintain the existing treatment for these contracts under the Board’s capital and liquidity rules by accounting for the restrictions that the proposal would place on default rights related to covered entities’ QFCs. The Board does not believe that the disqualification of master netting agreements that would result in the absence of the proposed amendment would accurately reflect the risk posed by the affected QFCs. As discussed above, the implementation of consistent restrictions on default rights in GSIB QFCs would increase the prospects for the orderly resolution of a failed GSIB and thereby protect the financial stability of the United States.

The proposal would similarly revise certain other definitions in the regulatory capital rules to make analogous conforming changes designed to account for this proposal’s restrictions and ensure that a banking organization may continue to recognize the risk-mitigating effects of financial collateral received in a secured lending transaction, repo-style transaction, or eligible margin loan for purposes of the Board’s rules. Specifically, the proposal would revise the definitions of “collateral agreement,” “eligible margin loan,” and “repo-style transaction” to provide that a counterparty’s default rights may be limited as required by this proposal without unintended effects.

The rule establishing margin and capital requirements for covered swap entities (swap margin rule) defines the term “eligible master netting agreement” in a manner similar to the definition of “qualifying master netting agreement.”<sup>137</sup> Thus, it may also be appropriate to amend the definition of “eligible master netting agreement” to account for the proposed restrictions on covered entities’ QFCs. Because the Board issued the swap margin rule jointly with other U.S. regulatory agencies, however, the Board would consult with the other agencies before amending that rule’s definition of “eligible master netting agreement.”

*Question 22: The Board invites comment on all aspects of the proposed amendments to the definitions of “qualifying master netting agreement,” “collateral agreement,” “eligible margin loan,” and “repo-style transaction.” Would the proposed amendments have the intended effect?*

*Question 23: Would it be appropriate to incorporate state law resolution regimes into these definitions (for example, state insurance law that provides similar stays of QFC default rights)?*

## **VI. Regulatory Analysis**

### **A. Paperwork Reduction Act**

Certain provisions of the proposed rule contain “collection of information” requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501 through 3521). The Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget (OMB). The reporting requirements are found in sections 252.85(b) and 252.87(b). These information collection requirements would implement section 165 of the Dodd Frank Act, as described in the Abstract below. In accordance with the

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<sup>137</sup> 80 FR 74840, 74861–74862 (November 30, 2015).



requirements of the PRA, the Board may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid OMB control number.

The proposed rule would revise the Reporting, Recordkeeping, and Disclosure Requirements Associated with Enhanced Prudential Standards (Regulation YY) (Reg YY; OMB No. 7100-0350). In addition, as permitted by the PRA, the Board proposes to extend for three years, with revision, the Reporting, Recordkeeping, and Disclosure Requirements Associated with Enhanced Prudential Standards (Regulation YY) (Reg YY; OMB No. 7100-0350).

Comments are invited on:

- (a) Whether the collections of information are necessary for the proper performance of the Board's functions, including whether the information has practical utility;
- (b) The accuracy of the Board's estimates of the burden of the information collections, including the validity of the methodology and assumptions used;
- (c) Ways to enhance the quality, utility, and clarity of the information to be collected;
- (d) Ways to minimize the burden of information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and
- (e) Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments on aspects of this notice that may affect reporting, recordkeeping, or disclosure requirements and burden estimates should be sent to the addresses listed in the ADDRESSES section. A copy of the comments may also be submitted to the OMB desk officer: By mail to U.S. Office of Management and Budget, 725 17<sup>th</sup>

Street NW, #10235, Washington, DC 20503, or by facsimile to 202-395-5806, Attention, Federal Reserve Desk Officer.

*Proposed Revision, With Extension, of the Following Information Collection*

*Title of Information Collection:* Reporting, Recordkeeping, and Disclosure Requirements Associated with Enhanced Prudential Standards (Regulation YY).

*Agency Form Number:* Reg YY.

*OMB Control Number:* 7100-0350.

*Frequency of Response:* Annual, semiannual, quarterly, one-time, and on occasion.

*Affected Public:* Businesses or other for-profit.

*Respondents:* State member banks, U.S. bank holding companies, savings and loan holding companies, nonbank financial companies, foreign banking organizations, U.S. intermediate holding companies, foreign saving and loan holding companies, and foreign nonbank financial companies supervised by the Board.

*Abstract:* Section 165 of the Dodd-Frank Act requires the Board to implement enhanced prudential standards for bank holding companies with total consolidated assets of \$50 billion or more, including global systemically important foreign banking organizations with \$50 billion or more in total consolidated assets. Section 165 of the Dodd-Frank Act also permits the Board to establish such other prudential standards for such banking organizations as the Board determines are appropriate.

