

FEDERAL DEPOSIT INSURANCE CORPORATION

RIN 12 CFR Parts 324, 329, and 382 3064-AE46

Restrictions on Qualified Financial Contracts of Certain FDIC-Supervised Institutions; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Final rule.

SUMMARY: The FDIC is adding a new part 382 (the “final rule”) to its rules to improve the resolvability of systemically important U.S. banking organizations and systemically important foreign banking organizations and enhance the resilience and the safety and soundness of certain state savings associations and state-chartered banks that are not members of the Federal Reserve System (“state non-member banks” or “SNMBs”) for which the FDIC is the primary federal regulator (together, “FSIs” or “FDIC-supervised institutions”). Under this final rule, FSIs and their subsidiaries (“covered FSIs”) would be required to ensure that covered qualified financial contracts (QFCs) to which they are a party 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 Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and the Federal Deposit Insurance Act (FDI Act). In addition, covered FSIs would generally be prohibited from being party to QFCs that would allow a QFC counterparty to exercise default rights against the covered FSI based on the entry into a resolution proceeding under the FDI Act, or any other resolution proceeding of an affiliate of the covered FSI.

The final rule also amends the definition of “qualifying master netting agreement” in the FDIC’s capital and liquidity rules, and certain related terms in the FDIC’s capital rules. These amendments are intended to ensure that the regulatory capital and liquidity treatment of QFCs to which a covered FSI is party would not be affected by the restrictions on such QFCs. The requirements of this final rule are substantively identical to those contained in the final rulemaking adopted by the Board of Governors of the Federal Reserve System (FRB) on September 1, 2017 regarding “covered entities,” and the final rulemaking that is expected to be issued by the Office of the Comptroller of the Currency (OCC) regarding “covered banks.”

DATES: The final rule is effective on January 1, 2018.

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I. Introduction

A. Background

This final rule addresses one of the ways the failure of a major financial firm could destabilize the financial system. The disorderly 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 is a core objective of the Dodd-Frank Act,¹ which Congress passed in response to the 2007–2009 financial crisis and the ensuing recession. One way the Dodd-Frank Act helps to protect the financial stability of the United States is by

¹ 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.”

reducing the damage that such a company’s failure would cause to the financial system if it were to occur. This strategy centers on measures designed to help ensure that a failed company’s 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.²

The 2016 Notices of Proposed Rulemaking

On May 3, 2016, the FRB issued a Notice of Proposed Rulemaking, (the FRB NPRM), pursuant to section 165 of the Dodd-Frank Act.³ The FRB’s proposed rule stated that it is intended as a further step to increase the resolvability of U.S. global systemically important banking organizations (GSIBs)⁴ and global systemically important foreign banking organizations (foreign GSIBs) that operate in the United States (collectively, “covered entities”).⁵ Subsequent to the FRB NPRM, the OCC issued the OCC Notice of Proposed Rulemaking (OCC NPRM),⁶ which applies the same QFC requirements to “covered banks” within the OCC’s jurisdiction.

The FDIC issued a parallel proposal (FDIC NPRM, also referred to as the proposal or the

² 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 under bankruptcy if they were to fail and by creating a new back-up resolution regime, the Orderly Liquidation Authority, applicable to systemically important financial companies. 12 U.S.C. 5365(d), 5381–5394.

³ 81 Fed. Reg. 29169 (May 11, 2016).

⁴ 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. See FRB NPRM, 81 Fed. Reg. 29169, 29175 (May 11, 2016). 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.

⁵ See FRB NPRM at § 252.82(a) (defining “covered entity” to include: (1) A bank holding company that is identified as a global systemically important [bank holding company] pursuant to 12 CFR 217.402; (2) A subsidiary of a company identified in paragraph (a)(1) of section 252.82 (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)). In its final rule, the FRB also excluded entities supervised by the FDIC from the definition of a “covered entity.” 82 Fed. Reg. 42882 (September 12, 2017).

⁶ 81 Fed. Reg. 55,381 (Aug. 19, 2016).

proposed rule) applicable to FSIs that are subsidiaries of a “covered entity” as defined in the FRB NPRM and to subsidiaries of such FSIs (collectively, “covered FSIs”).⁷ After considering the comments received on the FDIC NPRM, the FDIC is now finalizing its rule (“FDIC FR”). The final rule is intended to work in tandem with the FRB’s final rule adopted on September 1, 2017 (“FRB FR”) and the OCC’s expected final rule (“OCC FR”).

The policy objective of this final rule is to improve the orderly resolution of a GSIB by limiting disruptions to a failed GSIB through its FSI subsidiaries’ financial contracts with other companies. The FRB FR, the OCC FR, and FDIC FR complement the ongoing work of the FRB and the FDIC on resolution planning requirements for GSIBs.

The FDIC has a strong interest in preventing a disorderly termination of covered FSIs’ QFCs upon a GSIB’s entry into resolution proceedings. In fulfilling the FDIC’s responsibilities as (i) the primary federal supervisor for SNMBs and state savings associations;⁸ (ii) the insurer of deposits and manager of the Deposit Insurance Fund (DIF); and (iii) the resolution authority for all FDIC-insured institutions under the FDI Act and, if appointed by the Secretary of the Treasury, for large complex financial institutions under Title II of the Dodd-Frank Act, the FDIC’s interests include ensuring that large complex financial institutions are resolvable in an orderly manner, and that FDIC-insured institutions operate safely and soundly.⁹

The final rule specifically addresses QFCs, which are typically entered into by various operating entities in a GSIB group, including covered FSIs. These covered FSIs are affiliates of

⁷ 81 Fed. Reg. 74,326 (Oct. 26, 2016).

⁸ Although the FDIC is the insurer for all insured depository institutions in the United States, it is the primary federal supervisor only for state-chartered banks that are not members of the Federal Reserve System, state-chartered savings associations, and insured state-licensed branches of foreign banks. As of June 30, 2017, the FDIC had primary supervisory responsibility for 3,711 SNMBs and state-chartered savings associations.

⁹ See <https://www.fdic.gov/about/strategic/strategic/supervision.html>

U.S. GSIBs or foreign GSIBs that have OTC derivatives exposure. The exercise of default rights against an otherwise healthy covered FSI resulting from the failure of its affiliate—e.g., its top-tier U.S. holding company—may cause it to weaken or fail. Accordingly, FDIC-supervised affiliates of U.S. or foreign GSIBs are exposed, through the interconnectedness of their QFCs and their affiliates' QFCs, to destabilizing effects if their counterparties or the counterparties of their affiliates exercise default rights upon the entry into resolution of the covered FSI itself or its GSIB affiliate.¹⁰

These potentially destabilizing effects are best addressed by requiring all GSIB entities to amend their QFCs to include contractual provisions aimed at avoiding such destabilization. It is imperative that all entities within the GSIB group amend their QFCs in a similar way, thereby eliminating an incentive for counterparties to concentrate QFCs in entities subject to fewer restrictions. Therefore, the application of this final rule to the QFCs of covered FSIs is not only necessary for the safety and soundness of covered FSIs individually and collectively, but also to avoid potential destabilization of the overall banking system.

The FDIC received a total of 14 comment letters in response to the FDIC NPRM from trade groups representing GSIBs or GSIB groups, buy-side and end-users of derivatives, individuals and community advocates. There was substantial overlap in the comments received by the FRB, OCC and FDIC regarding the NPRMs. Notably, a copy of comments the commenter had already sent to the FRB or the OCC generally accompanied the comments received by the FDIC and were incorporate therein by reference. Commenters requested that the

¹⁰ For additional background regarding the interconnectivity of the largest financial firms, see FRB NPRM, 81 Fed. Reg. 29175-29176 (May 11, 2016).

agencies coordinate in developing final rules and consider comments submitted to the other agencies regarding their NPRMs.

All comments were considered in developing the final rule. Comments are discussed in the relevant sections that follow. The FDIC consulted with the FRB and the OCC in developing the final rule.

Qualified financial contracts, default rights, and financial stability. Like the FDIC NPRM, this final rule pertains to several important classes of financial transactions that are collectively known as QFCs.¹¹ QFCs include swaps, other derivatives contracts, repurchase agreements (also known as “repos”) and reverse repos, and securities lending and borrowing agreements.¹² Financial institutions 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. The final rule focuses on a context in which that threat is especially great: the failure of a GSIB that is an affiliate of a covered FSI that is party to large volumes of QFCs, which are likely to include QFCs with counterparties that are themselves systemically important.

¹¹ The final rule adopts 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 final rule § 382.1.

¹² 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 QFCs. See final rule § 382.1.

QFC continuity is important for the orderly resolution of a GSIB because it helps to ensure that the GSIB entities remain viable and to avoid instability caused by asset fire sales. Together, the FRB and 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,¹³ and have instructed 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.”¹⁴ More recently, in April 2016,¹⁵ the FRB and FDIC noted the important changes that have been made to the structure and operations of the largest financial firms, including the adherence by all U.S. GSIBs and their affiliates to the ISDA 2015 Universal Resolution Stay Protocol.¹⁶

Direct defaults and cross-defaults. This rule focuses on two distinct scenarios in which a party to a QFC is commonly able to exercise default rights. These two scenarios involve a default that occurs when either the GSIB entity that is a direct party¹⁷ to the QFC or an affiliate of that entity enters a resolution proceeding.¹⁸ The first scenario occurs when a GSIB entity that

¹³ 12 U.S.C. 5365(d).

¹⁴ FRB and FDIC, “Agencies Provide Feedback on Second Round Resolution Plans of ‘First-Wave’ Filers” (Aug. 5, 2014), available at <https://www.fdic.gov/news/news/press/2014/pr14067.html>. See also FRB and FDIC, “Agencies Provide Feedback on Resolution Plans of Three Foreign Banking Organizations” (Mar. 23, 2015), available at <https://www.fdic.gov/news/news/press/2015/pr15027.html>; FRB and FDIC, “Guidance for 2013 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012” 5–6 (Apr. 15, 2013), available at <https://www.fdic.gov/news/news/press/2013/pr13027.html>.

¹⁵ See <https://www.fdic.gov/news/news/press/2016/pr16031a.pdf>, at 13.

¹⁶ 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>.

¹⁷ 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.

¹⁸ 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.”

is itself a direct party to the QFC enters a resolution proceeding and such event gives rise to default rights under the QFC it is a party to; 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 and such event gives rise to default rights under the QFC it is a party to; 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.” A GSIB parent entity will often 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.

Importantly, the final rule does not affect all types of default rights, and, where it affects a default right, the rule 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 or to transfer the QFC. Moreover, the final rule is concerned only with default rights that run *against* a GSIB entity—that is, direct default rights and cross-default rights that arise from the entry into resolution of a GSIB entity. The final rule does not affect default rights that a GSIB entity (or any other entity) may have against a counterparty that is not a GSIB entity. This

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 FDIC under the FDI 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.

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.

Resolution Strategies

Single-point-of-entry resolution. Cross-default rights are especially significant in the context of a GSIB failure because GSIBs and their affiliates often enter into large volumes of QFCs. 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, or similar entities organized in other countries.

Many complex GSIBs 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 effect of losses that led to the GSIB’s failure would pass 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. This strategy is designed to help ensure that the GSIB subsidiaries remain adequately capitalized, and that operating subsidiaries of the GSIB are able to stabilize and continue meeting their financial obligations without immediately 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 fire sales. A successful SPOE resolution would also avoid the need for separate resolution proceedings for separate legal entities run by separate authorities across multiple jurisdictions, which would be more complex and could therefore destabilize the resolution of a GSIB. An SPOE resolution can also avoid the need for insured bank subsidiaries, including covered FSIs, to be placed into receivership or similar proceedings as the likelihood of their continuing to operate as going concerns will be significantly enhanced if the parent's entry into resolution proceedings does not trigger the exercise of cross-default rights. Accordingly, this final rule, by limiting such cross-default rights in covered QFCs based on an affiliate's entry into resolution proceedings, assists in stabilizing both the covered FSIs and the larger banking system.

Multiple-Point-of-Entry Resolution. This final rule is also intended to 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 FDI Act. As discussed above, the final rule should help support the continued operation of one or more affiliates of an entity that has entered resolution to the extent the affiliate continues to perform on its QFCs.

U.S. Bankruptcy Code. While insured depository institutions are not subject to resolution under the U.S. Bankruptcy Code, if a bank holding company were to fail, it would likely be resolved under the U.S. Bankruptcy Code. When an entity goes into resolution under the U.S. Bankruptcy Code, attempts by the debtor'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 blocked by the imposition of an automatic stay.¹⁹ 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.²⁰

However, the U.S. Bankruptcy Code largely exempts QFC²¹ counterparties of the debtor from the automatic stay through special "safe harbor" provisions.²² Under these provisions, any rights that a QFC counterparty has to terminate the contract, set-off obligations, or 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 U.S. 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 U.S. 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,²³ 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.

¹⁹ See 11 U.S.C. 362.

²⁰ See, e.g., Aiello v. Providian Financial Corp., 239 F.3d 876, 879 (7th Cir. 2001).

²¹ The U.S. 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 final rule.

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

²³ 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 (Title II) imposes stay requirements on QFCs of financial companies that enter resolution under that back-up resolution authority. In general, 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 U.S. Bankruptcy Code. With Title II of the Dodd-Frank Act, 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, 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.²⁴ Title II of the Dodd-Frank Act 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.²⁵

Title II of the Dodd-Frank Act empowers the FDIC to transfer 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.²⁶ To give the FDIC time to effect this transfer, Title II of the Dodd-Frank Act 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 Title II resolution, its insolvency, or its financial

²⁴ Section 204(a) of the Dodd-Frank Act, codified at 12 U.S.C. 5384(a).

²⁵ See section 203 of the Dodd-Frank Act, codified at 12 U.S.C. 5383.

²⁶ See 12 U.S.C. 5390(c)(9).

condition.²⁷ Once the QFCs are transferred in accordance with the statute, Title II of the Dodd-Frank Act permanently stays the exercise of default rights for those reasons.²⁸

Title II of the Dodd-Frank Act 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, if such contracts are guaranteed or otherwise supported by the covered financial company, the FDIC takes certain steps to protect the QFC counterparties’ interests by the end of the business day following the company’s entry into Title II resolution.²⁹

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 appropriate protections for QFC counterparties of the failed financial company. The provisions stay the exercise of default rights based on the failed company’s entry into resolution, the fact of its insolvency, or its financial condition. Further, the stay period is temporary, 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, in the case of cross-default rights relating to guaranteed or supported QFCs, the FDIC takes the action required in order to continue to enforce those contracts.³⁰

²⁷ 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.

²⁸ 12 U.S.C. 5390(c)(10)(B)(i)(II).

²⁹ 12 U.S.C. 5390(c)(16); 12 C.F.R. 380.12.

³⁰ See id.

The Federal Deposit Insurance Act. Under the FDI Act, a failing insured depository institution would generally enter a receivership administered by the FDIC.³¹ 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.³² 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, or liquidate QFCs with such affiliates based on the depository institution's entry into resolution. Moreover, as with Title II, 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. Notice of Proposed Rulemaking and General Summary of Comments

The proposal was intended to increase GSIB resolvability and resiliency by addressing two QFC-related issues. First, the proposal sought 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 sought to address the potential disruptions 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 have applied to all "covered FSIs." "Covered FSIs" include: any state savings associations (as defined in 12 U.S.C. 1813(b)(3)) or state non-member bank (as defined in 12 U.S.C. 1813(e)(2)) that is a direct or indirect subsidiary of (i) a global systemically important bank holding company that has been

³¹ 12 U.S.C. 1821(c).

³² See 12 U.S.C. 1821(e)(8)–(10).

designated pursuant to section 252.82(a)(1) of the FRB’s Regulation YY (12 CFR 252.82); or (ii) a global systemically important foreign banking organization³³ that has been designated pursuant to section 252.87 of the FRB’s Regulation YY (12 CFR 252.87). This final rule also makes clear that the mandatory contractual stay requirements apply to the subsidiaries of any covered FSI. Under the final rule, the term “covered FSI” also includes “any subsidiary of a covered FSI.” For the reasons noted above, all subsidiaries of covered FSIs should also be subject to mandatory contractual stay requirements—e.g., to avoid concentrating QFCs in entities subject to fewer restrictions.

In the proposal, “qualified financial contract” or “QFC” was defined to have the same meaning as in section 210(c)(8)(D) of the Dodd-Frank Act,³⁴ and included, among other arrangements, derivatives, repos, and securities borrowing and lending agreements. Subject to the exceptions discussed below, the proposal’s requirements would have applied to any QFC to which a covered FSI is party (covered QFC).³⁵ Under the proposal, a covered FSI would have been required to conform pre-existing QFCs if a covered FSI entered into a new QFC with a counterparty or its affiliate.

³³ The definition of covered FSI does not include insured state-licensed branches of FBOs. Any insured state-licensed branches of global systemically important FBOs would be covered by the FRB FR. Therefore, unlike the FRB FR, the FDIC is not including in the rule any special provisions relating to multi-branch netting arrangements.

³⁴ 12 U.S.C. 5390(c)(8)(D). See proposed rule § 382.1.

³⁵ In addition, the proposed rule states at § 382.2(d) that it does not modify or limit, in any manner, the rights and powers of the FDIC as receiver under the FDI Act or Title II of the Dodd-Frank Act, including, without limitation, the rights of the receiver to enforce provisions of the FDI Act or Title II of the Dodd-Frank Act that limit the enforceability of certain contractual provisions. For example, the suspension of payment and delivery obligations to QFC counterparties during the stay period as provided under the FDI Act and Title II when an entity is in receivership under the FDI Act or Title II remains valid and unchanged irrespective of any contrary contractual provision and may continue to be enforced by the FDIC as receiver. Similarly, the use by a counterparty to a QFC of a contractual provision that allows the party to terminate a QFC on demand, or at its option at a specified time, or from time to time, for any reason, as a basis for termination of a QFC on account of the appointment of the FDIC as receiver (or the insolvency or financial condition of the company) remains unenforceable. This provision is retained in the final rule.

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

Under the proposal, covered FSIs would have been 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 at least the same extent as they would be pursuant to the U.S. Special Resolution Regimes—that is, Title II and the FDI Act.³⁶ The proposed requirements were 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 would be treated the same way in the context of an FDIC receivership under the Dodd-Frank Act or the FDI Act. This section of the proposal was also consistent with analogous legal requirements that have been imposed in other national jurisdictions³⁷ and with the Financial Stability Board’s “Principles for Cross-border Effectiveness of Resolution Actions.”³⁸

Prohibited cross-default rights. Under the proposal, a covered FSI would generally have been 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.³⁹ Covered FSIs would generally have been similarly prohibited from entering into covered QFCs that included a restriction on the transfer of a credit enhancement supporting the QFC from the covered FSI’s affiliate to a transferee upon or following the entry into resolution of the affiliate.

³⁶ See proposed rule § 382.3.

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

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

³⁹ See proposed rule § 382.4(b).

The FDIC did not propose to prohibit covered FSIs from entering into QFCs that allow its counterparties to exercise direct default rights against the covered FSI.⁴⁰ Under the proposal, a covered FSI also could, to the extent not inconsistent with Title II or the FDI Act, enter into a QFC that grants its counterparty the right to terminate the QFC if the covered FSI fails to perform its obligations under the QFC.

As an alternative to bringing their covered QFCs into compliance with the requirements set out in the proposed rule, covered FSIs would have been permitted to comply by adhering to the International Swaps and Derivatives Association (ISDA) 2015 Universal Resolution Stay Protocol, including the Securities Financing Transaction Annex and the Other Agreements Annex (together, the “Universal Protocol”).⁴¹ The preamble to the proposal explained that the FDIC viewed the Universal Protocol as achieving an outcome consistent with the outcome intended by the requirements of the proposed rule by similarly limiting direct default rights and cross-default rights.

Process for approval of enhanced creditor protection conditions. As noted above, in the context of addressing 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 allowed to exercise cross-default rights, the proposed rule would have generally restricted the exercise of cross-default rights by counterparties against a covered FSI. The proposal also would have allowed the FDIC, at the request of a covered FSI, to approve as compliant with the requirements of § 382.5 proposed creditor protection provisions for covered QFCs.⁴²

⁴⁰ However, those default rights would nonetheless have been subject to Title II and FDI Act.