*Reporting Requirements*

Section 252.85(b) of the proposed rule would require a covered banking entity to request the Board to approve as compliant with the requirements of section 252.84 of this subpart provisions of one or more forms of covered QFCs or amendments to one or more forms of

covered QFCs, with enhanced creditor protection conditions. Enhanced creditor protection conditions means a set of limited exemptions to the requirements of section 252.85(b) of this subpart that are different than those of paragraphs (e), (g), and (i) of section 252.84 of this subpart. A covered banking entity making a request must provide (1) an analysis of the proposal under each consideration of paragraph 252.85(d); (2) a written legal opinion verifying that proposed provisions or amendments would be valid and enforceable under applicable law of the relevant jurisdictions, including, in the case of proposed amendments, the validity and enforceability of the proposal to amend the covered QFCs; and (3) any additional information relevant to its approval that the Board requests.

Section 252.87(b) of the proposed rule would require each top-tier foreign banking organization that is or controls a covered company, as defined in section 243.2 the Board's Regulation QQ, to submit to the Board by January 1 of each calendar year (1) notice of whether the home country supervisor (or other appropriate home country regulatory authority) of the top-tier foreign banking organization has adopted standards consistent with the global methodology; and (2) whether the top-tier foreign banking organization or its home country supervisor has determined that the organization has the characteristics of a global systemically important banking organization under the global methodology.

*Estimated Paperwork Burden for Proposed Revisions*

*Estimated Number of Respondents:*

Section 252.85(b) - 1 respondent.

Section 252.87(b) - 22 respondents.

*Estimated Burden per Response:*

Section 252.85(b) - 40 hours.

Section 252.87(b) - 1 hour.

*Current estimated annual burden for Reporting, Recordkeeping, and Disclosure Requirements*

*Associated with Enhanced Prudential Standards (Regulation YY): 118,546 hours.*

*Proposed revisions estimated annual burden: 62 hours.*

*Total estimated annual burden: 118,608 hours.*

***B. Regulatory Flexibility Act: Initial Regulatory Flexibility Analysis***

The Regulatory Flexibility Act (“RFA”), 5 U.S.C. 601 et seq., requires an agency to consider whether the rules it proposes will have a significant economic impact on a substantial number of small entities.<sup>138</sup> If so, the agency must prepare an initial and final regulatory flexibility analysis respecting the significant economic impact. Pursuant to section 605(b) of the RFA, the regulatory flexibility analysis otherwise required under sections 603 and 604 of the RFA is not required if an agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.

An initial regulatory flexibility analysis must contain (1) a description of the reasons why action by the agency is being considered; (2) a succinct statement of the objectives of, and legal basis for, the proposed rule; (3) a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply; (4) a description of the projected reporting, recordkeeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities that will be subject to the requirement and the type of professional skills necessary for preparation of the report or record; and (5) an identification, to the extent

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<sup>138</sup> A banking organization is generally considered to be a small banking entity for the purposes of the RFA if it has assets less than or equal to \$175 million. See also 13 CFR 121.1302(a)(6) (noting factors that the Small Business Administration considers in determining whether an entity qualifies as a small business, including receipts, employees, and other measures of its domestic and foreign affiliates).

practicable, of all relevant Federal rules which may duplicate, overlap with, or conflict with the proposed rule.

The Board has considered the potential impact of the proposed rule on small entities in accordance with the RFA. As discussed below, the proposed rule would not appear to have a significant impact on a substantial number of small entities, including small banking organizations. Nevertheless, the Board is publishing and inviting comment on this initial regulatory flexibility analysis.

As discussed in detail above, the Board is issuing this proposed rule as part of its program to make GSIBs more resolvable in order to reduce the risk that their failure would pose to the financial stability of the United States, consistent with section 165 of the Dodd-Frank Act. In particular, the primary purpose of the proposal is to reduce the risk that the exercise of default rights by a failing GSIB's QFC counterparties would lead to a disorderly failure of the GSIB and would produce negative contagion and disruption that could destabilize the financial system. Section 165(b) of the Dodd-Frank Act provides the legal authority for this proposal.

The proposed rule would only apply to GSIBs, which are the largest, most systemically important banking organizations, and certain of their subsidiaries. More specifically, the proposed rule would apply to (a) any U.S. GSIB top-tier bank holding company, (b) any subsidiary of such a bank holding company that is not a covered bank,<sup>139</sup> and (c) the U.S. operations of any foreign GSIB with the exception of any covered bank. The Board estimates that the proposed rule would apply to approximately 29 banking organizations: eight U.S. bank holding companies (i.e., U.S. GSIBs) and approximately 21 foreign banking organizations (i.e. foreign GSIBs with U.S. operations). None of these banking organizations would qualify as a

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<sup>139</sup> The term "covered bank" would be defined to include certain entities, such as certain national banks, that are supervised by the OCC.

small banking entity for the purposes of the FRA. However, as discussed above, the proposed rule would also apply to each covered GSIB's subsidiary that meets the definition of a covered entity (regardless of the subsidiary's size) because an exemption for small entities would significantly impair the effectiveness of the proposed stay-and-transfer provisions and thereby undermine a key objective of the proposal: to reduce the execution risk of an orderly GSIB resolution. The Board anticipates that any small subsidiary of a GSIB that would be covered by this proposed rule would rely on its parent GSIB or a large subsidiary of that GSIB for reporting, recordkeeping, or similar compliance requirements and would not bear additional costs. Finally, the proposed rule does not appear to duplicate, overlap with, or conflict with any other federal regulation.

For the reasons stated above, the proposed rules would not appear to have a significant economic impact on a substantial number of small entities.

*Question 24: The Board welcomes written comments regarding this initial regulatory flexibility analysis, and requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate and support the extent of the impact. A final regulatory flexibility analysis will be conducted after consideration of comment received during the public comment period.*

### ***C. Riegle Community Development and Regulatory Improvement Act of 1994***

The Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA) requires that each Federal banking agency, in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, consider, consistent with principles of safety and soundness and the public interest, any administrative burdens that such

regulations would place on depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. In addition, new regulations that impose additional reporting, disclosures, or other new requirements on insured depository institutions generally must take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form.

The Board has invited comment on these matters in other sections of this Supplementary Information section and will continue to consider them as part of the overall rulemaking process.

*Question 25: The Board invites comment on this section, including any additional comments that will inform the Board's consideration of the requirements of RCDRIA.*

#### ***D. Solicitation of Comments on the Use of Plain Language***

Section 722 of the Gramm-Leach-Bliley Act requires the U.S. banking agencies to use plain language in proposed and final rulemakings.<sup>140</sup> The Board has sought to present the proposed rule in a simple and straightforward manner, and invites comment on the use of plain language in this proposal.

*Question 26: Has the Board organized the proposal in a clear way? If not, how could the proposal be organized more clearly?*

*Question 27: Are the requirements of the proposed rule clearly stated? If not, how could they be stated more clearly?*

*Question 28: Does the proposal contain unclear technical language or jargon? If so, which language requires clarification?*

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<sup>140</sup> 12 U.S.C. 4809(a).

*Question 29: Would a different format (such as a different grouping and ordering of sections, a different use of section headings, or a different organization of paragraphs) make the regulation easier to understand? If so, what changes would make the proposal clearer?*

*Question 30: What else could the Board do to make the proposal clearer and easier to understand?*

## **List of Subjects in 12 CFR Parts 217, 249, and 252**

### **12 CFR Chapter II**

Administrative practice and procedure, Banks, Banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

### **Authority and Issuance**

For the reasons stated in the Supplementary Information, the Board of Governors of the Federal Reserve System proposes to amend 12 CFR parts 217, 249, and 252 as follows:

### **PART 217—CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS (REGULATION Q).**

1. The authority citation for part 217 continues to read as follows:

**Authority:** 12 U.S.C. 248(a), 321–338a, 481–486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1851, 3904, 3906–3909, 4808, 5365, 5368, 5371.

#### **Part 217 [Amended]**

2. Section 217.2 is amended by:

- a. Revising the definitions of “collateral agreement” and “qualifying master netting agreement”;
- b. Revising paragraph (1)(iii) of the definition of “eligible margin loan”;
- c. Republishing the introductory text of the definition of “repo-style transaction”; and



d. Revising paragraph 3(ii)(A) of the definition of “repo-style transaction”.

The revisions are set forth below:

**§ 217.2 Definitions.**

\* \* \* \* \*

*Collateral agreement* means a legal contract that specifies the time when, and circumstances under which, a counterparty is required to pledge collateral to a Board-regulated institution for a single financial contract or for all financial contracts in a netting set and confers upon the Board-regulated institution a perfected, first-priority security interest (notwithstanding the prior security interest of any custodial agent), or the legal equivalent thereof, in the collateral posted by the counterparty under the agreement. This security interest must provide the Board-regulated institution with a right to close-out the financial positions and liquidate the collateral upon an event of default of, or failure to perform by, the counterparty under the collateral agreement. A contract would not satisfy this requirement if the Board-regulated institution’s exercise of rights under the agreement may be stayed or avoided under applicable law in the relevant jurisdictions, other than:

- (1) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar<sup>141</sup> to the U.S. laws referenced in this paragraph
- (1) in order to facilitate the orderly resolution of the defaulting counterparty;
- (2) Where the agreement is subject by its terms to any of the laws referenced in paragraph (1) of this definition; or

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<sup>141</sup> The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

(3) Where the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty is limited only to the extent necessary to comply with the requirements of subpart I of the Board’s Regulation YY or any similar requirements of another U.S. federal banking agency, as applicable.

\* \* \* \* \*

*Eligible margin loan* means:

(1) \* \* \*

(iii) The extension of credit is conducted under an agreement that provides the Board-regulated institution the right to accelerate and terminate the extension of credit and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, conservatorship, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(A) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs,<sup>142</sup> or laws of foreign jurisdictions that are substantially similar<sup>143</sup> to the U.S. laws referenced in this paragraph in order to facilitate the orderly resolution of the defaulting counterparty; or

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<sup>142</sup> This requirement is met where all transactions under the agreement are (i) executed under U.S. law and (ii) constitute “securities contracts” under section 555 of the Bankruptcy Code (11 U.S.C. 555), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act, or netting contracts between or among financial institutions under sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board’s Regulation EE (12 CFR part 231).