⁴¹ ISDA, “Attachment to the ISDA 2015 Universal Resolution Stay Protocol,” (Nov. 4, 2015), available at <http://assets.isda.org/media/ac6b533f-3/5a7c32f8-pdf/>. See proposed rule § 382.5(a).

⁴² See proposed rule § 382.5(c).

The FDIC would have been permitted to approve such a request if, in light of several enumerated considerations,⁴³ the alternative creditor protections 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.⁴⁴

Amendments to certain definitions in the FDIC's capital and liquidity rules. The proposal would have amended certain definitions in the FDIC's capital and liquidity rules to help ensure that the regulatory capital and liquidity treatment of QFCs to which a covered FSI is party would not be affected by the proposed restrictions on such QFCs. Specifically, the proposal would have amended the definition of "qualifying master netting agreement" in the FDIC's regulatory capital and liquidity rules and would have similarly amended the definitions of the terms "collateral agreement," "eligible margin loan," and "repo-style transaction" in the FDIC's regulatory capital rules.⁴⁵

Comments on the Proposal. The FDIC received 14 comments on the proposed rule from banking organizations, trade associations, public interest advocacy groups, and private individuals. FDIC staff also met with some commenters at their request to discuss their comments on the proposal, and summaries of these meetings may be found on the FDIC's public website.

A number of commenters including GSIBs that would be subject to the proposed requirements included in the proposal expressed strong support for the proposed rule as a well-considered effort to reduce systemic risk with minimal burden and as an important step to ensure

⁴³ See proposed rule § 382.5(c).

⁴⁴ This provision is retained in the final rule and the FDIC expects to consult with the FRB and OCC during its consideration of a request under this section.

⁴⁵ See proposed rule §§ 324.2 and 329.3.

a more efficient and orderly resolution process for GSIB entities and thereby to protect the stability of the U.S. financial system. Other commenters, however, expressed concern with the proposed rule. These commenters generally argued that the proposal should not restrict contractual rights of GSIB counterparties and contended that the proposal would have shifted the costs of resolving the covered FSIs, covered entities, and covered banks to non-defaulting counterparties. Some commenters argued that the proposal would not assuredly mitigate systemic risk, as the requirements could result in increased market and credit risk for QFC counterparties of a GSIB. Commenters also argued that it would be more appropriate for Congress to impose the proposal's restrictions on contractual rights through the legislative process rather than through a regulation.

As described above, the proposal applied to "covered FSIs." A covered FSI included any subsidiary of a covered FSI. The proposal defined "subsidiary of a covered FSI" as an entity owned or controlled directly or indirectly by a covered FSI. "Control" was defined by reference to the Bank Holding Company Act of 1956, as amended ("BHC Act"). The other NPRMs similarly used the definition of control from the BHC Act for purposes of determining the entities that would have been subject to the requirements of the NPRMs. Commenters urged the agencies to move to a financial consolidation standard to define the subsidiaries of covered FSIs, arguing that the concept of control under the BHC Act includes entities (1) that are not under the operational control of the GSIB entity and (2) over whom the GSIB may not have the practical ability to require remediation. Furthermore, commenters urged that non-financial consolidated subsidiaries are unlikely to raise the types of concerns for the orderly resolution of GSIBs targeted by the proposal. For similar reasons, these commenters argued that, for purposes of the requirement that a covered FSI conform existing QFCs if a covered FSI enters into a new QFC

with a counterparty or its affiliate, a counterparty's "affiliate" should also be defined by reference to financial consolidation rather than BHC Act control. Commenters also expressed concern that the definition of "covered QFCs" under the proposal was overly broad. The proposal required a covered QFC to explicitly provide that it is subject to the stay-and-transfer provisions of Title II and the FDI Act and generally prohibited a covered FSI from being a party to a QFC that would allow the exercise of cross-default rights. Commenters argued that the final rule should exclude QFCs that do not contain any contractual transfer restrictions, direct default rights, or cross-default rights, as these QFCs do not give rise to the risk that counterparties will exercise their contractual rights in a manner that is inconsistent with the provisions of the U.S. Special Resolution Regimes. Commenters also urged the FDIC to exclude QFCs governed by U.S. law from the requirement that QFCs explicitly "opt in" to the U.S. Special Resolution Regimes since it is already clear that such QFCs are subject to the stay-and-transfer provisions of Title II and the FDI Act. With respect to the proposal's prohibition against provisions that would allow the exercise of cross-default rights in covered QFCs of a GSIB, commenters argued that the final rule should clarify that QFCs that do not contain such cross-default rights or transfer restrictions regarding related credit enhancements are not within the scope of the prohibition.

Commenters also requested that certain types of contracts that may include transfer or default rights subject to the proposal's requirements (e.g., warrants; certain commodity contracts including commodity swaps; certain utility and gas supply contracts; certain retail customer and investment advisory agreements; securities underwriting agreements; securities lending authorization agreements) be excluded from all requirements of the final rule because these types of contracts do not raise the risks to the resolution of a covered FSI or financial stability that are the target of this final rule and because certain existing contracts of these types would be

difficult, if not impossible, to amend. Commenters also requested that securities contracts that typically settle in the short term or that typically include only transfer restrictions and not default rights similarly be excluded from all requirements of the final rule because they do not impose ongoing or continuing obligations on either party after settlement. In all of the above cases, commenters argued that remediation of such outstanding contracts would be burdensome with no meaningful resolution benefits. Certain commenters also urged that the final rule apply only to contracts entered into after the final rule's effective date and not to contracts existing as of the final rule's effective date.

As noted above, the proposal would have deemed compliant covered QFCs amended by the existing Universal Protocol (which allows for creditor protections in addition to those otherwise permitted by the proposed rule). Commenters generally supported this aspect of the proposal, although they requested express clarification that adherence to the existing Universal Protocol would satisfy all of the requirements of the final rule. Commenters urged that the final rule should also provide a safe harbor for a future ISDA protocol that would be substantially similar to the existing Universal Protocol except that it would seek to address the specific needs of buy-side market participants, such as asset managers, insurance companies, and pension funds who are counterparties to QFCs with GSIBs, to allow, for example, entity-by-entity adherence and the exclusion of certain foreign special resolution regimes.

Commenters expressed support for the exemption in the proposal for cleared QFCs but requested that this exemption be broadened to extend to the client leg of a cleared back-to-back transaction and also to exclude any contract cleared, processed, or settled on a financial market utility (FMU) as well as any QFC conducted according to the rules of an FMU. Commenters also requested an exemption for QFCs with sovereign entities and central banks. Commenters

further requested a longer period of time for covered FSIs, entities, and banks to conform covered QFCs with certain types of counterparties to the requirements of the final rule. Commenters also requested that the FDIC coordinate with other regulatory agencies, consider comments submitted to the OCC and the FRB regarding their proposals and from entities not regulated by the FDIC, and finalize a rule with conformance periods consistent with the OCC's and FRB's final rules. In addition, commenters requested confirmation that modifications to contracts to comply with this rule would not trigger other regulatory requirements (e.g., margin requirements for non-cleared swaps) or impact the enforceability of QFCs. The FDIC has considered the comments received on the proposal, including those of entities not regulated by the FDIC, as well as the comments submitted to the OCC and FRB regarding their respective proposals, and these comments and any corresponding changes in the final rule are described in more detail throughout the remainder of this SUPPLEMENTARY INFORMATION.

C. Overview of Final Rule

The FDIC is adopting this final rule to improve the resolvability of GSIBs and thereby furthering financial stability and enhancing the resilience, and the safety and soundness of covered FSIs. The FDIC has made a number of changes to the proposal in response to concerns raised by commenters, as further described below.

The final rule is intended to protect covered FSIs and to facilitate the orderly resolution of the most systemically important banking firms –GSIBs - by limiting the ability of the counterparties of the firms' FSI subsidiaries to terminate qualified financial contracts upon the entry of the GSIB or one or more of its affiliates into resolution. The rule requires the inclusion of contractual restrictions on the exercise of certain default rights in those QFCs. In particular, the final rule requires the QFCs of covered FSIs to contain contractual provisions that opt into the stay-and-

transfer provisions of the FDI Act and the Dodd-Frank Act to reduce the risk that the stay-and-transfer related actions by the receiver would be successfully challenged by a QFC counterparty or a court in a foreign jurisdiction. The final rule also prohibits covered FSIIs from entering into QFCs that contain cross-default rights, subject to certain creditor protection exceptions that would not be expected to interfere with an orderly resolution.

The final rule also furthers the implementation of the Universal Protocol, which extends, through contractual agreement, the application of the resolution frameworks of the FDI Act and the Dodd-Frank Act to all QFCs entered into by an adhering GSIB and its adhering subsidiaries, including QFCs entered into outside of the United States, and establishes restrictions on cross-default rights that are similar to those in the final rule. The final rule is necessary to implement the Universal Protocol provisions regarding the resolution of a GSIB under the U.S. Bankruptcy Code, as these provisions do not become effective until implemented by U.S. regulations. To support further adherence to the Universal Protocol, the final rule creates a safe harbor allowing covered FSIIs to sign up to the Universal Protocol and thereby amend their QFCs pursuant to the Universal Protocol as an alternative to implementing the restrictions of the final rule on a counterparty-by-counterparty basis. In addition, the final rule provides that covered QFCs amended pursuant to adherence of a covered FSI to a new protocol (the “U.S. Protocol”) would be deemed to conform to the requirements of the final rule. The U.S. Protocol may differ (and is required to differ) from the Universal Protocol in certain respects discussed below, but otherwise must be substantively identical to the Universal Protocol.

The final rule requires covered FSIIs to conform certain covered QFCs to the requirements of the final rule beginning one year after the effective date of the final rule (first compliance date) and phases in conformance requirements with respect to all covered QFCs over a two-year period

depending on the type of counterparty. As explained below, a covered FSI generally is required to conform pre-existing QFCs only if the covered FSI or an affiliate of the covered FSI enters into a new QFC with the same counterparty or a consolidated affiliate of the counterparty on or after the first compliance date.

Covered FSIs

The final rule, like the proposal, applies to “covered FSIs,” which generally are state savings associations and state non-member banks and their subsidiaries. “Subsidiary” continues to be defined in the final rule by reference to BHC Act control. As discussed below, certain other types of subsidiaries, including a subsidiary that is owned in satisfaction of debt previously contracted in good faith, a portfolio concern controlled by a small business investment company, or a subsidiary that promotes the public welfare, are excluded from the definition of covered FSI and therefore not required to conform any QFCs.

Covered Qualified Financial Contracts

The final rule like the proposal defines “qualified financial contract” or “QFC” to have the same meaning as in section 210(c)(8)(D) of the Dodd-Frank Act⁴⁶ and would include, among other things, derivatives, repos, and securities lending agreements.⁴⁷ Subject to the exceptions discussed below, the final rule’s requirements apply to any QFC to which a covered FSI is party (covered QFC). The final rule makes clear that covered FSIs do not need to conform QFCs that have no transfer restrictions, direct default rights, or cross-default rights as these QFCs have no provisions that the rule is intended to address.⁴⁸ The final rule also excludes certain retail

⁴⁶ 12 U.S.C. 5390(c)(8)(D). See proposed rule § 382.1.

⁴⁷ See final rule § 382.1.

⁴⁸ See final rule § 382.2.

investment advisory agreements, and certain existing warrants. It also provides the FDIC with authority to exempt one or more covered FSIs from conforming certain contracts or types of contracts to the one or more of the requirements of the final rule after considering, in addition to any other factor the FDIC deems relevant, the burden the exemption would relieve and the potential impact of the exemption on the resolvability of the covered FSI or its affiliates.⁴⁹

The final rule also makes clear that a covered FSI must conform existing QFCs with a counterparty if the GSIB group (i.e., the covered FSI or its affiliates that are covered FSIs or covered banks or covered entities) enters into a new QFC with that counterparty or its consolidated affiliate, defined by reference to financial consolidation principles. In particular, the final rule provides that a covered QFC includes a QFC that the covered FSI entered, executed, or otherwise became a party to before the first compliance date of this final rule if the covered FSI or any affiliate that is a covered FSI, covered entity or covered bank also enters, executes, or otherwise becomes a party to a QFC with the same person or a consolidated affiliate of that person on or after the first compliance date.⁵⁰ “Consolidated affiliate” is a defined term in the final rule that is defined by reference to financial consolidation principles.⁵¹

Required contractual provisions related to the U.S. Special Resolution Regimes

Under the final rule, covered FSIs are 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.⁵² However, any covered QFC that is governed under U.S. law and involves only

⁴⁹ See final rule § 382.7.

⁵⁰ See final rule § 382.2(c).

⁵¹ See final rule § 382.1.

⁵² See final rule § 382.3.

parties (other than the covered FSI) that are domiciled (in the case of individuals), incorporated in, organized under, the laws of the United States or any State, or whose principal place of business is located in the United States, including any state, or that is a U.S. branch or U.S. agency (U.S. counterparties) is also excluded from the requirements of the final rule relating to Title II of the Dodd-Frank Act and the FDI Act because it is clear that in these circumstances the stay-and-transfer provisions of those acts would be enforceable in a U.S. forum.⁵³

Prohibited cross-default rights

Under the final rule, a covered FSI is 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.⁵⁴ Covered FSIs are similarly prohibited from entering into covered QFCs that would restrict the transfer of a credit enhancement supporting the QFC from the covered FSI’s affiliate to a transferee upon the entry into resolution of the affiliate.⁵⁵

The final rule does not prohibit covered FSIs from entering into QFCs that provide their counterparties with direct default rights against the covered FSI. Under the final rule, a covered FSI may be a party to a QFC that provides the counterparty with the right to terminate the QFC if the covered FSI fails to perform its obligations under the QFC.⁵⁶

Industry-developed Protocol

As an alternative to bringing their covered QFCs into compliance with the requirements of the final rule, the final rule allows covered FSIs to comply with the rule by adhering to the

⁵³ See final rule § 382.3.

⁵⁴ See final rule § 382.4(b).

⁵⁵ See id.

⁵⁶ These rights may nonetheless be subject to limitations governing their exercise in a resolution under Title II or the FDI Act.

Universal Protocol.⁵⁷ The final rule also permits compliance with the final rule through adherence to a new protocol (the U.S. Protocol) that is the same as the existing Universal Protocol but for minor changes intended to encourage a broader range of QFC counterparties to adhere only with respect to covered FSIs, covered entities, and covered banks. The Universal Protocol and the U.S. Protocol differ from the requirements of this final rule in certain respects. Nevertheless, as described in greater detail below, the final rule allows compliance through adherence to these protocols in light of the fact that the protocols contain certain desirable features that the final rule lacks and produce outcomes substantially similar to this final rule.

Process for approval of enhanced creditor protection conditions.

The final rule also allows the FDIC, at the request of a covered FSI, to approve as compliant with the final rule covered QFCs with creditor protections other than those that would otherwise be permitted under section 382.4 of the final rule.⁵⁸ The FDIC could approve such a request if, in light of several enumerated considerations, the alternative approach would prevent or mitigate risks to the financial stability of the United States presented by a GSIB's failure and would protect the safety and soundness of covered FSIs to at least the same extent as the final rule's requirements.⁵⁹

Amendments to certain definitions in the FDIC's capital and liquidity rules

The final rule also amends certain definitions in the FDIC's capital and liquidity rules to help ensure that the regulatory capital and liquidity treatment of QFCs to which a covered FSI is party is not affected by the proposed restrictions on such QFCs. Specifically, the final rule amends the definition of "qualifying master netting agreement" in the FDIC's regulatory capital

⁵⁷ See final rule § 382.5(a).

⁵⁸ See final rule § 382.5(c).

⁵⁹ See final rule § 382.5(c)-(d).

and liquidity rules and similarly amends the definitions of the terms “collateral agreement,” “eligible margin loan,” and “repo-style transaction” in the FDIC’s regulatory capital rules.

D. Consultation with U.S Financial Regulators

In developing this final rule, the FDIC consulted with the FRB and the OCC as a means of promoting alignment across regulations and avoiding redundancy. Furthermore, the FDIC has consulted with and expects to continue to consult with foreign financial regulatory authorities regarding the implementation of this final rule 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.⁶⁰

The FRB has finalized a rulemaking that would subject entities to requirements substantially identical to those finalized here for covered FSIs. Similarly, the OCC is expected to finalize a rulemaking that would subject covered banks, including the national banks of GSIBs, to requirements substantially identical to those proposed here for covered FSIs. The FDIC has consulted with the OCC and the FRB in the development of their respective final rules. The banking agencies have endeavored to harmonize their respective rules to the extent possible and to provide specificity and clarity in the final rule to minimize the possibility of conflicting interpretations or uncertainty in their application. Moreover, the banking agencies intend to consult with each other and coordinate as needed regarding implementation of the final rule.

⁶⁰ Several commenters requested that the FDIC consult with the FRB and the OCC in developing its final rule and coordinate its final rule with that of the FRB and OCC. Certain commenters also requested that the FDIC consult with foreign regulatory authorities in developing its final rule.

E. Overview of Statutory Authority and Purpose

The FDIC is issuing this final rule under its authorities under the FDI Act (12 U.S.C. 1811 *et seq.*), including its general rulemaking authorities.⁶¹ The FDIC views the final rule as consistent with its overall statutory mandate.⁶² An overarching purpose of the final rule is to limit disruptions to an orderly resolution of a GSIB and its subsidiaries, thereby furthering financial stability generally. Another purpose is to enhance the safety and soundness of covered FSIs by addressing the two main issues raised by covered QFCs (noted above): cross-border recognition and cross-default rights.

As discussed above, the exercise of default rights by counterparties of a failed GSIB can have significant impacts on financial stability. These financial stability concerns are necessarily intertwined with the safety and soundness of covered FSIs and the banking system—the disorderly exercise of default rights can produce a sudden, contemporaneous threat to the safety and soundness of individual institutions, including insured depository institutions, throughout the system, which in turn threatens the system as a whole. Furthermore, the failure of multiple insured depository institutions in the same time period could stress the DIF, which is managed by the FDIC.

While a covered FSI may not itself be considered systemically important, as part of a GSIB, the disorderly resolution of the covered FSI could result in a significant negative impact on the GSIB. Additionally, the application of the final rule to the QFCs of covered FSIs should

⁶¹ See 12 U.S.C. 1819.

⁶² The FDIC is (i) the primary federal supervisor for SNMBs and state savings associations; (ii) insurer of deposits and manager of the DIF; and (iii) the resolution authority for all FDIC-insured institutions under the Federal Deposit Insurance Act and for large complex financial institutions under Title II of the Dodd-Frank Act. See 12 U.S.C. 1811, 1816, 1818, 1819, 1820(g), 1828, 1828m, 1831p-1, 1831u, 5301 *et seq.*

avoid creating what may otherwise be an incentive for GSIBs and their counterparties to concentrate QFCs in entities that are subject to fewer counterparty restrictions.

II. Proposed Restrictions on QFCs of Covered FSIs

A. Covered FSIs (Section 382.2(a) of the Proposed Rule)

The proposed rule applied to “covered FSIs.” The term “covered FSI” included: any state savings associations (as defined in 12 U.S.C. 1813(b)(3)) or state non-member bank (as defined in 12 U.S.C. 1813(e)(2)) that is a direct or indirect subsidiary of (i) a global systemically important bank holding company that has been designated pursuant to section 252.82(a)(1) of the FRB’s Regulation YY (12 CFR 252.82); or (ii) a global systemically important foreign banking organization that has been designated pursuant to section 252.87 of the FRB’s Regulation YY (12 CFR 252.87). Under the proposed rule, the term “covered FSI” included any “subsidiary of covered FSI.”

The definition of “subsidiary” under the proposal included any company that is owned or controlled directly or indirectly by another company where the term “control” was defined by reference to the BHC Act.⁶³ The BHC Act definition of control includes ownership, control or the power to vote 25 percent of any class of voting securities; control in any manner of the election of a majority of the directors or trustees of; or exercise of a controlling influence over the management or policies.⁶⁴

Commenters noted that covered FSIs are not excluded from the definition of covered entities in the FRB NPRM. They urged the FDIC to coordinate with the FRB and the OCC to ensure that only a single set of rules applies to a GSIB entity. As discussed above, the banking

⁶³ See 12 CFR 252.2.