<sup>143</sup> The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

(B) Where the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty is limited only to the extent necessary to comply with the requirements of subpart I of the Board's Regulation YY or any similar requirements of another U.S. federal banking agency, as applicable.

\* \* \* \* \*

*Qualifying master netting agreement* means a written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this definition, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the Board-regulated institution the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of

foreign jurisdictions that are substantially similar<sup>144</sup> to the U.S. laws referenced in this paragraph

(2)(i) in order to facilitate the orderly resolution of the defaulting counterparty;

(ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (2)(i) of this definition; or

(iii) Where the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty is limited only to the extent necessary to comply with the requirements of subpart I of the Board's Regulation YY or any similar requirements of another U.S. federal banking agency, as applicable;

\* \* \* \* \*

*Repo-style transaction* means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the Board-regulated institution acts as agent for a customer and indemnifies the customer against loss, provided that:

(3) \* \* \*

(ii) \* \* \*

(A) The transaction is executed under an agreement that provides the Board-regulated institution the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, or resolution under

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<sup>144</sup> The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar<sup>145</sup> to the U.S. laws referenced in this paragraph (3)(ii)(a) in order to facilitate the orderly resolution of the defaulting counterparty; or where the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty is limited only to the extent necessary to comply with the requirements of subpart I of the Board’s Regulation YY or any similar requirements of another U.S. federal banking agency, as applicable;

or

\* \* \* \* \*

**PART 249—LIQUIDITY RISK MEASUREMENT STANDARDS (REGULATION WW)**

3. The authority citation for part 249 continues to read as follows:

**Authority:** 12 U.S.C. 248(a), 321–338a, 481–486, 1467a(g)(1), 1818, 1828, 1831p–1, 1831o–1, 1844(b), 5365, 5366, 5368.

4. Section 249.3 is amended by revising the definition of “qualifying master netting agreement” to read as follows:

**§ 249.3 Definitions.**

\* \* \* \* \*

*Qualifying master netting agreement* means a written, legally enforceable agreement provided that:

- (1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this

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<sup>145</sup> The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

definition, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the Board-regulated institution the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar<sup>146</sup> to the U.S. laws referenced in this paragraph

(2)(i) in order to facilitate the orderly resolution of the defaulting counterparty;

(ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (2)(i) of this definition; or

(iii) Where the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty is limited only to the extent necessary to comply with the requirements of subpart I of the Board's Regulation YY or any similar requirements of another U.S. federal banking agency, as applicable;

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<sup>146</sup> The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

**PART 252—ENHANCED PRUDENTIAL STANDARDS (REGULATION YY).**

5. The authority citation for part 252 is revised to read as follows:

**Authority:** 12 U.S.C. 321–338a, 481–486, 1467a(g), 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 3904, 3906–3909, 4808, 5361, 5365, 5366, 5367, 5368, 5371.

6. Add subpart I to read as follows:

**Subpart I – Requirements for Qualified Financial Contracts of Global Systemically Important Banking Organizations**

Sec.

252.81 Definitions

252.82 Applicability

252.83 U.S. Special Resolution Regimes

252.84 Insolvency Proceedings

252.85 Approval of Enhanced Creditor Protection Conditions

252.86 Foreign Bank Multi-branch Master Agreements

252.87 Identification of Global Systemically Important Foreign Banking Organizations

252.88 Exclusion of Certain QFCs

**Subpart I – Requirements for Qualified Financial Contracts of Global Systemically Important Banking Organizations**

**§ 252.81 Definitions.**

Central counterparty (CCP) has the same meaning as in section 217.2 of the Board’s Regulation Q (12 CFR 217.2).

Chapter 11 proceeding means a proceeding under Chapter 11 of Title 11, United States Code (11 U.S.C. §§ 1101-74).

Credit enhancement means a QFC of the type set forth in section 210(c)(8)(D)(ii)(XII), (iii)(X), (iv)(V), (v)(VI), or (vi)(VI) of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. § 5390(c)(8)(D)(ii)(XII), (iii)(X), (iv)(V), (v)(VI), or (vi)(VI)) or a credit enhancement that the Federal Deposit Insurance Corporation determines by regulation is a QFC pursuant to section 210(c)(8)(D)(i) of Title II of the act (12 U.S.C. § 5390(c)(8)(D)(i)).

Covered bank means a national bank, Federal savings association, federal branch, or federal agency.