⁶⁴ 12 U.S.C. 1841(a).

agencies have coordinated and the FRB final rule excludes covered FSIs from the scope of entities covered by that rule.⁶⁵

A number of commenters urged the agencies to move to a financial consolidation standard to define a “subsidiary” of a covered entity, covered bank or covered FSI instead of by reference to BHC Act control.⁶⁶ These commenters argued that, under Generally Accepted Accounting Principles, a company generally would consolidate an entity in which it holds a majority voting interest or over which it has the power to direct the most significant economic activities, to the extent it also holds a variable interest in the entity. In addition, commenters asserted that financially consolidated subsidiaries are often subject to operational control and generally fully integrated into the parent’s enterprise-wide governance, policies, procedures, control frameworks, business strategies, information technology systems, and management systems. These commenters noted that the concept of BHC Act control was designed to serve other policy purposes (e.g., separation between banking and commercial activities). A number of commenters argued that BHC Act control may include an entity that is not under the day-to-day operational control of the GSIB and over whom the GSIB does not have the practical ability to require remediation of that entity’s QFCs to comply with the proposed rule. Moreover, commenters contended that entities that are not consolidated with a GSIB for financial reporting purposes are unlikely to raise the types of concerns for the orderly resolution of GSIBs targeted

⁶⁵ Commenters requested further clarification on the interaction between the final rules of the banking agencies to avoid legal uncertainty. As noted above, each banking agency either has already or is in the process of finalizing rules that are substantially identical to this final rule, and the banking agencies are expected to coordinate in the interpretation of the rules. Section 382.7(b) of the final rule, which addresses potential overlap between the agencies’ final rules, has been clarified in response to commenters’ requests. Section 382.7(b) is discussed in more detail below.

⁶⁶ Commenters generally expressed a similar view with respect to the definition of “affiliate” of a covered FSI as the term is used in sections 382.3 and 382.4 of the proposed rule. That term which was similarly defined by reference to BHC Act control under the proposal.

by the proposal. Commenters also noted that the Universal Protocol and, generally, the standard forms of ISDA master agreements define “affiliate” by reference to ownership of a majority of the voting power of an entity or person. For these reasons, commenters urged that the term “subsidiary” of a covered FSI should be based on financial consolidation under the final rule.

Commenters urged that regardless of whether financial consolidation standard is adopted for the purpose of defining “subsidiary,” the final rule should exclude from the definition of “covered FSI, covered bank, or covered entity” entities over which the GSIB does not exercise operational control, such as merchant banking portfolio companies, section 2(h)(2) companies, joint ventures, sponsored funds as distinct from their sponsors or investment advisors, securitization vehicles, entities in which the GSIB holds only a minority interest and does not exert a controlling influence, and subsidiaries held pursuant to provisions for debt previously contracted in good faith (DPC subsidiaries).⁶⁷ Further, commenters asked the FDIC to coordinate with the FRB and the OCC to ensure the scope of entities covered under the terms “subsidiary” and “affiliate” is consistent. Consistent with the FRB and the OCC, the FDIC is excluding from the definition of “covered FSI” subsidiaries that are portfolio concerns, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), or that is owned pursuant to paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24) and designed to promote the public welfare, and companies owned in satisfaction of debt previously contracted in good faith.

Certain commenters requested other exclusions from the definition of “covered entity” that are not applicable to the FDIC’s final rule. For example, certain commenters argued that

⁶⁷ See, e.g., 12 U.S.C. 1842(a)(A)(ii), 1843(c)(2); 12 CFR 225.12(b), 225.22(d)(1).

subsidiaries of foreign GSIBs for which the foreign GSIB has been given special relief by an FRB order not to hold the subsidiary under an intermediate holding company (IHC) should not be included in the definition of covered entity, even if such entities would be consolidated under financial consolidation principles. The FDIC is not addressing these comments.

Under the final rule, a “covered FSI” is generally any state savings associations (as defined in 12 U.S.C. 1813(b)(3)) or state non-member bank (as defined in 12 U.S.C. 1813(e)(2)) that is a direct or indirect subsidiary of (i) a global systemically important bank holding company that has been designated pursuant to section 252.82(a)(1) of the FRB’s Regulation YY (12 CFR 252.82); or (ii) a global systemically important foreign banking organization that has been designated pursuant to section 252.87 of the FRB’s Regulation YY (12 CFR 252.87), and any subsidiary of a covered FSI, other than a portfolio concern, as defined under 13 CFR 107.50 that is controlled by a small business investment company as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662) or owned pursuant to paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24).

U.S. GSIB subsidiaries. Covered FSI would also generally include all subsidiaries of a covered FSI other than the exceptions noted above.⁶⁸ Therefore, in order to increase the resilience and resolvability of the FSI and the entire GSIB entity of which it is a part by addressing the potential obstacles to orderly resolution posed by QFCs, it is necessary to apply the restrictions to the 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

⁶⁸ See final rule § 382.2(b).

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 an 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 as covered FSIs should help ensure that such cross-default rights do not affect the ability of performing and solvent entities—regardless of jurisdiction—to remain outside of resolution proceedings.

“Subsidiary” in the final rule continues to be defined by reference to BHC Act control as does the definition of “affiliate.”⁶⁹ The final rule does not limit the definition of covered FSIs to only those subsidiaries of GSIBs that are financially consolidated as requested by certain commenters. Defining “subsidiary” and “affiliate” by reference to BHC Act control is consistent with the definitions of those terms in the FDI Act and Title II of the Dodd-Frank Act. Specifically, Title II permits the FDIC, as receiver of a covered financial company or as receiver for its subsidiary, to enforce QFCs and other contracts of subsidiaries and affiliates, defined by reference to the BHC Act, notwithstanding cross-default rights based solely on the insolvency, financial condition, or receivership of the covered financial company.⁷⁰ Therefore, maintaining consistent definitions of subsidiary and affiliate with Title II should better ensure that QFC stays may be effected in resolution under a U.S. Special Resolution Regime. As covered FSIs are subsidiaries of GSIBs that are already subject to the requirements of the BHC Act, they should already know all of their BHC Act controlled subsidiaries and be familiar with BHC Act control principles.

B. Covered QFCs (Section 382.2 of the Final Rule)

⁶⁹ See final rule § 382.1.

⁷⁰ 12 U.S.C. 5390(c)(16).

General definition. The proposal applied to any “covered QFC,” generally defined as any QFC that a covered FSI enters into, executes, or otherwise becomes party to with the person or an affiliate of the same person.⁷¹ Under the proposal, “qualified financial contract” or “QFC” was defined as in section 210(c)(8)(D) of Title II of the Dodd-Frank Act and included swaps, repo and reverse repo transactions, securities lending and borrowing transactions, commodity contracts, securities contracts, and forward agreements.⁷²

The application of the rule’s requirements to a “covered QFC” was one of the most commented upon aspects of the proposal. Certain commenters argued that the definition of QFC in Title II of the Dodd-Frank Act was overly broad and imprecise and could include agreements that market participants may not expect to be subject to the stay-and-transfer provisions of the U.S. Special Resolution Regimes. More generally, commenters argued that the proposed definition of QFC was too broad and would capture contracts that do not present any obstacles to an orderly resolution. Commenters advocated for the exclusion of a variety of types of QFCs from the requirements of the final rule. In particular, a number of commenters requested the exclusion of QFCs that do not contain any transfer restrictions or default rights, because these types of QFCs do not give rise to the risk that counterparties will exercise their contractual rights in a manner that is inconsistent with the provisions of the U.S. Special Resolution Regimes. Commenters provided several examples of contracts that they asserted fall into this category, including cash market securities transactions, certain spot FX transactions (including securities conversion transactions), retail brokerage agreements, retirement/IRA account agreements, margin agreements, options agreements, FX forward master agreements, and delivery versus

⁷¹ See proposed rule §§ 382.1 and 382.3(a). For convenience, this preamble generally refers to “a covered FSI’s QFCs” or “QFCs to which a covered FSI is party” as shorthand to encompass the definition of “covered QFC.”

⁷² See proposed rule § 382.1. See also 12 U.S.C. 5390(c)(8)(D).

payment client agreements. Commenters contended that these types of QFCs number in the millions at some firms and that remediating these contracts to include the express provisions required by the final rule would require an enormous client outreach effort that would be extremely burdensome and costly while providing no meaningful resolution benefits. For example, commenters indicated that for certain types of transactions, such as cash securities transactions, FX spot transactions, and retail QFCs, such a requirement could require an overhaul of existing market practice and documentation that affects hundreds of thousands, if not millions, of transactions occurring on a daily basis and significant education of the general market.

Commenters also requested the exclusion of QFCs that do not contain any default or cross-default rights but that may contain transfer restrictions. Commenters contended that examples of these types of agreements included investment advisory account agreements with retail customers, which contain transfer restrictions as required by section 205(a)(2) of the Investment Advisers Act of 1940, but no direct default or cross-default rights; underwriting agreements;⁷³ and client onboarding agreements. A few commenters provided prime brokerage or margin loan agreements as examples of transactions that generally do not have default or cross-default rights but may have transfer restrictions. Another commenter also requested the exclusion of securities market transactions that generally settle in the short term, do not impose ongoing or continuing obligations on either party after settlement, and do not typically include default rights.⁷⁴ In these cases, commenters contended that remediation of these agreements would be burdensome with no meaningful resolution benefits.

⁷³ However, certain commenters noted that underwriting, purchase, subscription or placement agency agreements may contain rights that could be construed as cross-default rights or default rights.

⁷⁴ In the alternative, the commenter requested that such securities market transactions be excluded to the extent they are cleared, processed, and settled through (or subject to the rules of) FMUs through expansion of the proposed

Commenters also argued for the exclusion of a number of other types of contracts from the definition of covered QFC in the final rule. In particular, a number of commenters urged that contracts issued in the capital markets or related to a capital market issuance like warrants or a certificate representing a call option, typically on a security or a basket of securities be excluded. Although warrants issued in capital markets may contain direct default and cross-default rights as well as transfer restrictions, commenters argued that remediation of outstanding warrant agreements would be difficult, if not impossible, since remediation would require the affirmative vote of a substantial number of separate voting groups of holders to amend the terms of the instruments and that obtaining such consent could be expensive due to “hold-out” premiums. Commenters also argued that since these instruments are traded in the markets, it is not possible for an issuer to ascertain whether a particular investor in such instruments has also entered into other QFCs with the dealer or any of its affiliates (or vice versa) for purposes of complying with the proposed mechanism for remediation of existing QFCs. Commenters argued that issuers would be able to comply if the final rule’s requirements applied only on a prospective basis with respect to new issuances since new investors could be informed of the terms of the warrant at the time of purchase and no after-the-fact consent would be required as is the case with existing outstanding warrants. Commenters expressed the view that prospective application of the final rule’s requirements to warrants would allow time for firms to develop new warrant agreements and warrant certificates, to engage in client outreach efforts, and to make any appropriate public disclosures. Commenters suggested that the requirements of the final rule should only apply to such instruments issued after the effective date of the final rule and that the compliance period

exemption for transactions with central counterparties. This aspect of the comment is addressed in the subsequent section discussing requests for expansion of the proposed exemption for transactions with central counterparties.

for such new issuances be extended to allow time to establish new issuance programs that comply with the final rule's requirements. Other examples of contracts in this category given by commenters include contracts with special purpose vehicles that are multi-issuance note platforms, which commenters urged would be difficult to remediate for similar reasons to warrants other than on a prospective basis.

Commenters also urged the exclusion of contracts for the purchase of commodities in the ordinary course of business (e.g., utility and gas energy supply contracts) or physical delivery commodity contracts more broadly.⁷⁵ In general, commenters argued that exempting these contracts would not increase systemic risk but would help ensure the smooth operation of utilities and the physical commodities markets.⁷⁶ Commenters indicated that failure to make commodity deliveries on time can result in the accrual of damages and penalties beyond the accrual of interest (e.g., demurrage and other fines in shipping) and that counterparties may not be able to obtain appropriate compensation for amendment of default rights due to the difficulty of pricing the risk associated with an operational failure due to the failure to deliver a commodity

⁷⁵ For example, some commenters urged the exclusion of all contracts requiring physical delivery between commercial entities in the course of regulatory business such as (i) contracts subject to a Federal Energy Regulatory Commission-filed tariff; (ii) contracts that are traded in markets overseen by independent system operators or regional transmission operators; (iii) retail electric contracts; (iv) contracts for storage or transportation of commodities; (v) contracts for financial services with regulated financial entities (e.g., brokerage agreements and futures account agreements); and (vi) public utility contracts.

⁷⁶ One commenter also argued that utility and gas supply contracts are covered sufficiently in section 366 of the U.S. Bankruptcy Code. This section of the U.S. Bankruptcy Code places restrictions on the ability of a utility to "alter, refuse, or discontinue service to, or discriminate against, the trustee or the debtor solely on the basis of the commencement of a case under [the U.S. Bankruptcy Code] or that a debt owed by the debtor to such utility for service rendered before the order for relief was not paid when due." 11 U.S.C. 366. The purpose and effect of section 382.44 of the final rule and section 366 of the U.S. Bankruptcy Code are different and therefore do not serve as substitutes. Section 366 of the U.S. Bankruptcy Code does not address cross-defaults or provide additional clarity regarding the application of the U.S. Special Resolution Regimes. Similarly, section 382.4 of the final rule does not prevent a covered FSI from entering into a covered QFC that allows the counterparty to exercise default rights once a non-bank covered FSI that is a direct party enters bankruptcy or fails to pay or perform under the QFC.

on time. Commenters also contended that agreements with power operators governed by regulatory tariffs would be difficult, if not impossible, to remediate.⁷⁷

The final rule applies to any “covered QFC,” which generally is defined as any “in-scope QFC” that a covered FSI enters into, executes, or to which the covered FSI otherwise becomes a party.⁷⁸ As under the proposal, “qualified financial contract” or “QFC” is defined in the final rule as in section 210(c)(8)(D) of Title II of the Dodd-Frank Act and includes swaps, repo and reverse repo transactions, securities lending and borrowing transactions, commodity contracts, and forward agreements.⁷⁹ Parties that enter into contracts with covered FSIs have been potentially subject to the stay-and-transfer provisions of Title II of the Dodd-Frank Act since its enactment. Consistent with Title II of the Dodd-Frank Act, the final rule does not exempt QFCs involving physical commodities. However as explained below, the final rule responds to concerns regarding the smooth operation of physical commodities end users and markets by allowing counterparties to terminate QFCs based on the failure to pay or perform.⁸⁰

In response to concerns raised by commenters, the final rule exempts QFCs that have no transfer restrictions or default rights, as these QFCs have no provisions that the rule is intended to address. The final rule effects this exemption by limiting the scope of QFCs potentially

⁷⁷ One commenter also requested exclusion of overnight transactions, particularly overnight repurchase agreements, arguing that such transactions present little risk of creating negative liquidity effects and that an express exclusion for such transactions may increase the likelihood that such contracts would remain viable funding sources in times of liquidity stress. Although the final rule does not exempt overnight repo transactions, the final rule may have limited if any effect on such transactions. As described below, the final rule provides a number of exemptions that may apply to overnight repo and similar transactions. Moreover, the restrictions on default rights in section 382.4 of the final rule do not apply to 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. *See* final rule § 382.1 (defining “default right”). Therefore, section 382.4 does not restrict the ability of QFCs, including overnight repos, to terminate at the end of the term of the contract.

⁷⁸ *See* final rule § 382.2(c).

⁷⁹ *See* 12 U.S.C. 5390(c)(8)(D); final rule § 382.1.

⁸⁰ However, those default rights remain subject to Title II and FDI Act.

subject to the rule to those QFCs that explicitly restrict the transfer of a QFC from a covered FSI or explicitly provide default rights that may be exercised against a covered FSI (in-scope QFCs).⁸¹ This change addresses a major concern raised by commenters regarding the overbreadth of the definition of “covered QFC” in the proposal. The change also mitigates the burden of complying with the rule without undermining its purpose by not requiring covered FSIs to conform contracts that do not contain the types of default rights and transfer restrictions that the final rule is intended to address. The final rule does not, however, exclude QFCs that have transfer restrictions (but no default rights or cross-default rights) as requested by certain commenters, as such QFCs would have provisions (i.e., transfer restrictions) that are subject to the requirements of the final rule and could otherwise impede the orderly resolution of a covered FSI or its affiliate.

The final rule provides that a covered FSI is not required to conform certain investment advisory contracts described by commenters (i.e., investment advisory contracts with retail advisory customers⁸² of the covered FSI that only contain transfer restrictions necessary to comply with section 205(a) of the Investment Advisers Act). The final rule also exempts any existing warrant evidencing a right to subscribe or to otherwise acquire a security of a covered FSI or its affiliate.⁸³ The final rule excludes these types of agreements because there is persuasive evidence that these types of contracts would be burdensome to conform and that it is unlikely that excluding such contracts from the requirements of the final rule would impair the

⁸¹ See final rule § 382.2(d). The final rule includes as an in-scope QFC a QFC that contains a restriction on the transfer of a QFC from a covered FSI. This would include any QFC that restricts the transfer of that QFC or any other QFC.

⁸² See final rule § 382.7(c)(1). The final rule defines retail customers or counterparty by reference to the FDIC’s rule relating to the liquidity coverage ratio, 12 C.F.R. part 329. Covered FSIs should be familiar with this definition and its application.

⁸³ See final rule § 382.7(c)(2). Warrants issued after the effective date of the final rule are not excluded from the requirements of the final rule.

orderly resolution of a GSIB.⁸⁴ The final rule also provides the FDIC with authority to exempt one or more covered FSIs from conforming certain contracts or types of contracts to the final rule after considering, in addition to any other factor the FDIC deems relevant, the burden the exemption would relieve and the potential impact of the exemption on the resolvability of the covered FSI or its affiliates.⁸⁵ Covered FSIs that request that the FDIC exempt additional contracts from the final rule should be prepared to provide information in support of their requests. The FDIC expects to consult as appropriate with the FRB and the OCC during its consideration of any such request.

Definition of covered QFC. As noted above, the proposal applied to any “covered QFC,” generally defined as a QFC that a covered FSI enters into, after the effective date and a QFC entered earlier, but only if the covered FSI or its affiliate enters into a new QFC with the same person or an affiliate of the same person.⁸⁶ “Affiliate” in the proposal was defined in the same manner as under the BHC Act to mean any company that controls, is controlled by, or is under common control with another company.⁸⁷ As noted above, “control” under the BHC Act means the power to vote 25 percent or more of any class of voting securities; control in any manner the election of a majority of the directors or trustees; or exercise of a controlling influence over the management or policies.⁸⁸

⁸⁴ The exclusions for investment advisory agreements and existing warrants set forth in the final rule are included to address commenters’ concerns as to the scope and potential compliance burden of the final rule. These exemptions are not interpretations of the definition of QFC and should not be construed as indicating that the FDIC has determined such contracts are necessarily QFCs.

⁸⁵ See final rule § 382.7(d).

⁸⁶ See proposed rule §§ 382.3(a); 382.4(a).

⁸⁷ See proposed rule § 382.1 (defining “affiliate”).

⁸⁸ See 12 U.S.C. 1841(k).

Commenters argued that requiring remediation of existing QFCs of a person if the GSIB entered into a new QFC with an affiliate of the person would make compliance with the proposed rule overly burdensome.⁸⁹ These arguments were similar to commenters' arguments regarding the definition of "subsidiary" of a covered FSI, which were discussed above. Commenters asserted that this requirement would demand that the GSIB track each counterparty's organizational structure by relying on information provided by counterparties, which would subject counterparties to enhanced tracking and reporting burdens. Commenters requested that the phrase "or affiliate of the same person" be deleted from the definition of covered QFC and argued that such a modification would not undermine the ultimate goals of the rule since existing QFCs with the counterparty's affiliate would still have to be remediated if the covered FSI or its affiliate enters into a new QFC with that counterparty affiliate. In the alternative, commenters argued that an affiliate of a counterparty be established by reference to financial consolidation principles rather than BHC Act control since counterparties may not be familiar with BHC Act control. Commenters argued that many counterparties are not regulated bank holding companies and would be unfamiliar with BHC Act control. Certain commenters also argued that a new QFC with one fund in a fund family should not result in other funds in the fund family being required to conform their pre-existing QFCs with the covered FSI or an affiliate.

The final rule's definition of "covered QFC" has been modified to address the concerns raised by commenters. In particular, the final rule provides that a covered QFC includes a QFC that the covered FSI entered, executed, or otherwise became a party to before January 1, 2019, if

⁸⁹ One commenter believed that the burden of conforming contracts with all affiliates of a counterparty would be too great, whether defined in terms of BHC Act control or financial consolidation principles, even though the burden would be reduced by definition in terms of financial consolidation principles.

the covered FSI or any affiliate that is a covered FSI, covered entity, or covered bank also enters, executes, or otherwise becomes a party to a QFC with the same person or a consolidated affiliate of the same person on or after January 1, 2019.⁹⁰ The final rule defines “consolidated affiliate” by reference to financial consolidation principles.⁹¹ As commenters indicated, counterparties will already track and monitor financially consolidated affiliates. Moreover, exposures to a non-consolidated affiliate may be captured as a separate counterparty (e.g., when the non-consolidated affiliate enters a new QFC with the covered FSI). As a consequence, modifying the coverage of affiliates in this manner addresses concerns raised by commenters regarding burden.

The definition of “covered QFC” is intended to limit the restrictions of the final rule 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 of QFC, with the modifications described above, the final rule generally extends stay-and-transfer protections to the same types of transactions as Title II of the Dodd-Frank Act. In this way, the final rule enhances the prospects for an orderly resolution in bankruptcy and under the U.S. Special Resolution Regimes.

Exclusion of cleared QFCs. The proposal excluded from the definition of “covered QFC” all QFCs that are cleared through a central counterparty.⁹² Commenters generally expressed support for this exclusion but some commenters requested that the agencies broaden this exclusion in the final rule. In particular, a number of commenters urged the agencies to exclude the “client-facing leg” of a cleared swap where a clearing member faces a CCP on one leg of the transaction

⁹⁰ See final rule § 382.2(c).

⁹¹ See final rule § 382.1.

⁹² See proposed rule § 382.7(a).

and faces the client on an otherwise identical offsetting transaction.⁹³ One commenter requested the agencies confirm its understanding that “FCM agreements,” which the commenter defined as futures and cleared swaps agreements with a futures commission merchant, are excluded because FCM agreements “are only QFCs to the extent that they relate to futures and swaps and, since futures and cleared swaps are excluded, the FCM Agreements are also excluded.”⁹⁴ The commenter requested, in the alternative, that the final rule expressly exclude such agreements.

A few commenters requested that the FDIC modify the definition of “central counterparty,” which was defined to mean “a counterparty (for example, a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating trades” in the proposal.⁹⁵ These commenters argued that a CCP does far more than “facilitate” or “guarantee” trades and that a CCP “interposes itself between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the

⁹³ Commenters argued that in the European-style principal-to-principal clearing model, the clearing member faces the CCP on one swap (the “CCP-facing leg”), and the clearing member, frequently a GSIB, faces the client on an otherwise identical, offsetting swap (the “client-facing leg”). Under the proposed rule, only the CCP-facing leg of the transaction was excluded even though the client-facing leg relates to the mechanics of clearing and is only entered into by the clearing member to effectuate the cleared transaction. Commenters argued that the proposed rule thus treated two pieces of the same transaction differently, which could result in an imbalance in insolvency or resolution and that the possibility of such an imbalance for the clearing member could expose the clearing member to unnecessary and undesired market risk. Commenters urged the agencies to adopt the same approach taken under Section 2 of the Universal Protocol, which allows the client-facing leg of the cleared swap with the clearing member that is a covered entity, covered bank or covered FSI to be closed out substantially contemporaneously with the CCP-facing leg in the event the CCP were to take action to close out the CCP-facing leg.

Some commenters requested clarification that transactions between a covered entity, covered bank, or covered FSI client and its clearing member (as opposed to transactions where the covered entity, covered bank, or covered FSI is the clearing member) would be subject to the rule’s requirements, since this would be consistent with the Universal Protocol. As explained in this section, the exemption in the final rule regarding CCPs does not depend on whether the covered entity, covered bank, or covered FSI is a clearing member or a client. A covered QFC—generally a QFC to which a covered entity, covered bank, or covered FSI is a party—is exempted from the requirements of the final rule if a CCP is also a party.

⁹⁴ Letter to Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation, from James M. Cain, Sutherland Asbill & Brennan LLP, writing on behalf of the eleven Federal Home Loan Banks, at 2 (Dec. 12, 2016).

⁹⁵ 12 CFR 324.2.

seller to every buyer and thereby ensuring the performance of open contracts.”⁹⁶ As an alternative definition of CCP, these commenters suggested the final rule should define central counterparty to mean: “an entity (for example, a clearinghouse or similar facility, system, or organization) that, with respect to an agreement, contract, or transaction: (i) enables each party to the agreement, contract, or transaction to substitute, through novation or otherwise, the credit of the CCP for the credit of the parties; and (ii) arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such agreements, contracts, or transactions executed by participants in the CCP.”⁹⁷

Commenters also urged the FDIC to exclude from the requirements of the final rule all QFCs that are cleared, processed, or settled through the facilities of an FMU as defined in section 803(6) of the Dodd-Frank Act⁹⁸ or that are entered into subject to the rules of an FMU.⁹⁹ For example, commenters argued that QFCs with FMUs such as the provision of an extension of credit by a central securities depository (CSD) to a GSIB entity that is a member of the CSD in connection with the settlement of securities transactions, should be excluded from the requirements of the final rule. Commenters contended that, similar to CCPs, the relationship between a covered FSI and FMU is governed by the rules of the FMU and that there are no market alternatives to continuing to transact with FMUs. Commenters argued that FMUs

⁹⁶ Letter to Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation, from Walt L. Lukken, President and CEO, Futures Industry Association, at 8–9 (Nov. 1, 2016) (citing Principles of Financial Market Infrastructures (Apr. 2012), published by the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions, at 9).

⁹⁷ *Id.* at 9.

⁹⁸ 12 U.S.C. 5462(6). In general, Title VIII of the Dodd-Frank Act defines “financial market utility” to mean any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person. *Id.*

⁹⁹ As discussed above, one commenter who recommended an exclusion of securities market transactions that generally settle in the short term, do not impose ongoing or continuing obligations on either party after settlement, and do not typically include the default rights targeted by this rule, requested this treatment in the alternative.

generally should be excluded for the same reasons as CCPs and that a broader exemption to cover FMUs would serve to mitigate the systemic risk of a GSIB in distress, an underlying objective of the rule's requirements. Commenters contended that such an exclusion would be consistent with the treatment of FMUs under U.K. regulations and German law. Some commenters also requested that related or underlying agreements to CCP-cleared QFCs and QFCs entered into with other FMUs also be excluded, since such agreements "form an integrated whole with [those] QFCs" and such an exemption would facilitate the continued expansion of the clearing and settlement framework and the benefits of such a framework.¹⁰⁰ One commenter urged that the final rule should not in any manner restrict an FMU's ability to close out a defaulting clearing member's portfolio, including potential liquidation of cleared contracts.

The issues that the final rule is intended to address with respect to non-cleared QFCs may also exist in the context of centrally cleared QFCs. However, clearing through a CCP provides unique benefits to the financial system while presenting unique issues related to the cancellation of cleared contracts. Accordingly, it is appropriate to exclude centrally 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 FDIC has not extended the exclusion for CCPs to the client-facing leg of a cleared transaction because bilateral trades between a GSIB and a non-CCP counterparty are the types of transactions that the final rule intends to address and because nothing in the final rule would prohibit a covered FSI clearing member and a client from agreeing to terminate or novate a trade to balance the clearing member's exposure. The final rule continues to define central counterparty as a counterparty

¹⁰⁰ Letter to Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation, from Larry E. Thompson, Vice Chairman and General Counsel, The Depository Trust & Clearing Corporation, at 6 (Dec. 12, 2016).

that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating trades, which is a broad definition that should be familiar to market participants as it is used in the regulatory capital rules and does not sweep in entities that market participants would not normally recognize as clearing organizations.¹⁰¹

The final rule also makes clear that, if one or more FMUs are the only counterparties to a covered QFC, the covered FSI is not required to conform the covered QFC to the final rule.¹⁰² Therefore, an FMU's default rights and transfer restrictions under the covered QFC are not affected by the final rule. However, this exclusion would not include a covered QFC with a non-FMU counterparty, even if the QFC is settled by an FMU or if the FMU is a party to such QFC, because the final rule is intended to address default rights of non-FMU parties. For example, if two covered FSIs engage in a bilateral QFC that is facilitated by an FMU and in the course of this facilitation each covered FSI maintains a QFC solely with the FMU then the final rule would not apply to each QFC between the FMU and each covered FSI but the requirements of the final rule would apply to the bilateral QFC between the two covered FSIs. This approach ensures that QFCs that are directly with FMUs are treated in a manner similar to transactions between covered FSIs and CCPs but also ensures that QFCs conducted by covered FSIs that are related to the direct QFC with the FMU remain subject to the final rule's requirements.

The final rule does not explicitly exclude futures and cleared swaps agreements with a futures commission merchant, as requested by a commenter. The nature and scope of the

¹⁰¹ See final rule § 382.1. See also 12 CFR 324.2.

¹⁰² See final rule § 382.7(a)(2). In response to commenters, the final rule uses the definition of FMU in Title VIII of the Dodd-Frank Act and may apply, for purposes of the final rule, to entities regardless of jurisdiction. The definition of FMU in the final rule includes a broader set of entities, in addition to CCPs. However, the definition in the final rule does not include depository institutions that are engaged in carrying out banking-related activities, including providing custodial services for tri-party repurchase agreements. The definition also explicitly excludes certain types of entities (e.g., registered futures associations, swap data repositories) and other types of entities that perform certain functions for or related to FMUs (e.g., futures commission merchants).

requested exclusion is unclear, and, therefore, it is unclear whether the exclusion would be necessary, on the one hand, or overbroad, on the other hand. However, the final rule makes a number of clarifications and exemptions that may help address the commenter's concern regarding FCM agreements.

QFCs with Central Banks and Sovereign Entities. The proposal included covered QFCs with sovereign entities and central banks, consistent with Title II of the Dodd-Frank Act and the FDI Act. Commenters urged the FDIC to exclude QFCs with central bank and sovereign counterparties from the final rule. Commenters argued that sovereign entities might not be willing to agree to limitations on their QFC default rights and noted that other countries' measures such as those of the United Kingdom and Germany, consistent with their governing laws, exclude central banks and sovereign entities. Commenters contended that central banks and sovereign entities are sensitive to financial stability concerns and resolvability goals, thus reducing the concern that they would exercise default rights in a way that would undermine resolvability of a GSIB or financial stability. Commenters indicated it was unclear whether central banks or sovereign entities would be permitted under applicable statutes to enter into QFCs with limited default rights, but did not provide specific examples of such statutes.¹⁰³ Commenters further noted that these entities did not participate in the development of the Universal Protocol and that the Universal Protocol does not provide a viable mechanism for compliance with the final rule by these entities.

The FDIC continues to believe that covering QFCs with sovereigns and central banks under the final rule is an important requirement and has not modified the final rule to address the

¹⁰³ These commenters argued that, to the extent central banks and sovereign entities are unable or unwilling to agree to limitations on their QFC default rights, application of the rule's requirements to QFCs with these entities creates a significant disincentive for these entities to enter into QFCs with covered FSI, resulting in the loss of valuable counterparties in a way that will hinder market liquidity and covered FSI risk management.

requests made by commenters. Excluding QFCs with sovereigns and central banks would be inconsistent with Title II of the Dodd-Frank Act and the FDI Act. Moreover, the mass termination of such QFCs has the potential to undermine the resolution of a GSIB and the financial stability of the United States. The final rule provides covered FSIs two years to conform covered QFCs with central banks and sovereigns (as well as certain other counterparties, as discussed below). This additional time should provide covered FSIs sufficient time to develop separate conformance mechanisms for sovereigns and central banks, if necessary.

C. Definition of “Default Right” (Section 382.1 of the Final Rule)

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.¹⁰⁴ The phrase “default right” in the proposed rule was broadly defined to include these common

¹⁰⁴ But see 12 USC 1821(e)(8)(G); 12 USC 5390(c)(8)(F).

rights as well as “any similar rights.”¹⁰⁵ Additionally, the definition included all such rights regardless of source, including rights existing under contract, statute, or common law.

However, the proposed definition of default right excluded 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 was excluded from the definition of “default right.”¹⁰⁶ Second, contractual margin requirements that arise solely from the change in the value of the collateral or the amount of an economic exposure were also excluded from the definition.¹⁰⁷ The reason for these exclusions was to leave such rights unaffected by the proposed rule. The proposal’s preamble explained that such exclusions were appropriate because the proposal was 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.¹⁰⁸

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 FSI could be similar to the impact of the liquidation and acceleration rights discussed above. Therefore, the proposed definition of “default right” included such rights (with the exception discussed in the previous paragraph for margin requirements based solely on the value of collateral or the amount of an economic exposure).¹⁰⁹

¹⁰⁵ See proposed rule § 382.1.

¹⁰⁶ See proposed rule § 382.1.

¹⁰⁷ See id. These rights are nonetheless subject to the stay provisions of the FDIA and Title II.

¹⁰⁸ See 81 Fed. Reg. 74332.

¹⁰⁹ See id.

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, were excluded from the definition of “default right” under the proposal for purposes of the proposed rule’s restrictions on cross-default rights.¹¹⁰ This exclusion was 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 FSI, while leaving other default rights unrestricted.¹¹¹

Commenters expressed support for a number of aspects of the definition of default rights. For example, a number of commenters supported the proposed exclusion from the definition of “default right” of contractual rights to terminate without the need to show cause, noting that such rights exist for a variety of reasons and that reliance on these rights is unlikely to result in a fire sale of assets during a GSIB resolution. At least one commenter requested that this exclusion be expanded to include force majeure events. Commenters also expressed support for the exclusion for what commenters referred to as “business-as-usual” payments associated with a QFC. However, these commenters requested clarification that certain “business-as-usual” actions would not be included in the definition of default right, such as payment netting, posting and return of collateral, procedures for the substitution of collateral and modification to the terms of the QFC, and also requested clarification that the definition of “default right” would not include off-setting transactions to third parties by the non-defaulting counterparty. One commenter to the FRB and the OCC’s proposal urged that if the FRB’s and OCC’s goal is to provide that a party cannot enforce a provision that requires more margin because of a credit downgrade but

¹¹⁰ See proposed rule §§ 382.1, 382.4.

¹¹¹ The definition of “default right” parallels the definition contained in the ISDA Protocol. However, certain rights not included as such “default rights” are nonetheless subject to the stay and other provisions of the FDI Act and the Dodd-Frank Act. The final rule does not modify or limit the FDIC’s powers in its capacity as receiver under the FDI Act or the Dodd-Frank Act with respect to a counterparties’ contractual or other rights.

may demand more margin for market price changes, the rule should state so explicitly. Another commenter expressed concern that the definition of default right in the proposal would permit a defaulting covered FSI to demand collateral from its QFC counterparty as margin due to a market price change, but would not allow the non-covered FSI to demand collateral from the covered FSI.

The final rule retains the same definition of “default right” as that of the proposal. The FDIC believes that the definition of default right is sufficiently clear and that additional modifications are not needed to address the concerns raised by commenters. The final rule does not adopt a particular exclusion for force majeure events as requested by certain commenters as it is not clear without reference to particular contractual provisions what this term would encompass. Moreover, it should be clear that events typically considered to be captured by force majeure clauses (e.g., natural disasters) would not be related, directly or indirectly, to the resolution of an affiliate.¹¹²

“Business as usual” rights regarding changes in collateral or margin would not be included within the definition of default right to the extent that the right or operation of a contractual provision arises solely from either a change in the value of collateral or margin or a change in the amount of an economic exposure.¹¹³ In response to commenters’ requests for clarification, this exception includes changes in margin due to changes in market price, but does not include changes due to counterparty credit risk (e.g., credit rating downgrades). Therefore, the right of either party to a covered QFC to require margin due to changes in market price would be unaffected by the definition of default right. Moreover, default rights that are

¹¹² See final rule § 382.4(b).

¹¹³ However, as noted previously, such rights are subject to the provisions of the FDI Act and Title II.

exercised before a covered FSI or its affiliate enter resolution and that would not be affected by the stay-and-transfer provisions of the U.S. Special Resolution Regimes also would not be affected.

Regarding transactions with third parties, the final rule, like the proposal, does not require covered FSIs to address default rights in QFCs solely between parties that are not covered FSIs (e.g., off-setting transactions to third parties by the non-GSIB counterparty, to the extent none are covered FSIs).

D. Required Contractual Provisions Related to the U.S. Special Resolution Regimes (Section 382.3 of the Proposed Rule)

The proposed rule generally would have required a covered QFC 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 FSI to a transferee will 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 FSI 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.¹¹⁴ The final rule contains these same provisions.¹¹⁵

A number of commenters noted that the wording of these requirements in proposed section 382.3(b) was confusing and could be read to be inconsistent with the intent of the section. In response to comments, the final rule makes clearer that the substantive restrictions apply only

¹¹⁴ See proposed rule § 382.3.

¹¹⁵ See final rule § 382.3(b).

in the event the covered FSI (or, in the case of the requirement regarding default rights, its affiliate) becomes subject to a proceeding under a U.S. Special Resolution Regime.¹¹⁶

A number of commenters argued that QFCs should be exempt from the requirements of proposed section 382.3 if the QFC is governed by U.S. law. An example of such a QFC provided by commenters includes the standard form repurchase and securities lending agreement published by the Securities Industry and Financial Markets Association. These commenters argued that counterparties to such agreements are already required to observe the stay-and-transfer provisions of the FDI Act and Title II of the Dodd-Frank Act, as mandatory provisions of U.S. federal law, and that requiring an amendment of these types of QFCs to include the express provisions required under section 382.3 would be redundant and would not provide any material resolution benefit, but would significantly increase the remediation burden on covered FSIs.

Other commenters proposed a three-prong test of “nexus with the United States” for purposes of recognizing an exclusion from the express acknowledgment of the requirements of proposed section 382.3. In particular, these commenters argued that the presence of two factors, in addition to the contract being governed by U.S. law, would provide greater certainty that courts would apply the stay-and-transfer provisions of the FDI Act and Title II of the Dodd-Frank Act: (1) if a contract is entered into between entities organized in the United States; and (2) to the extent the GSIB’s obligations under the QFC are collateralized, if the collateral is held with a

¹¹⁶ See final rule § 382.3. The proposal defined the term “U.S. special resolution regimes” to mean the FDI Act and Title II of the Dodd-Frank Act, along with regulations issued under those statutes. 12 U.S.C. 1811–1835a; 12 U.S.C. 5381–5394. See final rule § 382.1.

U.S. custodian or depository pursuant to an account agreement governed by U.S. law.¹¹⁷ Other commenters contended that only whether the contract is under U.S. law, and not the location of the counterparty or the collateral, is relevant to the analysis of whether the FDI Act and the Dodd-Frank Act would govern the contract. Commenters also requested that if the first additional factor (i.e., that the QFC be entered into between entities organized in the United States) were to be included within the exception, it should be broadened to include counterparties that have principal places of business or that are otherwise domiciled in the United States.

The requirements of the final rule seek to provide certainty that all covered QFCs would be treated the same way in the context of a resolution of a covered entity, covered bank or covered FSI 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 general, the requirement that the effect of the statutory stay-and-transfer provisions be incorporated directly into the QFC contractually helps to 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.¹¹⁸ Further, the knowledge that a court in a foreign jurisdiction would reject the purported exercise of default rights in violation of the required contractual provisions should deter covered FSIs' counterparties from attempting to exercise such rights.

¹¹⁷ These commenters stated that it would be unlikely that any court interpreting a QFC governed by U.S. law could have a reasonable basis for disregarding the stay-and-transfer provisions of the FDI Act or Title II of the Dodd-Frank Act.

¹¹⁸ See generally Financial Stability Board, "Principles for Cross-border Effectiveness of Resolution Actions" (Nov. 3, 2015), available at <http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf>.

In response to comments, the final rule exempts from the requirements of section 382.3 a covered QFC that meets two requirements.¹¹⁹ First, the covered QFC must state that it is governed by the laws of the United States or a state of the United States.¹²⁰ It has long been clear that the laws of the United States and the laws of a state of the United States both include U.S. Federal law, such as the U.S. Special Resolution Regimes.¹²¹ Therefore, this requirement ensures that contracts that meet this exemption also contain language that helps ensure that foreign courts will enforce the stay-and-transfer provisions of the U.S. Special Resolution Regimes. Second, the counterparty to the covered FSI must be organized under the laws of the United States or a State,¹²² have its principal place of business¹²³ located in the United States, or be a U.S. branch or U.S. agency.¹²⁴ Similarly, a counterparty that is an individual must be domiciled in the United States.¹²⁵ This requirement helps ensure that the FDIC will be able to quickly and easily enforce the stay-and-transfer provisions of the U.S. Special Resolution

¹¹⁹ See final rule § 382.3(a).