Default right (1) Means, with respect to a QFC, any

(i) Right of a party, whether contractual or otherwise (including, without limitation, rights incorporated by reference to any other contract, agreement, or document, and rights afforded by statute, civil code, regulation, and common law), to liquidate, terminate, cancel, rescind, or accelerate such agreement or transactions thereunder, set off or net amounts owing in respect thereto (except rights related to same-day payment netting), exercise remedies in respect of collateral or other credit support or property related thereto (including the purchase and sale of property), demand payment or delivery thereunder or in respect thereof (other than a right or operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an economic exposure), suspend, delay, or defer payment or performance thereunder, or modify the obligations of a party thereunder, or any similar rights; and

(ii) Right or contractual provision that alters the amount of collateral or margin that must be provided with respect to an exposure thereunder, including by altering any initial amount, threshold amount, variation margin, minimum transfer amount, the margin value of collateral, or



any similar amount, that entitles a party to demand the return of any collateral or margin transferred by it to the other party or a custodian or that modifies a transferee's right to reuse collateral or margin (if such right previously existed), or any similar rights, in each case, other than a right or operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an economic exposure;

(2) With respect to section 252.84, does not include any right under a contract that allows a party to terminate the contract on demand or at its option at a specified time, or from time to time, without the need to show cause.

FDI Act proceeding means a proceeding in which the Federal Deposit Insurance Corporation is appointed as conservator or receiver under section 11 of the Federal Deposit Insurance Act (12 U.S.C. § 1821).

FDI Act stay period means, in connection with an FDI Act proceeding, the period of time during which a party to a QFC with a party that is subject to an FDI Act proceeding may not exercise any right that the party that is not subject to an FDI Act proceeding has to terminate, liquidate, or net such QFC, in accordance with section 11(e) of the Federal Deposit Insurance Act (12 U.S.C. § 1821(e)) and any implementing regulations.

Master agreement means a QFC of the type set forth in section 210(c)(8)(D)(ii)(XI), (iii)(IX), (iv)(IV), (v)(V), or (vi)(V) of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. § 5390(c)(8)(D)(ii)(XI), (iii)(IX), (iv)(IV), (v)(V), or (vi)(V)) or a master agreement that the Federal Deposit Insurance Corporation determines by regulation is a QFC pursuant to section 210(c)(8)(D)(i) of Title II of the act (12 U.S.C. § 5390(c)(8)(D)(i)).

Qualified financial contract (QFC) has the same meaning as in section 210(c)(8)(D) of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. § 5390(c)(8)(D)).

U.S. special resolution regimes means the Federal Deposit Insurance Act (12 U.S.C. §§ 1811-1835a) and regulations promulgated thereunder and Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. §§ 5381–5394) and regulations promulgated thereunder.

§ 252.82 Applicability.

(a) Scope of firms. This subpart applies to a “covered entity,” which is

(1) A bank holding company that is identified as a global systemically important BHC pursuant to 12 CFR 217.402;

(2) A subsidiary of a company identified in paragraph (a)(1) of this section (other than a subsidiary that is a covered bank); or

(3) A U.S. subsidiary, U.S. branch, or U.S. agency of a global systemically important foreign banking organization (other than a U.S. subsidiary, U.S. branch, or U.S. agency that is a covered bank, section 2(h)(2) company or a DPC branch subsidiary).

(b) Initial applicability of requirements for covered QFCs. A covered entity must comply with the requirements of sections 252.83 and 252.84 beginning on the later of

(1) The first day of the calendar quarter immediately following 365 days (1 year) after becoming a covered entity; or

(2) The date this subpart first becomes effective.

(c) Rule of construction. For purposes of this subpart, the exercise of a default right with respect to a covered QFC includes the automatic or deemed exercise of the default right pursuant to the terms of the QFC or other arrangement.

§ 252.83 U.S. Special Resolution Regimes.

(a) QFCs required to be conformed. (1) A covered entity must ensure that each covered QFC conforms to the requirements of this section 252.83.

(2) For purposes of this section 252.83, a covered QFC means a QFC that the covered entity:

(i) Enters, executes, or otherwise becomes a party to; or

(ii) Entered, executed, or otherwise became a party to before the date this subpart first becomes effective, if the covered entity or any affiliate that is a covered entity or a covered bank also enters, executes, or otherwise becomes a party to a QFC with the same person or affiliate of the same person on or after the date this subpart first becomes effective.

(3) To the extent that the covered entity is acting as agent with respect to a QFC, the requirements of this section apply to the extent the transfer of the QFC relates to the covered entity or the default rights relate to the covered entity or an affiliate of the covered entity.

(b) Provisions required. A covered QFC must explicitly provide that

(1) The transfer of the covered QFC (and any interest and obligation in or under, and any property securing, the covered QFC) from the covered entity will be effective to the same extent as the transfer would be effective under the U.S. special resolution regimes if the covered QFC (and any interest and obligation in or under, and any property securing, the covered QFC) were governed by the laws of the United States or a state of the United States and the covered entity were under the U.S. special resolution regime; and

(2) Default rights with respect to the covered QFC that may be exercised against the covered entity are permitted to be exercised to no greater extent than the default rights could be exercised under the U.S. special resolution regimes if the covered QFC was governed by the laws of the United States or a state of the United States and the covered entity were under the U.S. special resolution regime.

(c) Relevance of creditor protection provisions. The requirements of this section apply notwithstanding paragraphs (e), (g), and (i) of section 252.84.

§ 252.84 Insolvency Proceedings.

(a) QFCs required to be conformed. (1) A covered entity must ensure that each covered QFC conforms to the requirements of this section 252.84.