¹²⁰ However, a contract that explicitly provides that one or both of the U.S. Special Resolution Regimes, including a broader set of laws that includes a U.S. special resolution regime, is excluded from the laws governing the QFC would not meet this exemption under the final rule. For example, a covered QFC would not meet this exemption if the contract stated that it was governed by the laws of the state of New York but also stated that it was not governed by U.S. federal law. In contrast, a contract that stated that it was governed by the laws of the state of New York but opted out of a specific non-mandatory federal law (e.g., the Federal Arbitration Act) would meet this exemption. Cf. Volt Info. Scis. v. Bd. Of Trs., 489 U.S. 468 (1989).

¹²¹ Although many QFCs only explicitly state that the contract is governed by the laws of a specific state of the United States, it has been made clear on numerous occasions that the laws of each state include federal law. See e.g., Hauenstein v. Lynham, 100 U.S. 483, 490 (1979) (stating that federal law is “as much a part of the law of every State as its own local laws and the Constitution”); Fid. Fed. Sav. & Loan Ass’n v. de la Cuesta, 458 U.S. 141, 157 (1982) (same); Testa v. Katt, 330 U.S. 386, 393 (1947) (“For the policy of the federal Act is the prevailing policy in every state.”).

¹²² For purposes of this requirement of the exemption, “State” means any state, commonwealth, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, or the United States Virgin Islands.

¹²³ See Hertz Corp. v. Friend, 559 U.S. 77(2010) (describing the appropriate test for principal place of business).

¹²⁴ See final rule § 382.3(a)(1)(ii).

¹²⁵ See id.

Regimes.¹²⁶ This exemption is expected to significantly reduce the burden associated with complying with the final rule while continuing to provide assurance that the stay-and-transfer provisions of the U.S. Special Resolution Regimes may be enforced.

This section of the final rule 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 U.K.'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.¹²⁷ Similarly, the 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.¹²⁸ Additionally, the Swiss Federal Council requires that banks "ensure

¹²⁶ See e.g., *Daimler AG v. Bauman*, 134 S. Ct. 746 (2014); *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915 (2011); *Hertz Corp. v. Friend*, 559 U.S. 77 (2010).

¹²⁷ See PRA Rulebook: CRR Firms and Non-Authorised Persons: Stay in Resolution Instrument 2015 (Nov. 12, 2015), available at <http://www.bankofengland.co.uk/pradocuments/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) (Nov. 2015), available at <http://www.bankofengland.co.uk/pradocuments/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 UK financial holding companies and U.K. mixed financial holding companies.

¹²⁸ 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>, as amended by Gesetz zur Anpassung des nationalen Bankenabwicklungsrechts an den Einheitlichen Abwicklungsmechanismus und die europäischen Vorgaben Zur Bankenabgabe, Nov. 2, 2015, Artikel 1(17).

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.¹²⁹ Japan’s Financial Services Agency also revised its supervisory guidelines for major banks to require those banks to ensure that the effect of the statutory stay decision and statutory special creditor protections under Japanese resolution regimes extends to contracts governed by foreign laws.¹³⁰

Commenters also argued that it would be more appropriate for Congress to act to obtain cross-border recognition of U.S. Special Resolution Regimes, rather than for the FDIC to do so through this final rule. The FDIC believes it is appropriate to adopt this final rule in order to ensure the safety and soundness of covered FSIs and, to that end, to improve the resolvability and resilience of U.S. GSIBs and foreign GSIB parents of covered FSIs. Because of the current risk that the stay-and-transfer provisions of U.S. Special Resolution Regimes may not be recognized by courts of other jurisdictions, section 382.3 of the final rule requires contractual recognition to help ensure that courts in foreign jurisdictions will recognize these provisions.

This requirement would advance the goal of the final rule 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

¹²⁹ 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^{bis}, [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).

¹³⁰ See section III-11 of Comprehensive Guidelines for Supervision of Major Banks, etc., available at <http://www.fsa.go.jp/common/law/guide/city.pdf>.

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 FSIs and their affiliates 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 QFCs if such QFCs could escape the effect of those provisions. To remove doubt about the scope of coverage of these provisions, the requirements of section 382.3 of the final rule would ensure that the stay-and-transfer provisions apply as a matter of contract to all non-exempted covered QFCs, whatever the transaction.

E. Prohibited Cross-Default Rights (Section 382.4 of the Final Rule)

Definitions. Section 382.4 of the final rule, like the proposal, applies in the context of insolvency proceedings¹³¹ and pertains to cross-default rights in QFCs between covered FSIs and their counterparties, many of which are subject to credit enhancements (such as a guarantee) provided by an affiliate of the covered FSI. Because credit enhancements of QFCs are themselves “qualified financial contracts” under the Dodd-Frank Act’s definition of that term (which this final rule adopts), the final rule includes the following additional definitions in order to facilitate a precise description of the relationships to which it would apply. These additional

¹³¹ See proposed rule § 382.4 (noting that section does not apply to proceedings under Title II of the Dodd-Frank Act). As noted in final rule § 382.4, the final rule does not modify or limit, in any manner, the rights and powers of the FDIC as receiver under the FDI Act or Title II of the Dodd-Frank Act, including, without limitation, the rights of the receiver to enforce provisions of the FDI Act or Title II of the Dodd-Frank Act that limit the enforceability of certain contractual provisions.

definitions are the same as under the proposal as no comments were received on these definitions.

First, the final rule distinguishes between a credit enhancement and a “direct QFC,” defined as any QFC that is not a credit enhancement.¹³² The final rule also defines “direct party” to mean a covered FSI that is itself a party to the direct QFC, as distinct from an entity that provides a credit enhancement.¹³³ In addition, the final rule defines “affiliate credit enhancement” to mean “a credit enhancement that is provided by an affiliate of a 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.¹³⁴ Moreover, the final rule defines “covered affiliate credit enhancement” to mean an affiliate credit enhancement provided by a covered entity, covered bank, or covered FSI, and defines “covered affiliate support provider” to mean the affiliate of the covered entity, covered bank, or covered FSI that provides the covered affiliate credit enhancement.¹³⁵ Finally, the final rule defines the term “supported party” to mean any party that is the beneficiary of the covered affiliate support provider’s obligations under 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).¹³⁶

General prohibitions. The final rule, like the proposal, prohibits a covered FSI 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 affiliate of the covered FSI, subject to the

¹³² See final rule § 382.4(c)(2).

¹³³ See final rule § 382.4(c)(1).

¹³⁴ See final rule § 382.4(c)(3).

¹³⁵ See final rule § 382.4(e)(2)-(3).

¹³⁶ See final rule § 382.4(e)(4).

exceptions discussed below.¹³⁷ The final rule also generally prohibits a covered FSI from being party to a covered QFC that would prohibit the transfer of any covered affiliate credit enhancement applicable to the QFC (such as another entity's guarantee of the covered FSI's obligations under the QFC), along with associated obligations or collateral, upon the entry into resolution of an affiliate of the covered FSI.¹³⁸

One commenter expressed strong support for these provisions.¹³⁹ Another commenter expressed support for this provision as currently limited in scope under the proposal to prohibited cross-default rights and requested that the scope not be expanded. The FDIC's final rule retains the same scope as the proposal.

A number of commenters representing counterparties to covered FSIs objected to section 382.4 of the proposal and requested the elimination of this provision. These commenters expressed concern about limitations on counterparties' exercise of default rights during

¹³⁷ See final rule § 382.4(b)(1). A few commenters requested that the FDIC clarify that covered QFCs that do not contain the cross-default rights or transfer restrictions on credit enhancement that are prohibited by section 382.4 would not be required to be remediated. This reading of section 382.4 of the final rule is correct. In addition, section 382.4(a) of the final rule provides the requested clarity.

¹³⁸ See final rule § 382.4(b)(2). This prohibition is 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 Universal Protocol, which was added to address concerns expressed by asset managers during the drafting of the 2014 Protocol.

One commenter requested that the exception be broadened to include transfers that would result in the supported party being unable, without further action, to satisfy the requirements of any law applicable to the supported party. As an example of a type of transfer that the commenter intended to be included within the broadened exception, the commenter stated that the supported party would be able to prevent the transfer if it would result in less favorable tax treatment. The exception would seem to also include filing requirements that may arise as a result of transfer or other requirements that could be satisfied with minimal "action" by, or cost to, the supported party. More generally, the scope of the laws that supported parties deem themselves to satisfy and the method of such satisfaction is unclear and potentially very broad.

The final rule retains the exception as proposed. The requested exception would add uncertainty as to how the contractual provisions relate to transfers made during the stay period and potentially unduly limit the restrictions on transfer prohibitions.

¹³⁹ This commenter also expressed support for parallel Congressional amendment of the U.S. Bankruptcy Code.

insolvency proceedings and argued that rights should not be taken away from contracting parties other than where limitation of such rights is necessary for public policy reasons and the resolution process is controlled by a regulatory authority with particular expertise in the resolution of the type of entity subject to the proceedings. Certain commenters argued that eliminating cross-default termination rights undermines the ability of QFC counterparties to effectively manage and mitigate their exposure to market and credit risk to a GSIB and interferes with market forces. One commenter similarly argued that, unless the FDIC takes appropriate measures to strengthen the financial condition and creditworthiness of a failing GSIB during and after the temporary stay, the stay will only expose QFC counterparties to an additional 48 hours of credit risk exposure without achieving the orderly resolution goals of the rule. Another commenter argued that non-defaulting counterparties should not be prevented from filing proofs of claim or other pleadings in a bankruptcy case during the stay period, since bankruptcy deadlines might pass and leave the counterparty unable to collect the unsecured creditor dividend. Commenters contended that restrictions on cross-default rights may lead to pro-cyclical behavior with asset managers moving funds away from covered entities, covered FSIIs, or covered banks as soon as those entities show signs of distress, and perhaps even in normal situations, and would disadvantage non-GSIB parties (e.g., end users who rarely receive initial margin from GSIB counterparties and are less well protected against a GSIB default).¹⁴⁰

Some commenters argued that if these rights must be restricted by law, Congress should impose such restrictions and that the requirements of the proposed rule circumvented the

¹⁴⁰ One commenter stated that, to the extent the final rule prevents an insurer from terminating QFC transactions upon the credit rating downgrade of a GSIB counterparty, the insurer may be in violation of state insurance laws that typically impose strict counterparty credit rating guidelines and limits. This commenter did not give any specific examples of such laws. Counterparties including insurance companies should evaluate and comply with all relevant applicable requirements.

legislative process by creating a de facto amendment to the U.S. Bankruptcy Code that forecloses countless QFC counterparties from exercising their rights of cross-default protection under section 362 of the U.S. Bankruptcy Code. Some of these commenters argued that parties cannot by contract alter the U.S. Bankruptcy Code's provisions, such as the administrative priority of a claim in bankruptcy, and one commenter suggested that non-covered FSI counterparties may challenge the legality of contractual stays on the exercise of default rights if a GSIB becomes distressed. Other commenters, however, argued that the provisions of the proposed rule were necessary to address systemic risks posed by the exemption for QFCs in the U.S. Bankruptcy Code.

As an alternative to eliminating these requirements, these commenters expressed the view that if the FDIC moves forward with these provisions, the final rule should include at least those minimum creditor protections established by the Universal Protocol. Certain commenters also argued that this provision was overly broad in that it covered not only U.S. federal resolution and insolvency proceedings but also state and foreign resolution and insolvency proceedings.¹⁴¹ Certain commenters also urged the FDIC to provide a limited exception to these restrictions, if retained in the final rule, to help ensure the continued functioning of physical commodities markets.¹⁴²

¹⁴¹ Certain commenters also indicated that these provisions should only apply to U.S. Special Resolution Regimes, which provide certain protections for counterparties, or, at most, to U.S. Special Resolution Regimes, resolution under the Securities Investor Protection Act, and insolvency under Chapter 11 of the U.S. Bankruptcy Code. That commenter noted that liquidation and insolvency under Chapter 7 of the Bankruptcy Code do not seek to preserve the GSIB as a viable entity, which is an objective of the final rule. As discussed later, among the goals of the rule is the facilitation of the resolution of a GSIB outside of U.S. Special Resolution Regimes, including under the U.S. Bankruptcy Code. Therefore, the final rule applies these provisions in the same way as the proposal. In addition, the additional creditor protections for supported parties under the final rule permit contractual requirements that any transferee not be in bankruptcy proceedings and that the credit support provider not be in bankruptcy proceedings other than a Chapter 11 proceeding. See final rule § 382.4(f).

¹⁴² In particular, these commenters requested that, when a covered FSI defaults on any physical delivery obligation to any counterparty following the insolvency of an affiliate of a covered FSI, its counterparties with obligations to

Some commenters argued that the FDIC should eliminate the stay on default rights that are related “indirectly” to an affiliate of the direct party becoming subject to insolvency proceedings, claiming it is unclear what constitutes a right related “indirectly” to insolvency and noting that any default right exercised by a counterparty after an affiliate of that counterparty enters resolution could arguably be motivated by the affiliate’s entry into resolution.

A primary purpose of these restrictions is to facilitate the orderly resolution of a GSIB outside of Title II of the Dodd-Frank Act, including under the U.S. Bankruptcy Code. As discussed above, the potential for mass exercises of QFC default rights is one reason why a GSIB’s failure could cause 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 fire sales, which likely would affect other financial companies and undermine financial stability. Similar disruptive results can occur with an MPOE resolution of a GSIB affiliate if an otherwise performing GSIB entity is subject to having its QFCs terminated or accelerated as a result of the default of its affiliate.

In an SPOE resolution, this damage could be avoided if actions of the following two types are prevented: the exercise of direct default rights against the top-tier holding company that

deliver or take delivery of physical commodities within a short time frame after the default should be able to immediately terminate all trades (both physical and financial) with the covered FSI. The final rule, like the proposal, allows covered QFCs to permit a counterparty to exercise its default rights under a covered QFC if the covered FSI not subject to Title II or FDI Act proceedings has failed to pay or perform its obligations under the covered QFC. See final rule § 382.4(d). The final rule, like the proposal, also allows covered QFCs to permit a counterparty to exercise its default rights under a covered QFC if the covered FSI has failed to pay or perform on other contracts between the same parties and the failure gives rise to a default right in the covered QFC. See id. These exceptions should help reduce credit risk and ensure the smooth operation of the physical commodities markets without permitting one failure to pay or perform by a covered FSI to allow a potentially large number of its counterparties that are not directly affected by the failure to exercise their default rights and thereby endanger the viability of the covered FSI.

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

The stay-and-transfer provisions of Title II of the Dodd-Frank Act would address both direct default rights and cross-default rights. But, as explained above, no similar statutory provisions apply in a resolution under the U.S. Bankruptcy Code. This final rule attempts to address these obstacles to orderly resolution by extending provisions similar to the stay-and-transfer provisions to any type of resolution of an affiliate of a covered FSI that is not an insured depository institution. Similarly, the final rule 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 FSIs 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.¹⁴³

The final rule 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.¹⁴⁴ Similarly, the final rule, along with the FRB and OCC final rules, would facilitate the orderly resolution of a foreign GSIB under its home

¹⁴³ See final rule § 382.4(b).

¹⁴⁴ As discussed above, the FDI Act limits 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. The final rule would facilitate orderly resolution under the FDI Act by filling that gap. See final rule § 382.4(b).

jurisdiction resolution regime by preventing the exercise of cross-default rights against the foreign GSIB's U.S. operations. The final rules would also facilitate the resolution of an IHC of a foreign GSIB, and the recapitalization of its U.S. operating subsidiaries, as part of a broader MPOE resolution strategy under which the foreign GSIB's operations in other regions would enter separate resolution proceedings. Finally, the final rules will help to 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 final rule is intended to enhance the potential for orderly resolution of a GSIB under the U.S. Bankruptcy Code, the FDI Act, or a similar resolution regime. The risks to an orderly resolution under the U.S. Bankruptcy Code include separate resolution insolvency proceedings, including proceedings in non-U.S. jurisdictions. Therefore, by staying default rights arising from affiliates entering into such proceedings, the final rule will advance the Dodd-Frank Act's goal of making orderly GSIB resolution workable under the Bankruptcy Code.¹⁴⁵

Likewise, the final rule retains the prohibition against contractual provisions that permit the exercise of default rights that are indirectly related to the resolution of an affiliate. QFCs may include a number of default rights triggered by an event that is not the resolution of an affiliate but is caused by the resolution, such as a credit rating downgrade in response to the resolution. A primary purpose of the final rule is to prevent early terminations caused by the resolution of an affiliate. A regulation that specifies each type of early termination provision that should be stayed would be over-inclusive or under-inclusive, and easy to evade. Similarly, a stay

¹⁴⁵ See 12 U.S.C. 5365(d).

of default rights that are only directly related to the resolution of an affiliate could increase the likelihood of litigation to determine the relationship between the default right and the affiliate resolution was sufficient to be considered “directly” related. The final rule attempts to decrease such uncertainty and litigation risk by including default rights that are related (i.e., directly or indirectly) to the resolution of an affiliate.

Moreover, the final rule does not affect parties’ direct default rights under the U.S. Bankruptcy Code. As explained above, the regulation does not prohibit a covered QFC from permitting the exercise of default rights against a non-bank covered FSI that has entered bankruptcy proceedings.¹⁴⁶ Therefore, counterparties to a non-bank covered FSI in bankruptcy would be able to exercise their existing default rights to the full extent permitted under any applicable safe harbor to the automatic stay of the U.S. Bankruptcy Code.

The final rule should also benefit the counterparties of a subsidiary of a failed GSIB by preventing the severe stress or disorderly failure of an otherwise-solvent 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 against 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 final rule seeks to 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,

¹⁴⁶ See final rule § 382. 4(d)(1).

improving outcomes for those creditors and counterparties should further protect the financial stability of the United States.

General creditor protections. While the restrictions of the final rule are intended to facilitate orderly resolution, they may also diminish the ability of covered FSI's QFC counterparties to include certain protections for themselves in covered QFCs, as noted by certain commenters. In order to reduce this effect, the final rule like the proposal includes several substantive exceptions to the restrictions.¹⁴⁷ 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 prohibitions would apply only to cross-default rights (and not direct default rights), the final rule provides that a covered QFC may permit the exercise of default rights based on the direct party's entry into a resolution proceeding.¹⁴⁸ This provision helps to ensure that, if the direct party to a QFC were to enter bankruptcy, its QFC counterparties could exercise any relevant direct default rights. Thus, direct QFC counterparties of a covered

¹⁴⁷ See final rule § 382.4(d).

¹⁴⁸ See final rule § 382.4(d)(1).

The proposal exempted from this creditor protection provision proceedings under a U.S. or foreign special resolution regime. As explained in the proposal, 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) and 5390(c)(16). The proposed exemption of special resolution regimes from the creditor protection provisions was intended to help ensure that special resolution regimes that do not stay cross-defaults, such as the FDI Act, would not disrupt the orderly resolution of a GSIB under the U.S. Bankruptcy Code or other ordinary insolvency proceedings.

One commenter requested the FDIC revise this provision to clarify that default rights based on a covered FSI or an affiliate entering resolution under the FDI Act or Title II of the Dodd-Frank Act are not prohibited but instead are merely subject to the terms of such regimes. The commenter requested the FDIC clarify that such default rights are permitted so long as they are subject to the provisions of the FDI Act or Title II of the Dodd-Frank Act as required under section 385.3. The final rule eliminates this proposed exemption for special resolution regimes because the rule separately addresses cross-defaults arising from the FDI Act and because foreign special resolution regimes, along with efforts in other jurisdictions to contractually recognize stays of default rights under those regimes, should reduce the risk that such a regime should pose to the orderly resolution of a GSIB under the U.S. Bankruptcy Code or other ordinary insolvency proceedings.

FSI's subsidiaries 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 U.S. Bankruptcy Code's safe harbor provisions.

The final rule also allows, in the context of an insolvency proceeding, and subject to the statutory requirements and restrictions thereunder, covered QFCs to permit the exercise of default rights based on (i) the failure of the direct party; (ii) the direct party not satisfying a payment or delivery obligation; or (iii) a covered affiliate support provider or transferee not satisfying its payment or delivery obligations under the direct QFC or credit enhancement.¹⁴⁹ Moreover, the final rule allows 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 payment or delivery obligations under another contract between the same parties.¹⁵⁰ This exception takes appropriate account of the interdependence that exists among the contracts in effect between the same counterparties.

As explained in the proposal, the exceptions in the final rule for the creditor protections described above are intended to help ensure that the final rule permits a covered FSI'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 FSI'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 FSI's counterparty would be permitted to exercise its default rights, such as by liquidating collateral). These

¹⁴⁹ See final rule § 382.4(d)(1)-(3). These provisions should respond to comments requesting that the final rule confirm the ability of a covered FSI's counterparty to exercise default rights arising from the failure of a direct party to satisfy a payment or delivery obligation during the stay period. But see final rule § 382.3(c).

¹⁵⁰ See final rule § 382.4(d)(2).

exceptions are generally consistent with the treatment of payment and delivery obligations, following the applicable stay period, under the U.S. Special Resolution Regimes.

These exceptions also help to ensure that counterparties of a covered FSI's non-IDI subsidiaries or affiliates 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 U.S. 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 period leading 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 final rule, like the proposal, allows the inclusion of additional creditor protections for a non-defaulting counterparty that is the beneficiary of a credit enhancement from an affiliate of the covered FSI that is a covered entity, covered bank, or covered FSI.¹⁵¹ The final rule allows these creditor protections in recognition of the supported party's interest in receiving the benefit of its credit enhancement.

Where a covered QFC is supported by a covered affiliate credit enhancement,¹⁵² the covered QFC and the credit enhancement are permitted to allow the exercise of default rights under the circumstances discussed below after the expiration of a stay period.¹⁵³ Under the final rule, the applicable stay period would begin at the commencement of the proceeding and would

¹⁵¹ See final rule § 382.4(f).

¹⁵² Note that the exception in § 382.4(f) of the final 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, covered FSI, or covered bank under the proposal. See final rule § 382.4(e)(2) (defining "covered affiliate credit enhancement").

¹⁵³ 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).

end at the later of 5:00 p.m. (eastern time) on the next business day and 48 hours after the entry into resolution.¹⁵⁴ This portion of the final rule is similar to the stay treatment provided in a resolution under Title II of the Dodd-Frank Act or the FDI Act.¹⁵⁵

Under the final rule, contractual provisions may permit the exercise of default rights 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 U.S. Bankruptcy Code or the FDI Act.¹⁵⁶ QFCs may also permit the exercise of default rights at the end of the stay period if the transferee (if any) of the credit enhancement enters an insolvency proceeding, protecting the supported party from a transfer of the credit enhancement to a transferee that is unable to meet its financial obligations.¹⁵⁷

QFCs may also permit the exercise of default rights 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 covered affiliate credit enhancement (b) all other covered affiliate credit enhancements provided by the credit support provider on any other covered QFCs between the same parties, and (c) all credit enhancements provided by the credit support provider between the

¹⁵⁴ See final rule § 382.4(g)(1).

¹⁵⁵ See 12 U.S.C. 1821(e)(10)(B)(I), 5390(c)(10)(B)(i), 5390(c)(16)(A). While the final rule's 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.

¹⁵⁶ See proposed rule § 382.4(g)(1). Chapter 11 (11 U.S.C. 1101–1174) is the portion of the U.S. 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.

¹⁵⁷ See final rule § 382.4(f)(2).

direct party and affiliates of the direct party's QFC counterparty.¹⁵⁸ Such creditor protections are 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 of the Dodd-Frank Act and the FDI Act also contain provisions to prevent cherry picking.

Finally, if the covered affiliate credit enhancement is transferred to a transferee, the QFC may permit non-defaulting counterparty to exercise default rights at the end of the stay period unless either (a) all of the covered affiliate 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 covered affiliate support provider's assets (or the net proceeds from the sale of those assets) will be transferred or sold to the transferee in a timely manner.¹⁵⁹ These conditions will help to assure the supported party that the transferee would be providing substantively the same credit enhancement as the covered affiliate support provider.¹⁶⁰ Title II of the Dodd-Frank Act also requires that certain conditions be met with respect to affiliate credit enhancements.¹⁶¹

Commenters generally expressed strong support for these exclusions but also requested that these exclusions be broadened in a number of ways. Certain commenters urged the FDIC to broaden the exclusions to permit, after the trigger of the stay-and-transfer provisions, the exercise of default rights by a counterparty against a direct counterparty or covered support provider with respect to any default right under the QFC (other than a default right explicitly

¹⁵⁸ See proposed rule § 382.4(g)(3).

¹⁵⁹ See final rule § 382.4(f)(4).

¹⁶⁰ See 12 U.S.C. 5390(c)(16)(A).

¹⁶¹ See 12 U.S.C. 5390(c)(16)(A).

based on the failure of an affiliate) and not just with respect to defaults resulting from payment or delivery failure or the direct party becoming subject to certain resolution or insolvency proceedings (e.g., failure to maintain a license or certain capital level, materially breaching its representations under the QFC). Certain commenters contended that at a minimum the final rule should provide for creditor protections that meet the minimum standards set forth by the Universal Protocol. One commenter specifically identified three creditor protections found in the Universal Protocol that it argued the FDIC should include in section 382.4: (1) priority rights in a bankruptcy proceeding against the transferee or original credit support provider (if the QFC providing credit support was not transferred); (2) a right to submit claims in the insolvency proceeding of the insolvent credit support provider if the transferee becomes insolvent; and (3) the ability to declare a default and close out of both the original QFC with the direct counterparty as well as QFCs with the transferee if the transferee defaults under the transferred QFC or under any other QFC with the non-defaulting counterparty, subject to the contractual terms and consistent with applicable law. Another commenter argued for creditor protections not found in the Universal Protocol, including that the transferee be required to be a U.S. person and be registered with and licensed by the primary regulator of either the direct counterparty or transferor entity. Certain commenters also asked for the right to exercise direct default rights and general creditor protections even if the exercise occurs during the stay period. Commenters also asked the FDIC to delete the phrases “or after” in section 382.4(b) regarding the restrictions on transfers of affiliate credit enhancements, as neither the FRB’s nor the OCC’s rules have that phrase.- These commenters asserted that, when coupled with the definition of “transferee” in section 382.4(g)(3), section 382.4(b) could be read as overriding transfers indefinitely, even with

respect to subsequent transfers following the initial transfer to a bridge financial company or a third party transferee.

The final rule does not include the additional creditor protections of the Universal Protocol or other creditor protections requested by commenters. As explained in the proposal and below, the additional creditor protections of the Universal Protocol do not appear to materially diminish the prospects for an orderly resolution of a GSIB because the Universal Protocol includes a number of desirable features that the final rule otherwise lacks.¹⁶² Providing additional circumstances under which default rights may be exercised during and immediately after the stay period, in the absence of any counterbalancing benefits to resolution, would increase the risk of a disorderly resolution of a GSIB in contravention of the purposes of the rule.

Additionally, in response to commenters, the definition of “transferee” in section 382.4(g)(3) of the final rule has been changed to define a “transferee” as a person to whom a covered affiliate credit enhancement is transferred upon the covered affiliate credit support provider entering a receivership, insolvency, liquidation, resolution, or similar proceeding or thereafter as part of the resolution, restructuring or reorganization involving the covered affiliate support provider. The provisions of the FRB final rule are consistent with this final rule.

One commenter also argued that transfer should be limited to a bridge bank under the FDI Act or a bridge financial company under Title II of the Dodd-Frank Act to ensure that the transferee is more likely to be able to satisfy the obligations of a credit support provider and is subject to regulatory oversight. Section 382.4 of the final rule does not apply in situations where the covered affiliate support provider is in Title II of the Dodd-Frank Act. Furthermore, this section is limited in its application to the FDI Act as well, limiting the exercise of cross-default

¹⁶² See 81 Fed. Reg. 74326 (Oct. 26, 2016).

rights as contemplated by 382.4(h) of the final rule. Therefore, the FDIC is not adopting the proposed additional creditor protection because it would defeat in large part the purpose of section 382.4 and potentially create confusion regarding the requirements and purposes of sections 382.3 and 382.4 of the final rule.¹⁶³

A few commenters expressed concern that the additional creditor protections applied only to QFCs supported by a credit enhancement provided by a “covered affiliate support provider” (i.e., an affiliate that is a covered entity, covered bank, or covered FSI) and noted that foreign GSIBs often will have their QFCs supported by a non-U.S. affiliate that is not a covered entity, covered bank, or covered FSI. Such non-U.S. affiliate credit supporter providers would not be able to rely on the additional creditor protections for supported QFCs. Such credit enhancements are 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.¹⁶⁴

One commenter requested clarification that the creditors of a non-U.S. credit support provider are permitted to exercise any and all rights against that non-U.S. credit support provider that they could exercise under the non-U.S. resolution regime applicable to that non-U.S. credit support provider. The final rule, like the proposal, is limited to QFCs to which a covered FSI is a party. Section 382.4 of the final rule generally prohibits QFCs to which a covered FSI is a party from allowing the exercise of cross-default rights of the covered QFC, regardless of whether the

¹⁶³ To the extent the commenter’s reference to “bridge financial company” was not only to a bridge financial company under Title II of the Dodd-Frank Act, the requested amendment would not appear to provide a meaningful reduction in credit risk to counterparties compared to the creditor protections permitted under section 382.84 of the final rule and those available under the Universal Protocol and U.S. Protocol, discussed below.

¹⁶⁴ See generally 81 FR 74326, 74335 (Oct. 26, 2016) (“Note that the exception in § 382.4(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. ”). See also final rule § 382.4(f).

affiliate entering resolution and/or the credit support provider is organized or operates in the United States.

Another commenter expressed concern that the proposed section 382.4(g)(3) (section 382.4(f)(3) of the final rule) would provide a right without a remedy because if the covered affiliate credit support provider is no longer obligated and no transferee has taken on the obligation, the non-covered FSI counterparty may have only a breach of contract claim against an entity that has transferred all of its assets to a third party. The creditor protections of section 382.4, if triggered, permit contractual provisions allowing the exercise of existing default rights against the direct party to the covered QFC, as well as any existing rights against the credit enhancement provider.

Another commenter suggested revising section 382.4(g) (section 382.4(f) of the final rule) to clarify that, for a covered direct QFC 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 after the stay period that is related, directly or indirectly, to the covered affiliate support provider entering into resolution proceedings. This reading is incorrect and revising the rule as requested would largely defeat the purpose of section 382.4 of the final rule by merely delaying QFC termination en masse.

Some commenters also requested specific provisions related to physical commodity contracts, including a provision that would allow regulators to override a stay if necessary to avoid disruption of the supply or prevent exacerbation of price movements in a commodity or a provision that would allow the exercise of default rights of counterparties delivering or taking delivery of physical commodities if a GSIB entity defaults on any physical delivery obligation to any counterparty. As noted above, QFCs may permit a counterparty to exercise its default rights

immediately, even during the stay period, if the direct party fails to pay or perform on the covered QFC with the counterparty (or another contract between the same parties that gives rise to a default under the covered QFC).

Creditor protections related to FDI Act proceedings. 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 Act¹⁶⁵ only under the following circumstances: (a) after the FDI Act stay period,¹⁶⁶ if the credit enhancement is not transferred under the relevant provisions of the FDI Act¹⁶⁷ 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.¹⁶⁸ This provision is intended to ensure that a QFC counterparty of a subsidiary of a covered FSI that goes into FDI Act receivership can receive the equivalent level of protection that the FDI Act provides to QFC counterparties of the covered FSI itself.¹⁶⁹ No comments were received on this aspect of the proposal and the final rule contains no substantive changes from the proposal.

¹⁶⁵ 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.

¹⁶⁶ 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). See also final rule § 382.1.

¹⁶⁷ 12 U.S.C. 1821(e)(9)–(10).

¹⁶⁸ See final rule § 382.4(h).

¹⁶⁹ See id. (noting that the general creditor protections in section 382.4(d), and the additional creditor protections for supported QFCs in section 382.4(f), are inapplicable to FDI Act proceedings).

Prohibited terminations. In case of a legal dispute as to a party's right to exercise a default right under a covered QFC, the final rule, like the proposal, requires 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 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,¹⁷⁰ or a more demanding standard.¹⁷¹

The purpose of this requirement is to deter the QFC counterparty of a covered FSI from thwarting the purpose of the final rule 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.

A few commenters requested guidance on how to satisfy the burden of proof of clear and convincing evidence so that they may avoid seeking such clarity through litigation. Other commenters urged that this standard was not appropriate and should be eliminated. In particular, a number of commenters expressed concern that the burden of proof requirements, which are more stringent than the burden of proof requirements for typical contractual disputes adjudicated in a court, unduly hamper the creditor protections of counterparties and impose a burden directly on non-covered FSIs, who should be able to exercise default rights if it is commercially reasonable in the context. One commenter contended that this burden, combined with the stay on default rights related "indirectly" to an affiliate entering insolvency proceedings effectively

¹⁷⁰ 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 is not permitted to provide for a lower standard.

¹⁷¹ See final rule 382.4(i).

prohibits counterparties from exercising any default rights during the stay period. These commenters argued that it is inappropriate for the rulemaking to alter the burden of proof for contractual disputes. One commenter suggested that, in a scenario involving a master agreement with some transactions out of the money and others in the money, the defaulting GSIB will have a lower burden of proof for demonstrating that it is owed money than for demonstrating that it owes money, should the non-GSIB counterparty exercise its termination rights. Certain commenters suggested instead that the final rule shift the burden and instead adopt a rebuttable presumption that the non-defaulting counterparty's exercise of default rights is permitted under the QFC unless the defaulting covered FSI demonstrates otherwise. One commenter requested that the burden of proof not apply to the exercise of direct default rights. Another commenter suggested that the burden of proof provision imposes a higher burden of proof on counterparties affected by the rule than domestic and foreign GSIBs and that the requirements for satisfying this burden should be clarified and any case law or statutory standard that a federal judge would apply in this instance be provided.

The final rule retains the proposed burden of proof requirements. The requirement is based on a primary goal of the final rule—to avoid the disorderly termination of QFCs in response to the failure of an affiliate of a GSIB. The requirement accomplishes this goal by making clear that a party that exercises a default right when an affiliate of its direct party enters receivership or insolvency proceedings is unlikely to prevail in court unless there is clear and convincing evidence that the exercise of the default right against a covered FSI is not related to the insolvency or resolution proceeding. The requirement therefore should discourage the impermissible exercise of default rights without prohibiting the exercise of all default rights. Moreover, the burden of proof requirement should not discourage the exercise of default rights

after or in response to a failure to satisfy a creditor protection provision (e.g., direct default rights); such a failure should be easily evidenced, even under a heightened burden of proof, such that clarification through court proceedings should not be necessary.

Agency transactions. In addition to entering into QFCs as principals, GSIBs may engage in QFCs as agents 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 subsidiary 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.¹⁷² Similarly, a covered FSI may also enter into a QFC as agent acting on behalf of a principal.

The proposal would have applied to a covered QFC regardless of whether the covered FSI was acting as a principal or as an agent. Section 382.3 and section 382.4 of the proposal did not distinguish between agents and principals with respect to default rights or transfer restrictions applicable to covered QFCs. Under the proposal, section 382.3 would have limited default rights and transfer restrictions that a counterparty may have against a covered FSI consistent with the U.S. Special Resolution Regimes.¹⁷³ Section 382.4 of the proposed rule would have ensured that, subject to the enumerated creditor protections, counterparties could not exercise cross-

¹⁷² The definition of QFC under Title II of the Dodd-Frank Act, which is adopted in the final rule, includes security agreements and other credit enhancements as well as master agreements (including supplements). 12 U.S.C. 5390(c)(8)(D); see also final rule § 382.1.

¹⁷³ See proposed rule § 382.3(a)(3).

default rights under the covered QFC against the covered FSI, acting as agent or principal, based on the resolution of an affiliate of the covered FSI.¹⁷⁴

Commenters argued that the provisions of sections 382.3 and 382.4 that relate to transactions entered into by the covered FSI as agent should exclude QFCs where the covered FSI or its affiliate does not have any liability (including contingent liability) under or in connection with the contract, or any payment or delivery obligations with respect thereto. Commenters also argued that the proposed agent provisions should not apply to circumstances where the covered FSI acts as agent for a counterparty whose transactions are excluded from the requirements of the rule.¹⁷⁵ Commenters provided as an example where an agent simply executes an agreement on behalf of the principal but bears no liability thereunder, such as where an investment manager signs an agreement on behalf of a client. Commenters noted that such agreements could contain events of default relating to the insolvency of the agent or an affiliate of the agent but that such default rights would be difficult to track and that close-out of such QFCs would not result in any loss or liquidity impact to the agent. Rather, early termination under the agreements would subject the cash and securities of the principals—not the agent—to realization and liquidation. Therefore, the agent would not be exposed to the liquidity and asset fire sale risks the proposal was intended to address.

Commenters contended that the requirement to conform QFCs with all affiliates of a counterparty when an agent is acting on behalf of the counterparty would be particularly burdensome, as the agent may not have information about the counterparty's affiliates or their

¹⁷⁴ See proposed rule §§ 382.4(a)(3) and (d).

¹⁷⁵ Commenters argued this should be the case even where an agent has entered an umbrella master agreement on behalf of more than one principal, but only with respect to the contract of any principals that are excluded counterparties.

contracts with covered FSIs, covered banks, or covered entities. Commenters also requested clarification that conformance is not required of contracts between a covered FSI as agent on behalf of a non-U.S. affiliate of a foreign GSIB that would not be a covered FSI under the proposal, since default rights related to the non-U.S. operations of foreign GSIBs are not the focus of the rule and do not bear a sufficient connection to U.S. financial stability to warrant the burden and cost of compliance.

One commenter also urged that securities lending authorization agreements (SLAAs) should also be exempt from the rule. The commenter explained that SLAAs are banking services agreements that establish an agency relationship with the lender of securities and an agent and may be considered credit enhancements for securities lending transactions (and therefore QFCs) because the SLAAs typically require the agent to indemnify the lender for any shortfall between the value of the collateral and the value of the securities in the event of a borrower default. The commenter explained that SLAAs typically do not contain provisions that may impede the resolution of a GSIB, but may contain termination rights or contractual restrictions on assignability. However, the commenter argued that the beneficiaries under SLAAs lack the incentive to contest the transfer of the SLAA to a bridge institution in the event of GSIB insolvency.

To respond to concerns raised by commenters, the agency provisions of the proposed rule have been modified in the final rule. The final rule provides that a covered FSI does not become a party to a QFC solely by acting as agent to a QFC.¹⁷⁶ Therefore, an in-scope QFC would not be a covered QFC solely because a covered FSI was acting as agent for a principal for the

¹⁷⁶ See final rule § 382.2(e)(1).

QFC.¹⁷⁷ For example, the final rule would not require a covered FSI to conform a master securities lending arrangement (or the transactions under the agreement) to the requirements of the final rule if the only obligations of the covered FSI under the agreement are to act as an agent on behalf of one or more principals. This modification should address many of the concerns raised by commenters.

The final rule does not specifically exempt SLAAs because the agreements provide the beneficiaries with contractual rights that may hinder the orderly resolution of a GSIB and because it is unclear how such beneficiaries would act in response to the failure of their agent. More generally, the final rule does not exempt a QFC with respect to which an agent also acts in another capacity, such as guarantor. Continuing the example regarding the covered FSI acting as agent with respect to a master securities lending agreement, if the covered FSI also provided a SLAA that included the typical indemnification provision, discussed above, the agency exemption of the final rule would not exclude the SLAA but would still exclude the master securities lending agreement. This is because the covered FSI is acting solely as agent with respect to the master securities lending agreement but is acting as agent and guarantor with respect to the SLAA. However, SLAAs would be exempted under the final rule to the extent that they are not “in-scope QFCs” or otherwise meet the exemptions for covered QFCs of the final rule.