(2) For purposes of this section 252.84, a covered QFC has the same definition as in paragraph (a)(2) of section 252.83.

(3) To the extent that the covered entity is acting as agent with respect to a QFC, the requirements of this section apply to the extent the transfer of the QFC relates to the covered entity or the default rights relate to an affiliate of the covered entity.

(b) General Prohibitions.

(1) A covered QFC may not permit the exercise of any default right with respect to the covered QFC that is related, directly or indirectly, to an affiliate of the direct party becoming subject to a receivership, insolvency, liquidation, resolution, or similar proceeding.

(2) A covered QFC may not prohibit the transfer of a covered affiliate credit enhancement, any interest or obligation in or under the covered affiliate credit enhancement, or any property securing the covered affiliate credit enhancement to a transferee upon an affiliate of the direct party becoming subject to a receivership, insolvency, liquidation, resolution, or similar

proceeding unless the transfer would result in the supported party being the beneficiary of the credit enhancement in violation of any law applicable to the supported party.

(c) Definitions relevant to the general prohibitions.

(1) Direct party. Direct party means a covered entity, or covered bank referenced in paragraph (a) of section 252.82, that is a party to the direct QFC.

(2) Direct QFC. Direct QFC means a QFC that is not a credit enhancement, provided that, for a QFC that is a master agreement that includes an affiliate credit enhancement as a supplement to the master agreement, the direct QFC does not include the affiliate credit enhancement.

(3) Affiliate credit enhancement. Affiliate credit enhancement means a credit enhancement that is provided by an affiliate of a party to the direct QFC that the credit enhancement supports.

(d) Treatment of agent transactions. With respect to a QFC that is a covered QFC for a covered entity solely because the covered entity is acting as agent under the QFC, the covered entity is the direct party.

(e) General creditor protections. Notwithstanding paragraph (b) of this section, a covered direct QFC and covered affiliate credit enhancement that supports the covered direct QFC may permit the exercise of a default right with respect to the covered QFC that arises as a result of

(1) The direct party becoming subject to a receivership, insolvency, liquidation, resolution, or similar proceeding other than a receivership, conservatorship, or resolution under the FDI Act, Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, or

laws of foreign jurisdictions that are substantially similar to the U.S. laws referenced in this paragraph (e)(1) in order to facilitate the orderly resolution of the direct party;

(2) The direct party not satisfying a payment or delivery obligation pursuant to the covered QFC or another contract between the same parties that gives rise to a default right in the covered QFC; or

(3) The covered affiliate support provider or transferee not satisfying a payment or delivery obligation pursuant to a covered affiliate credit enhancement that supports the covered direct QFC.

(f) Definitions relevant to the general creditor protections.

(1) Covered direct QFC. Covered direct QFC means a direct QFC to which a covered entity, or covered bank referenced in paragraph (a) of section 252.82, is a party.

(2) Covered affiliate credit enhancement. Covered affiliate credit enhancement means an affiliate credit enhancement in which a covered entity, or covered bank referenced in paragraph (a) of section 252.82, is the obligor of the credit enhancement.

(3) Covered affiliate support provider. Covered affiliate support provider means, with respect to a covered affiliate credit enhancement, the affiliate of the direct party that is obligated under the covered affiliate credit enhancement and is not a transferee.

(4) Supported party. Supported party means, with respect to a covered affiliate credit enhancement and the direct QFC that the covered affiliate credit enhancement supports, a party that is a beneficiary of the covered affiliate support provider's obligation(s) under the covered affiliate credit enhancement.

(g) Additional creditor protections for supported QFCs. Notwithstanding paragraph (b) of this section, with respect to a covered direct QFC that is supported by a covered affiliate credit

enhancement, the covered direct QFC and the covered affiliate credit enhancement may permit the exercise of a default right that is related, directly or indirectly, to the covered affiliate support provider after the stay period if:

(1) The covered affiliate support provider that remains obligated under the covered affiliate credit enhancement becomes subject to a receivership, insolvency, liquidation, resolution, or similar proceeding other than a Chapter 11 proceeding;

(2) Subject to paragraph (i) of this section, the transferee, if any, becomes subject to a receivership, insolvency, liquidation, resolution, or similar proceeding;

(3) The covered affiliate support provider does not remain, and a transferee does not become, obligated to the same, or substantially similar, extent as the covered affiliate support provider was obligated immediately prior to entering the receivership, insolvency, liquidation, resolution, or similar proceeding with respect to:

(i) The covered affiliate credit enhancement;

(ii) All other covered affiliate credit enhancements provided by the covered affiliate support provider in support of other covered direct QFCs between the direct party and the supported party under the covered affiliate credit enhancement referenced in paragraph (g)(3)(i) of this section; and

(iii) All covered affiliate credit enhancements provided by the covered affiliate support provider in support of covered direct QFCs between the direct party and affiliates of the supported party referenced in paragraph (g)(3)(ii) of this section; or

(4) In the case of a transfer of the covered affiliate credit enhancement to a transferee,

(i) All of the ownership interests of the direct party directly or indirectly held by the covered affiliate support provider are not transferred to the transferee; or

(ii) Reasonable assurance has not been provided that all or substantially all of the assets of the covered affiliate support provider (or net proceeds therefrom), excluding any assets reserved for the payment of costs and expenses of administration in the receivership, insolvency, liquidation, resolution, or similar proceeding, will be transferred or sold to the transferee in a timely manner.

(h) Definitions relevant to the additional creditor protections for supported QFCs.

(1) Stay period. Stay period means, with respect to a receivership, insolvency, liquidation, resolution, or similar proceeding, the period of time beginning on the commencement of the proceeding and ending at the later of 5:00 p.m. (eastern time) on the business day following the date of the commencement of the proceeding and 48 hours after the commencement of the proceeding.

(2) Business day. Business day means a day on which commercial banks in the jurisdiction the proceeding is commenced are open for general business (including dealings in foreign exchange and foreign currency deposits).

(3) Transferee. Transferee means a person to whom a covered affiliate credit enhancement is transferred upon the covered affiliate support provider entering a receivership, insolvency, liquidation, resolution, or similar proceeding or thereafter as part of the restructuring or reorganization involving the covered affiliate support provider.

(i) Creditor protections related to FDI Act proceedings. Notwithstanding paragraph (b) of this section, with respect to a covered direct QFC that is supported by a covered affiliate credit enhancement, the covered direct QFC and the covered affiliate credit enhancement may permit the exercise of a default right that is related, directly or indirectly, to the covered affiliate support provider becoming subject to FDI Act proceedings



(1) After the FDI Act stay period, if the covered affiliate credit enhancement is not transferred pursuant to 12 U.S.C. § 1821(e)(9)–(e)(10) and any regulations promulgated thereunder; or

(2) During the FDI Act stay period, if the default right may only be exercised so as to permit the supported party under the covered affiliate credit enhancement to suspend performance with respect to the supported party’s obligations under the covered direct QFC to the same extent as the supported party would be entitled to do if the covered direct QFC were with the covered affiliate support provider and were treated in the same manner as the covered affiliate credit enhancement.

(j) Prohibited terminations. A covered QFC must require, after an affiliate of the direct party has become subject to a receivership, insolvency, liquidation, resolution, or similar proceeding,

(1) The party seeking to exercise a default right to bear the burden of proof that the exercise is permitted under the covered QFC; and

(2) Clear and convincing evidence or a similar or higher burden of proof to exercise a default right.

§ 252.85 Approval of Enhanced Creditor Protection Conditions.

(a) Protocol compliance. Notwithstanding paragraph (b) of section 252.4, a covered QFC may permit the exercise of a default right with respect to the covered QFC if the covered QFC has been amended by the ISDA 2015 Universal Resolution Stay Protocol, including the Securities Financing Transaction Annex and Other Agreements Annex, published by the International Swaps and Derivatives Association, Inc., as of May 3, 2016, and minor or technical amendments thereto.

(b) Proposal of enhanced creditor protection conditions. (1) A covered entity may request that the Board approve as compliant with the requirements of section 252.84 proposed provisions of one or more forms of covered QFCs, or proposed amendments to one or more forms of covered QFCs, with enhanced creditor protection conditions.

(2) Enhanced creditor protection conditions means a set of limited exemptions to the requirements of section 252.84(b) of this subpart that are different than that of paragraphs (e), (g), and (i) of section 252.84.

(3) A covered entity making a request under paragraph (b)(1) of this section must provide

(i) An analysis of the proposal that addresses each consideration in paragraph (d) of this section;

(ii) A written legal opinion verifying that proposed provisions or amendments would be valid and enforceable under applicable law of the relevant jurisdictions, including, in the case of proposed amendments, the validity and enforceability of the proposal to amend the covered QFCs; and

(iii) Any other relevant information that the Board requests.

(c) Board approval. The Board may approve, subject to any conditions or commitments the Board may set, a proposal by a covered entity under paragraph (b) of this section if the proposal, as compared to a covered QFC that contains only the limited exemptions in paragraphs of (e), (g), and (i) of section 252.84 or that is amended as provided under paragraph (a) of this section, would prevent or mitigate risks to the financial stability of the United States that could arise from the failure of a global systemically important BHC, a global systemically important

foreign banking organization, or the subsidiaries of either and would protect the safety and soundness of bank holding companies and state member banks to at least the same extent.