Enforceability. Commenters also requested that the final rule should clarify that obligations under a QFC would still be enforceable even if its terms do not comply with the

¹⁷⁷ Such a QFC would nonetheless be a covered QFC with respect to a principal that also was a covered FSI. In response to comments, the FDIC notes that covered FSIs do not include non-U.S. subsidiaries of a foreign GSIB.

requirements of the final rule similar to assurances provided in respect of the UK rule and German legislation. The enforceability of a contract is beyond the scope of this rule.

Interaction with Other Regulatory Requirements. Certain commenters requested clarification that amending covered QFCs as required by this final rule should not trigger other regulatory requirements for covered FSIs such as the swap margin requirements issued by the FDIC, other prudential regulators (the OCC, FRB, Farm Credit Administration and Federal Housing Financing Agency), and the U.S. Commodity Futures Trading Commission (CFTC). In particular, commenters urged that amending a swap to conform to this final rule should not jeopardize the status of the swap as a legacy swap for purposes of the swap margin requirements for non-cleared swaps. These issues are outside the scope of this rule as they relate to the requirements of another rule issued by the FDIC jointly with the other prudential regulators as well as a rule issued by the CFTC. As commenters highlighted, addressing such issues may require consultation with the other prudential regulators as well as the CFTC and the U.S. Securities and Exchange Commission to determine the impact of the amendments required by this final rule for purposes of the regulatory requirements under Title VII. However, as the proposal noted, the FDIC is considering an amendment to the definition of “eligible master netting agreement” to account for the restrictions on covered QFCs and is consulting with the other prudential regulators and the CFTC on this aspect of the final rule.¹⁷⁸ The FDIC does not expect that compliance with this final rule will trigger the swap margin requirements for non-cleared swaps.

Compliance with the ISDA 2015 Resolution Stay Protocol. The final rule, like the proposal, allows covered FSIs to conform covered QFCs to the requirements of the rule through

¹⁷⁸ See 81 Fed. Reg. 74326 (Oct. 26, 2016).

adherence to the Universal Protocol.¹⁷⁹ The two primary operative provisions of the Universal Protocol are Section 1 and Section 2. Under Section 1, adhering parties essentially “opt in” to the U.S. Special Resolution Regimes and certain other special resolution regimes. Therefore, Section 1 is generally responsive to the concerns addressed in section 382.3 of the final rule. Under Section 2, adhering parties essentially forego, subject to the creditor protections of Section 2, cross-default rights and transfer restrictions on affiliate credit enhancements. Therefore, Section 2 is generally responsive to the concerns addressed in section 382.4 of the final rule.

The proposal noted that, while the scope of the stay-and-transfer provisions of the Universal Protocol are narrower than the stay-and-transfer provisions that would have been required under the proposal and the Universal Protocol provides a number of creditor protection provisions that would not otherwise have been available under the proposal, the Universal Protocol includes a number of desirable features that the proposal lacked. When an entity (whether or not it is a covered FSI) adheres to the Universal Protocol, it necessarily adheres to the Universal Protocol with respect to all covered FSIs that have also adhered to the Protocol rather than one or a subset of covered FSIs (as the proposal would otherwise have permitted). This feature appears to allow the Universal 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.¹⁸⁰ This feature is referred to as “universal adherence.” Other favorable features of the Universal Protocol included that it amends all existing transactions of adhering parties, does not provide the counterparty with default rights in addition to those provided under the underlying QFC, applies to all QFCs, and includes

¹⁷⁹ See final rule § 382.5(a).

¹⁸⁰ See 81 Fed. Reg. 74326.

resolution under bankruptcy as well as U.S. and certain non-U.S. Special Resolution Regimes. Because the features of the Universal Protocol, considered together, appeared to increase the likelihood that the resolution of a GSIB under a range of scenarios could be carried out in an orderly manner, the proposal stated that QFCs amended by the Universal Protocol would have been consistent with the proposal, notwithstanding section 382.4 of the proposal.

Commenters generally supported the proposal's provisions to allow covered FSIs to comply with the requirements of the proposed rule through adherence to the Universal Protocol. For the reasons discussed above and in the proposal, the final rule allows covered FSIs to comply with the rule through adherence to the Universal Protocol and makes other modifications to the proposal to address comments.

A few commenters requested that the final rule clarify two technical aspects of adherence to the Universal Protocol. These commenters requested confirmation that adherence to the Universal Protocol would also satisfy the requirements of section 382.3. The commenters also requested confirmation that QFCs that incorporate the terms of the Universal Protocol by reference also would be deemed to comply with the terms of the proposed alternative method of compliance.¹⁸¹ By clarifying section 382.5(a), the final rule confirms that adherence to the Universal Protocol is deemed to satisfy the requirements of section 382.3 of the final rule (as

¹⁸¹ "As between two Adhering Parties, the [Universal Protocol] only amends agreements between the Adhering Parties that have been entered into as of the date that the Adhering Parties adhere (as well as any subsequent transactions thereunder), but it does not amend agreements that Adhering Parties enter into after that date. . . . If Adhering Parties wish for their future agreements to be subject to the terms of the [Universal Protocol] or a Jurisdictional Module Protocol under the ISDA JMP, it is expected that they would incorporate the terms of the [relevant protocol] by reference into such agreements." Letter to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, from Katherine T. Darras, ISDA General Counsel, The International Swaps and Derivatives Association, Inc., at 8–9 (Aug. 5, 2016) This commenter noted that incorporation by reference was consistent with the proposal and asked that the text of the rule be clarified. *Id.* at 9. ISDA requested the FDIC to consider ISDA's FRB comment letter in ISDA's comment letter to the FDIC. *See* Letter to Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation, from Katherine T. Darras, ISDA General Counsel, The International Swaps and Derivatives Association, Inc., at 3 (Dec. 12, 2016).

well as section 382.4) and that conformance of a covered QFC through the Universal Protocol includes incorporation of the terms of the Universal Protocol by reference by protocol adherents. This clarification also applies to the U.S. Protocol, discussed below.

One commenter indicated that many non-covered FSI counterparties do not have ISDA master agreements for physically-settled forward and commodity contracts and, therefore, compliance with the rule's requirements through adherence to the Universal Protocol would entail substantial time and educational effort. As in the proposal, the final rule simply permits adherence to the Universal Protocol as one method of compliance with the rule's requirements, and parties may meet the rule's requirements through bilateral negotiation, if they choose. Moreover, the Securities Financing Transaction Annex and Other Agreements Annex of the Universal Protocol, which are specifically identified in the proposed and final rule, are designed to amend QFCs that are not ISDA master agreements.

Many commenters argued that the final rule should also allow compliance with the rule through a yet-to-be-created "U.S. Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol" (an "approved U.S. JMP") that is generally the same but narrower in scope than the Universal Protocol.¹⁸² Many non-GSIB commenters argued that they were not involved with the drafting of the Universal Protocol and that an approved U.S. JMP would create a level playing field between those that were involved in the drafting and those that were not. In general, commenters identified two aspects of the Universal Protocol that they argued should be narrowed in the approved U.S. JMP: the scope of the special resolution regimes and the universal adherence feature of the Universal Protocol. Commenters also asked that the

¹⁸² Commenters argued that approval of the approved U.S. JMP should not require satisfaction of the administrative requirements of proposed rule section 382.5(b)(3), since the FDIC has already conducted that analysis in deciding to provide a safe harbor for the Universal Protocol.

FDIC coordinate with the FRB and the OCC regarding treatment of the JMP and to ensure that any determinations made concerning the JMP are consistent.

With respect to the scope of the special resolution regimes of the Universal Protocol, commenters' concern focused on the special resolution regimes of "Protocol-eligible Regimes." Some commenters also expressed concern with the scope of "Identified Regimes" of the Universal Protocol.

The Universal Protocol defines "Identified Regimes" as the special resolution regimes of France, Germany, Japan, Switzerland, and the United Kingdom as well as the U.S. Special Resolution Regimes. The Universal Protocol defines "Protocol-eligible Regimes" as resolution regimes of other jurisdictions specified in the protocol that satisfies the requirements of the Universal Protocol. The Universal Protocol provides a "Country Annex," which is a mechanism by which individual adherents to the Universal Protocol may agree that a specific jurisdiction satisfies the requirements of a "Protocol-eligible Regime." The Universal Protocol referred to in the proposal did not include any Country Annex for any Protocol-eligible Regime.¹⁸³

Commenters requested the final rule include a safe harbor for an approved U.S. JMP that does not include Protocol-eligible Regimes. Commenters argued that many counterparties may not be able to adhere to the Universal Protocol because they would not be able to adhere to a Protocol-eligible Regime in the absence of law or regulation mandating such adherence, as it

¹⁸³ The proposal defined the Universal Protocol as 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." See proposed rule § 382.5(a). As of May 3, 2016, ISDA had not published any Country Annex for a Protocol eligible Regime and such publication would not be a minor or technical amendment to the Universal Protocol. Consistent with the proposal, the final rule does not define the Universal Protocol to include any Country Annex. However, the final rule does not penalize adherence to any Country Annex. A covered QFC that is amended by the Universal Protocol—but not a Country Annex—will be deemed to conform to the requirements of the final rule. In addition, a covered QFC that is amended by the Universal Protocol—including one or more Country Annexes—is also deemed to conform to the requirements of the final rule. See final rule § 382.5(a)(2).

would force counterparties to give up default rights in jurisdictions where that is not yet legally required.¹⁸⁴ In support of their argument, commenters cited their fiduciary duties to act in the best interests of their clients or shareholders. Commenters also argued that an approved U.S. JMP should not include Identified Regimes and noted that the other Identified Regimes have already adopted measures to require contractual recognition of their special resolution regimes.¹⁸⁵

With respect to the universal adherence feature of the Universal Protocol, commenters argued that universal adherence imposed significant monitoring burden since new adherents may join the Universal Protocol at any time. To address this concern, some commenters requested that an approved U.S. JMP allow a counterparty to adhere on a firm-by-firm or entity-by-entity basis. Other commenters suggested or supported approval of, an approved U.S. JMP in which a counterparty would adhere to all current covered FSIs under the final rule (to be identified on a “static list”) and would adhere to new covered FSIs on an entity-by-entity basis. This static list, commenters argued, would retain the “universal adherence mechanics” of the Universal Protocol and allow market participants to fulfill due diligence obligations related to compliance. Commenters also argued that universal adherence would be overbroad because the Universal Protocol could amend QFCs to which a covered FSI, covered bank, or covered entity was not a party. Certain commenters argued that adhering with respect to any counterparty would also be inconsistent with their fiduciary duties.

¹⁸⁴ The Protocol-eligible Regime requirements of the Universal Protocol do not include a requirement that a law or regulation, such as the final rule, require parties to contractually opt in to the regime.

¹⁸⁵ One commenter requested clarification that a QFC of a covered FSI with a non-U.S. credit support provider for the covered FSI complies with the requirements of the final rule to the extent the covered FSI has adhered to the relevant jurisdictional modular protocol for the jurisdiction of the non-U.S. credit support provider. The jurisdictional modular protocols for other countries do not satisfy the requirements of the final rule.

In response to comments and to further facilitate compliance with the rule, the final rule provides that covered QFCs amended through adherence to the Universal Protocol or a new (and separate) protocol (the “U.S. Protocol”) would be deemed to conform the covered QFCs to the requirements of the final rule.¹⁸⁶ The U.S. Protocol may differ (and is required to differ) from the Universal Protocol in certain respects, as discussed below, but otherwise must be substantively identical to the Universal Protocol.¹⁸⁷ Therefore, the reasons for deeming covered QFCs amended by the Universal Protocol to conform to the final rule, discussed above and in the proposal, apply to the U.S. Protocol.

Consistent with the proposal¹⁸⁸ and requests by commenters, the U.S. Protocol may limit the application of the provisions the Universal Protocol identifies as Section 1 and Section 2 to only covered FSIs, covered banks, and covered entities.¹⁸⁹ As requested by commenters, this limitation on the scope of the U.S. Protocol may ensure that the U.S. Protocol would only amend covered QFCs under this final rule or the substantially identical final rules expected to be issued by the OCC and already issued by the FRB and not also QFCs outside the scope of the agencies’ final rules (i.e., QFCs between parties that are not covered FSIs, covered banks, or covered entities).

¹⁸⁶ The final rule also provides that the FDIC may determine otherwise based on specific facts and circumstances. See final rule § 382.5(a).

¹⁸⁷ Commenters expressed support for having the U.S. Protocol apply to both existing and future QFCs. One commenter requested that an approved U.S. JMP should apply only to QFCs governed by non-U.S. law because the U.S. Special Resolution Regimes already apply to QFCs governed by U.S. law. As discussed above, the final rule does not exempt a QFC solely because the QFC explicitly states that is governed by U.S. law. Moreover, such a limited application would reduce the desirable additional benefits of the Universal Protocol, discussed above.

¹⁸⁸ The proposal explained that a “jurisdictional module for the United States that is substantively identical to the [Universal] Protocol in all respects aside from exempting QFCs between adherents that are not covered entities, covered FSIs, or covered banks would be consistent with the current proposal.” 81 Fed. Reg. 74326, 74337, n. 91 (Oct. 26, 2016).

¹⁸⁹ The final rule does not require the U.S. Protocol to retain the same section numbering as the Universal Protocol. The final rule allows the U.S. protocol to have minor and technical differences from the Universal Protocol. See final rule § 382.5(a)(3)(ii)(F).

The final rule also provides that the U.S. Protocol is required to include the U.S. Special Resolution Regimes and the other Identified Regimes but is not required to include Protocol-eligible Regimes.¹⁹⁰ As noted above, the Universal Protocol, as defined in the proposal, did not include any Country Annex for a Protocol-eligible Regime; the only special resolution regimes specifically identified in the Universal Protocol, as defined in the proposal, were the U.S. Special Resolution Regimes and the other Identified Regimes. As explained in the proposal, the inclusion of the Identified Regimes should help facilitate the resolution of a GSIB across a broader range of circumstances.¹⁹¹ Inclusion of the Identified Regimes in the U.S. Protocol also should support laws and regulations similar to the final rule and help encourage GSIB entities in the United States to adhere to a protocol that includes all Identified Regimes. However, the final rule does not require the U.S. Protocol to include Protocol-eligible Regimes, including definitions and adherence mechanisms related to Protocol-eligible Regimes.¹⁹² Inclusion of only the Identified Regimes in the U.S. Protocol, considered in light of the other benefits to the resolution of GSIBs provided by the Universal Protocol and U.S. Protocol as well as commenters' concerns with potential adherence to Protocol-eligible Regimes, should sufficiently advance the objective of the final rule to increase the likelihood that a resolution of a GSIB could be carried out in an orderly manner under a range of scenarios.

The U.S. Protocol does not permit parties to adhere on a firm-by-firm or entity-by-entity basis because such adherence mechanisms requested by commenters would obviate one of the

¹⁹⁰ See final rule § 382.5(a)(3)(ii)(A). The U.S. Protocol is likewise not required to include definitions and adherence mechanisms related to Protocol-eligible Regimes. The final rule allows the U.S. Protocol to include minor and technical differences from the Universal Protocol and, similarly, differences necessary to conform the U.S. Protocol to the substantive differences allowed or required from the Universal Protocol. See final rule § 382.5(a)(3)(ii)(F).

¹⁹¹ 81 Fed. Reg. 74326, 74337 (Oct. 26, 2016).

¹⁹² See final rule § 382.5(a)(3)(ii)(A).

primary benefits of the Universal Protocol: universal adherence. Similarly, the final rule does not permit adherence to a “static list” of all current covered FSIs, which other commenters requested.¹⁹³ Although the static list would initially provide for universal adherence, the static list would not provide for universal adherence with respect to entities that became covered FSIs after the static list was finalized. To help ensure that the additional creditor protections of the Universal Protocol and U.S. Protocol continue to be justified, both protocols must ensure that the desirable features of the protocols, including universal adherence, continue to be present as GSIBs acquire subsidiaries with existing QFCs and existing organizations become designated as GSIBs.

The final rule also addresses provisions that allow an adherent to elect that Section 1 and/or Section 2 of the Universal Protocol do not apply to the adherent’s contracts.¹⁹⁴ The Universal Protocol refers to these provisions as “opt-outs.” The proposal explained that adherence to the Universal Protocol was an alternative method of compliance with the proposed rule and that covered QFCs that were not amended by the Universal Protocol must otherwise conform to the proposed rule. In other words, the proposal would have required that a covered QFC be conformed regardless of the method the covered FSI and counterparty choose to conform the QFC.¹⁹⁵

Consistent with the basic purposes of the proposed and final rules, the U.S. Protocol requires that opt-outs exercised by its adherents will only be effective to the extent that the

¹⁹³ The final rule, however, does not prohibit the creation of a dynamic list identifying of all current “Covered Parties,” as would be defined in the U.S. Protocol, to facilitate due diligence and provide additional clarity to the market. See final rule § 382.5(a)(2)(ii)(F) (allowing minor and technical differences from the Universal Protocol).

¹⁹⁴ Section 4(b) of the Universal Protocol.

¹⁹⁵ Under the final rule, if an adherent to the Universal Protocol or U.S. Protocol exercises an available opt-out, covered FSIs with covered QFCs affected by the exercise would be required to otherwise conform the covered QFCs to the requirements of the final rule.

affected covered QFCs otherwise conform to the requirements of the final rule. Therefore, the U.S. Protocol allows counterparties to exercise available opt-out rights in a manner that also allows covered FSI to ensure that their covered QFCs continue to conform to the requirements of the rule.

The final rule also provides that, under the U.S. Protocol, the opt-out in Section 4(b)(i)(A) of the attachment to the Universal Protocol(Sunset Opt-out)¹⁹⁶ must not apply with respect to the U.S. Special Resolution Regimes, because the opt-out is no longer relevant with respect to the U.S. Special Resolution Regimes. This final rule, along with the substantially identical rules already issued by the FRB and expected to be issued by the OCC, should prevent exercise of the Sunset Opt-out provision with respect to the U.S. Special Resolution Regimes under the Universal Protocol. Inapplicability of this opt-out with respect to U.S. Special Resolution Regimes in the U.S. Protocol should provide additional clarity to adherents that the U.S. Protocol will continue to provide for universal adherence after January 1, 2018.

The final rule also expressly addresses a provision in the Universal Protocol that concerns the client-facing leg of a cleared transaction. As discussed above, the final rule, like the proposal, does not include the exemption in Section 2 of the Universal Protocol regarding the client-facing leg of a cleared transaction. Therefore, the final rule provides that the U.S. Protocol must not exempt the client-facing leg of the transaction.¹⁹⁷

F. Process for Approval of Enhanced Creditor Protections (Section 382.5 of the Proposed Rule)

¹⁹⁶ See Section 4(b)(i)(A) of the Universal Protocol.

¹⁹⁷ Section 2 of the Universal Protocol provides an exemption for any client-facing leg of a cleared transaction. See Section 2(k) of the Universal Protocol and the definition of “Cleared Client Transaction.” The final rule does not amend the proposal’s treatment of QFCs that are “Cleared Client Transactions” under the Universal Protocol, but requires that the provisions of that section must not apply with respect to the U.S. Protocol. See final rule § 382.5(a)(3)(ii)(E).

As discussed above, the restrictions of the final rule would leave many creditor protections that are commonly included in QFCs unaffected. The final rule would also allow any covered FSI to submit to the FDIC 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.¹⁹⁸ A covered FSI 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 final rule and intended to facilitate the FDIC’s consideration of whether permitting the contractual terms would be consistent with the proposed restrictions.¹⁹⁹ The FDIC also expects to consult with the FRB and OCC during its consideration of such a request—in particular, when the covered QFC is between a covered FSI and either a covered bank or a covered entity.

The first two factors concern the potential impact of the requested creditor protections on GSIB resilience and resolvability. The next four concern the scope of the final rule: 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, covered banks, and covered FSIs. 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, covered banks, and covered FSIs would increase the chances 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

¹⁹⁸ See final rule § 382.5(b).

¹⁹⁹ See Final rule §§ 382.5(d)(1)–(10).

that would expand counterparties' rights beyond those afforded under existing QFCs would conflict with the proposal's goal of reducing the risk of mass unwinds of GSIB QFCs. The final rule also includes three factors that focus on the creditor protections specific to supported parties. The FDIC 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 FSI requesting that the FDIC 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 FDIC.²⁰⁰

Under the final rule, the FDIC 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 creditor protections permitted by the final rule, would promote the safety and soundness of covered FSIs by mitigating the potential destabilizing effects of the resolution of a GSIB that is an affiliate of the covered FSI to at least the same extent.²⁰¹ Once approved by the FDIC, enhanced creditor protections could be used by other covered FSIs (in addition to the covered FSI that submitted the request for FDIC approval), as appropriate. The request-and-approval process would improve flexibility by allowing for an industry-proposed alternative to the set of creditor protections permitted by the final rule while ensuring that any approved alternative would serve the final rule's policy goals to at least the same extent as a covered QFC that complies fully with the final rule.