(d) Considerations. In reviewing a proposal under this section, the Board may consider all facts and circumstances related to the proposal, including:

(1) Whether, and the extent to which, the proposal would reduce the resiliency of such covered entities during distress or increase the impact on U.S. financial stability were one or more of the covered entities to fail;

(2) Whether, and the extent to which, the proposal would materially decrease the ability of a covered entity, or an affiliate of a covered entity, to be resolved in a rapid and orderly manner in the event of the financial distress or failure of the entity that is required to submit a resolution plan;

(3) Whether, and the extent to which, the set of conditions or the mechanism in which they are applied facilitates, on an industry-wide basis, contractual modifications to remove impediments to resolution and increase market certainty, transparency, and equitable treatment with respect to the default rights of non-defaulting parties to a covered QFC;

(4) Whether, and the extent to which, the proposal applies to existing and future transactions;

(5) Whether, and the extent to which, the proposal would apply to multiple forms of QFCs or multiple covered entities;

(6) Whether the proposal would permit a party to a covered QFC that is within the scope of the proposal to adhere to the proposal with respect to only one or a subset of covered entities;

(7) With respect to a supported party, the degree of assurance the proposal provides to the supported party that the material payment and delivery obligations of the covered affiliate

credit enhancement and the covered direct QFC it supports will continue to be performed after the covered affiliate support provider enters a receivership, insolvency, liquidation, resolution, or similar proceeding;

(8) The presence, nature, and extent of any provisions that require a covered affiliate support provider or transferee to meet conditions other than material payment or delivery obligations to its creditors;

(9) The extent to which the supported party's overall credit risk to the direct party may increase if the enhanced creditor protection conditions are not met and the likelihood that the supported party's credit risk to the direct party would decrease or remain the same if the enhanced creditor protection conditions are met; and

(10) Whether the proposal provides the counterparty with additional default rights or other rights.

§ 252.86 Foreign Bank Multi-branch Master Agreements.

(a) Treatment of foreign bank multi-branch master agreements. With respect to a U.S. branch or U.S. agency of a global systemically important foreign banking organization, a foreign bank multi-branch master agreement that is a covered QFC solely because the master agreement permits agreements or transactions that are QFCs to be entered into at one or more U.S. branches or U.S. agencies of the global systemically important foreign banking organization will be considered a covered QFC for purposes of this subpart only with respect to such agreements or transactions booked at such U.S. branches and U.S. agencies or for which a payment or delivery may be made at such U.S. branches or U.S. agencies.

(b) Definition of foreign bank multi-branch master agreements. A foreign bank multi-branch master agreement means a master agreement that permits a U.S. branch or U.S. agency

and another place of business of a foreign bank that is outside the United States to enter transactions under the agreement.

§ 252.87 Identification of Global Systemically Important Foreign Banking Organizations.

(a) For purposes of this part, a top-tier foreign banking organization that is or controls a covered company (as defined at 12 CFR 243.2(f)) is a global systemically important foreign banking organization if any of the following conditions is met:

(1) The top-tier foreign banking organization determines, pursuant to paragraph (c) of this section, that the top-tier foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology; or

(2) The Board, using information available to the Board, determines:

(i) That the top-tier foreign banking organization would be a global systemically important banking organization under the global methodology;

(ii) That the top-tier foreign banking organization, if it were subject to the Board's Regulation Q, would be identified as a global systemically important BHC under section 217.402 of the Board's Regulation Q; or

(iii) That any U.S. intermediate holding company controlled by the top-tier foreign banking organization, if the U.S. intermediate holding company is or were subject to section 217.402 of the Board's Regulation Q, is or would be identified as a global systemically important BHC.

(b) Each top-tier foreign banking organization that is or controls a covered company (as defined at 12 CFR 243.2(f)) shall submit to the Board by January 1 of each calendar year:

(1) Notice of whether the home country supervisor (or other appropriate home country regulatory authority) of the top-tier foreign banking organization has adopted standards consistent with the global methodology; and

(2) Whether the top-tier foreign banking organization or its home country supervisor has determined that the organization has the characteristics of a global systemically important banking organization under the global methodology.

(c) A top-tier foreign banking organization that prepares or reports for any purpose the indicator amounts necessary to determine whether the top-tier foreign banking organization is a global systemically important banking organization under the global methodology must use the data to determine whether the top-tier foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology.

(d) For purposes of this section,

(1) Global methodology means the assessment methodology and the higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision, as updated from time to time;

(2) Global systemically important foreign banking organization means a global systemically important bank, as such term is defined in the global methodology;

(3) Home country means, with respect to a foreign banking organization, the country in which the foreign banking organization is chartered or incorporated; and

(4) Top-tier foreign banking organization means, with respect to a foreign banking organization, the top-tier foreign banking organization or, alternatively, a subsidiary of the top-tier foreign banking organization designated by the Board.

§ 252.88 Exclusion of Certain QFCs.

(a) Exclusion of CCP-cleared QFCs. A covered entity is not required to conform a covered QFC to which a CCP is party to the requirements of sections 252.83 or 252.84.

(b) Exclusion of covered bank QFCs. A covered entity is not required to conform a covered QFC to the requirements of sections 252.83 or 252.84 to the extent that a covered bank is required to conform the covered QFC to similar requirements of the Office of the Comptroller of the Currency if the QFC is either a direct QFC to which a covered bank is a direct party or an affiliate credit enhancement to which a covered bank is the obligor.

**By order of the Board of Governors of the Federal Reserve System, [ ], 2016.**

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**Robert deV. Frierson,**  
*Secretary of the Board.*

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