²⁰⁰ See final rule §§ 382.5(b)(3)(ii)-(iii).

²⁰¹ See final rule § 382.5(c).

Commenters requested that this approval process be made less burdensome and more flexible and urged for additional clarifications on the process for submitting and approving such requests (e.g., whether approvals would be published in the Federal Register). For example, commenters requested the final rule include a reasonable timeline (e.g., 180 days) by which the FDIC would approve or deny a request. Certain commenters urged that counterparties and trade groups, in addition to covered entities, covered FSIs, and covered banks, should be permitted to make such requests. One commenter noted that the proposal's approval process would have created a free-rider problem, where parties that submit enhanced creditor protection conditions for FDIC approval bear the full cost of learning which remedies are available for creditors while other parties will gain that information for free. Commenters contended that the provision requiring a "written legal opinion verifying the proposed provisions and amendments would be valid and enforceable under applicable law of the relevant jurisdictions" should be eliminated as unnecessary.²⁰² Additionally, commenters also urged that the provision should be broadened to allow approvals of provisions not directly related to enhanced creditor protections.

Finally, commenters also urged the FDIC, FRB, and OCC to either harmonize their standards for approving enhanced creditor protections or otherwise be consistent in approving enhanced creditor protection conditions. Imposing different conditions or arriving at different outcomes would subject identical QFCs to different creditor protections, raise fairness issues, increase legal and operational complexity, and hence impede the goal of orderly resolution of a GSIB.

²⁰² One commenter also suggested permitting amendments to QFCs to be accomplished through a confirmation document for a new agreement or by email instead of a formal amendment of the QFC signed by the parties. The final rule does not prescribe a specific method for amending covered QFCs.

The FDIC has clarified that the FDIC could approve an alternative proposal of additional creditor protections as compliant with sections 382.3 and 382.4 of the final rule, but has not otherwise modified these provisions of the proposal in response to changes requested by commenters. The provisions contain flexibility and guidance on the process for submitting and approving enhanced creditor protections. The final rule directly places requirements only on covered FSIs and thus only covered FSIs are eligible to submit requests pursuant to these provisions. In response to commenters' concerns, the FDIC notes that the final rule does not prevent multiple covered FSIs from presenting one request and does not prevent covered FSIs from seeking the input of counterparties when developing a request. The final rule does not provide a maximum time to review proposals because proposals could vary greatly in complexity and novelty. The final rule also maintains the provision requiring a written legal opinion which helps ensure that proposed provisions are valid and enforceable under applicable law. The final rule does not expand the approval process beyond additional creditor protections; however, revisions to aspects of the final rule may be made through the rulemaking process. The FDIC intends to consult with the FRB and OCC with respect to any requests for approvals for additional creditor protections. Therefore, the FDIC does not expect that the agencies would arrive at different outcomes with respect to an identical application for approval for enhanced creditor protections based on the differences in standards for approval.

III. Transition Periods

Under the proposal, the rule would have required compliance on the first day of the first calendar quarter beginning at least one year after issuance of the final rule, which the proposal

referred to as the effective date.²⁰³ A number of commenters urged the adoption of a phased-in approach to compliance that would extend the compliance deadline for covered QFCs with certain types of counterparties in order to allow time for necessary client outreach and education, especially for non-GSIB counterparties that may be unfamiliar with the Universal Protocol or the final rule's requirements. These commenters contended that the original compliance period of one year should be limited to counterparties that are banks, broker-dealers, swap dealers, security-based swap dealers, major swap participants, and major security-based swap participants. These commenters urged that the compliance period for QFCs with asset managers, commodity pools, private funds, and other entities that are predominantly engaged in activities that are financial in nature within the meaning of section 4(k) of the BHC Act should be extended for six months after the date of the original compliance period identified in the proposed rule. Finally, these commenters argued that the compliance period for QFCs with all other counterparties should be extended for 12 months after the date of the original compliance period identified in the proposed rule as these counterparties are likely to be least familiar with the requirements of the final rule.

One commenter suggested that the rule should take effect no sooner than one year from the date that an approved U.S. JMP is published and available for adherence, including any additional time it might take for the agencies to approve it. Certain commenters requested that the compliance deadline for covered QFCs entered into by an agent on behalf of a principal be extended by six months as well. Other commenters, however, cautioned against an approach that would impose different deadlines with respect to different classes of QFCs, as opposed to

²⁰³ See proposed rule § 382.2(b). Under section 302(b) of the Riegle Community Development and Regulatory Improvement Act of 1994, new FDIC 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).

counterparty types, since the main challenge in connection with the remediation is the need for outreach to and education of counterparties. These commenters contended that once a counterparty has become familiar with the requirements of the rule and the terms of the required amendments, it would be more efficient to remediate all covered QFCs with the counterparty at the same time.

A number of commenters also requested that the FDIC confirm that entities newly acquired by a GSIB, and thereby become new covered FSIs have until the first day of the first calendar quarter immediately following one year after becoming covered FSIs to conform their existing QFCs. Commenters argued that this would allow the GSIB to conform existing QFCs in an orderly fashion without impairing the ability of covered FSIs to engage in corporate activities. These commenters also requested clarification that, during that conformance period, affiliates of covered FSIs would not be prohibited from entering into new transactions or QFCs with counterparties of the newly acquired entity if the existing covered FSIs otherwise comply with the rule's requirements. Some commenters urged the FDIC to exclude existing contracts from the final rule's requirements and only apply the rule on a prospective basis. Additionally, commenters asked for harmonized compliance dates across the different agencies' rules.

The effective date for the final rule is January 1, 2018, more than 60 days following publication in the Federal Register. However, in order to reduce the compliance burden of the final rule, the FDIC has adopted a phased-in compliance schedule as requested by commenters. The final rule provides that a covered FSI must conform a covered QFC to the requirements of this final rule by the first day of the calendar quarter immediately following one year from the effective date of this subpart with respect to covered QFCs with other covered FSIs, covered

entities, and covered banks (referred to in this discussion as the “first compliance date”).²⁰⁴ This provision allows the counterparties that should be the most familiar with the requirements of the final rule over one year to comply with the rule’s requirements. Moreover, this is a relatively small number of counterparties that would need to modify their QFCs in the first year following the effective date of the final rule and many covered FSIs, covered entities, and covered banks with covered QFCs have already adhered to the Universal Protocol.

The final rule provides additional time for compliance with the requirements for other types of counterparties. In particular, for other types of financial counterparties²⁰⁵ (other than small financial institutions)²⁰⁶ the final rule provides 18 months from the effective date of the final rule for compliance with its requirements as requested by commenters.²⁰⁷ For smaller banks and other non-financial counterparties, the final rule provides approximately two years from the effective date of the final rule for compliance with its requirements, as requested by commenters.²⁰⁸ Adopting a phased-in compliance approach based on the type (and, in some cases, size) of the counterparty will allow market participants time to adjust to the new requirements and make required changes to QFCs in an orderly manner. It will also give time

²⁰⁴ See final rule § 382.2(f)(1)(A). The definition of covered QFC of the final rule has been revised to make clear that, consistent with the proposal, a covered QFC is a QFC that the covered FSI becomes a party to on or after the first day of the calendar quarter immediately following one year from the effective date of this part. See final rule § 382.2(c). As discussed above, a covered FSI’s in-scope QFC that is entered into before this date may also be a covered QFC if the covered FSI or any affiliate that is a covered entity, covered FSI, or covered bank also becomes a party to a QFC with the same counterparty or a consolidated affiliate of the same counterparty on or after the first compliance date. See id.

²⁰⁵ See final rule § 382.1 (defining “financial counterparty”).

²⁰⁶ The final rule defines small financial institution as an insured bank, insured savings association, farm credit system institution, or credit union with assets of \$10,000,000,000 or less. See final rule § 382.1.

²⁰⁷ See final rule § 382.2(f)(1)(B).

²⁰⁸ See final rule § 382.2(f)(1)(C).

for development of the U.S. Protocol or any other protocol that would meet the requirements of the final rule.

The FDIC is giving this additional time for compliance to respond to concerns raised by commenters. The FDIC encourages covered FSIIs to start planning and outreach efforts early in order to come into compliance with the rule on the time frames provided. The FDIC believes that this additional time for compliance should also address concerns raised by commenters regarding the burden of conforming existing contracts by allowing firms additional time to conform all covered QFCs to the requirements of the final rule.

Although the phased-in compliance period does not contain special rules related to acting as an agent as requested by certain commenters, the rule has been modified as described above to clarify that a covered FSI does not become a party to a QFC solely by acting as agent with respect to the QFC.²⁰⁹

Entities that are covered FSIIs when the final rule is effective would be required to comply with the requirements of the final rule beginning on the first compliance date, but would be given more time to conform such covered QFCs with entities that are not covered FSIIs, covered entities, or covered banks.²¹⁰ Thus, a covered FSI would be required to ensure that covered QFCs entered into on or after the effective date comply with the rule's requirements.²¹¹ Moreover, a covered FSI would be required to bring an in-scope QFC entered into prior to the first compliance date into compliance with the rule no later than the applicable date of the tiered compliance dates (discussed above) if the covered FSI or an affiliate (that is also a covered entity, covered bank, or covered FSI) enters into a new covered QFC with the counterparty to the

²⁰⁹ See final rule § 382.2(e)(1).

²¹⁰ See final rule §§ 382.2(c)(1); 382.2(f)(1).

²¹¹ See *id.*

pre-existing covered QFC or a consolidated affiliate of the counterparty on or after the first compliance date.²¹² (Thus, a covered FSI would not be required to conform a pre-existing QFC if that covered FSI and its covered FSI, covered entity or covered bank affiliates do not enter into any new QFCs with the same counterparty or its consolidated affiliates on or after the compliance date.)

In addition, an entity that becomes a covered FSI after the effective date of the final rule (a “new covered FSI” for purposes of this preamble) generally has the same period of time to comply as an entity that is a covered FSI on the effective date (i.e., compliance will phase in over a two-year period based on the type of counterparty).²¹³ The final rule also clarifies that a covered QFC, with respect to a new covered FSI, means an in-scope QFC that the new covered FSI becomes a party to (1) on the date the covered FSI first becomes a covered FSI, and (2) before that date, if the covered FSI or one of its affiliates that is a covered FSI, covered entity, or covered bank also enters, executes, or otherwise becomes a party to a QFC with the same counterparty or a consolidated affiliate of the counterparty after that date.²¹⁴ Under the final rule, a company that is a covered FSI on the effective date of the final rule (an “existing covered FSI” for purposes of this preamble) and becomes an affiliate of a new covered FSI, covered bank, or covered entity generally must conform any existing but non-conformed in-scope QFC that the existing covered FSI continues to have with a counterparty after the applicable initial compliance date by the date the new covered FSI enters a QFC with the same counterparty or any of its consolidated affiliates. Acquisitions of new entities are planned in advance and should include preparing to comply with applicable laws and regulations.

²¹² See final rule § 382.2(c)(1).

²¹³ See final rule § 382.2(f)(2).

²¹⁴ See final rule § 382.2(c)(2).

Certain commenters opposed application of the requirements of the rule to existing QFCs, requesting instead that the final rule only apply to QFCs entered into after the effective date of any final rule and that all pre-existing QFCs not be subject to the rule's requirements. Commenters suggested that end users of QFCs with GSIB affiliates might not have entered into existing contracts without the default rights prohibited in the proposed rule and that revising existing QFCs would be time-consuming and expensive. Commenters asserted that this treatment would be consistent with the final rules in the United Kingdom and the statutory requirements adopted by Germany.

The FDIC does not believe it is appropriate to exclude all pre-existing QFCs because of the current and future risk that existing covered QFCs pose to the orderly resolution of a covered FSI. Moreover, application of different default rights to existing and future transactions within a netting set could cause the netting set to be broken, which commenters noted could increase burden to both parties to the netting set.²¹⁵ Therefore, the final rule requires an existing QFC between a covered FSI and a counterparty to be conformed to the requirements of the final rule if the covered FSI (or an affiliate that is a covered FSI, covered entity, or covered bank) enters into another QFC with the counterparty or its consolidated affiliate on or after the first day of the calendar quarter immediately following one year from the effective date of the final rule.²¹⁶

By permitting a covered FSI to remain a party to noncompliant QFCs entered before the effective date unless the covered FSI or any affiliate (that is also a covered entity, covered bank, or covered FSI) enters into new QFCs with the same counterparty or its consolidated affiliates,

²¹⁵ The requirements of the final rule, particularly those of section 382.4, may have a different impact on netting, including close-out netting, than the UK and German requirements cited by commenters.

²¹⁶ Subject to any compliance date applicable to the covered FSI, the FDIC expects a covered FSI to conform existing QFCs that become covered QFCs within a reasonable period.

the final rule strikes a balance between ensuring QFC continuity if the GSIB were to fail and ensuring that covered FSIs and their existing counterparties can manage any compliance costs and disruptions associated with conforming existing QFCs by refraining from entering into new QFCs. The requirement that a covered FSI ensure that all existing QFCs with a particular counterparty and its consolidated affiliates are compliant before it or any affiliate of the covered FSI (that is also a covered entity, covered bank, or covered FSI) enters into a new QFC with the same counterparty or its consolidated affiliates after the effective date will provide covered FSIs with an incentive to seek the modifications necessary to ensure that their QFCs with their most important counterparties are compliant. Moreover, the volume of 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 consolidated affiliates, do not enter into new covered QFCs with the GSIB on or after the first day of the calendar quarter that is one year from the effective date of the final rule, it would be appropriate to permit a limited number of noncompliant QFCs to remain outstanding, in keeping with the terms described above. Moreover, the final rule also excludes existing warrants and retail investment advisory agreements to address concerns raised by commenters and mitigate burden.²¹⁷ The FDIC will monitor covered FSIs' levels of noncompliant QFCs and evaluate the risk, if any, that they pose to the safety and soundness of the covered FSIs.

IV. Expected Effects

²¹⁷ See final rule § 382.7(c).

The final rule is intended to promote the financial stability of the United States by reducing the potential that resolution of a GSIB, particularly through bankruptcy, will be disorderly. The final rule will help meet this policy objective by more effectively and efficiently managing the exercise of cross default rights and transfer restrictions contained in QFCs. It will therefore help mitigate the risk of future financial crises and imposition of substantial costs on the U.S. economy.²¹⁸ The final rule furthers the FDIC's mission and responsibilities, which include resolving failed institutions in the least costly manner and ensuring that FDIC-insured institutions operate safely and soundly. It also furthers the fulfillment of the FDIC's role as the (i) the primary federal supervisor for state non-member banks and state savings associations; (ii) the insurer of deposits and manager of the DIF; and (iii) the resolution authority for all FDIC-insured institutions under the FDI Act and, if appointed by the Secretary of the Treasury in accordance with the requirements of Title II of the Dodd-Frank Act, for large complex financial institutions.

The final rule only applies to FDIC-supervised institutions that are subsidiaries or affiliates of a GSIB. Of the 3,717 institutions that the FDIC supervises,²¹⁹ eleven are subsidiaries or affiliates of GSIBs.²²⁰ Out of those eleven institutions, eight had QFC contracts at some point over the past five years. Those eight institutions had an average of \$39 billion worth of QFC contracts, as measured by notional value, over the same time period compared to an average of

²¹⁸ A recent estimate of the unrealized economic output that resulted from 2007–09 financial crisis in the United States amounted to between \$6 and \$14 trillion. See “How Bad Was It? The Costs and Consequences of the 2007–09 Financial Crisis,” Staff Paper No. 20, Federal Reserve Bank of Dallas, July 2013, available at <https://dallasfed.org/assets/documents/research/staff/staff1301.pdf>.

²¹⁹ Call Report data, June 2017.

²²⁰ FFIEC National Information Center.

over \$200 trillion in notional value for all FDIC-insured GSIB affiliates.²²¹ Therefore, the final rule applies only to a small number of institutions and to a small portion of total QFC activity.

Benefits

The final rule will likely benefit the counterparties of covered FSIs by preventing the disorderly failure of the GSIB subsidiary and enabling it to continue to meet its obligations. The mass exercise of default rights against an otherwise healthy covered FSI resulting from the failure of an affiliate may cause it to weaken or fail. Therefore, 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 will be able to meet their obligations to QFC counterparties. Moreover, the creditor protections permitted under the rule will allow any counterparty that does not continue to receive payment under the QFC to exercise its default rights, after any applicable stay period.

Because financial crises impose enormous costs on the economy, even small reductions in the probability or severity of future financial crises create substantial economic benefits.²²² QFCs play a large role in the financial markets and are a major source of financial interconnectedness. Therefore, they can pose a threat to financial stability in times of market stress. The final rule will materially reduce 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 reduce the probability and severity of financial crises in the future.

²²¹ Call Report data, June 2012 – June 2017.

²²² “How Bad Was It? The Costs and Consequences of the 2007–09 Financial Crisis,” Staff Paper No. 20, Federal Reserve Bank of Dallas, July 2013.

The final rule will also likely benefit the DIF. Mass exercise of QFC default rights by the counterparties at the time the parent or other affiliate of an FDIC-insured institution enters resolution could lead to severe losses for, or possibly the failure of, FDIC-insured subsidiaries of failed GSIBs. Those losses and/or failures could result in considerable losses to the DIF.

Costs

The costs of the final rule are likely to be relatively small and only affect eleven covered FSIs. Only eight of the eleven affected institutions had QFC contracts over the past 5 years. The QFC activity of those eight firms represented less than .02 percent of QFC activity among all FDIC-insured GSIB subsidiaries.²²³ Covered FSIs and their counterparties may incur administrative costs associated with drafting and negotiating compliant QFCs. However, the rule only limits the execution of default rights for a brief time period in the event that a GSIB or GSIB affiliate enters a resolution process. Further, the rule only affects QFC contracts that contain default rights or transfer restrictions, so not all QFC activity will be affected by the rule. Affected institutions also have the option of adhering to the Universal Protocol or the U.S. Protocol as an alternative to amending QFC contracts, and they have a phase-in compliance period of up to two years to become fully compliant with the rule. The flexibility that the final rule allows for affected institutions and their counterparties further reduces the expected costs associated with this rule. Therefore, costs associated with drafting compliant QFCs are likely to be low.

In addition, the FDIC anticipates that covered FSIs would likely share resources with their parent GSIB and/or GSIB affiliates—which are subject to parallel requirements—to help

²²³ See Call Report data, June 2012 – June 2017.

cover compliance costs. The stay-and-transfer provisions of the Dodd-Frank Act and the FDI Act are already in force, and the Universal Protocol is already partially effective for the 25 existing GSIB adherents. The partial effectiveness of the Universal Protocol (regarding Section 1, which addresses recognition of stays on the exercise of default rights and remedies in financial contracts under special resolution regimes, including in the United States, the United Kingdom, Germany, France, Switzerland and Japan) suggests that to the extent covered FSIs already adhere to the Universal Protocol, some implementation costs will likely be reduced.

The final rule could potentially impose costs on covered FSIs 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. These costs may be higher than drafting and negotiating costs. However, they are also expected to be relatively small because of the limited reduction in the rights of counterparties and the availability of other forms of credit protection for counterparties.

The final rule could also create economic costs by causing a marginal reduction in QFC-related economic activity. For example, a covered FSI may not enter into a QFC that it would have otherwise entered into in the absence of the rule. Therefore, economic activity that would have been associated with that QFC absent the rule (such as economic activity that would have otherwise been hedged with a derivatives contract or funded through a repo transaction) might not occur. The FDIC does not expect any significant reduction in QFC activity to result from this rule because the restrictions on default rights in covered QFCs that the rule requires are relatively narrow and would not change a counterparty's rights 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 final rule.

V. Revisions to Certain Definitions in the FDIC’s Capital and Liquidity Rules

This final rule also amends several definitions in the FDIC’s capital and liquidity rules to help ensure that the final rule does not have unintended effects for the treatment of covered FSIs’ netting agreements under those rules, consistent with the amendments contained in the FRB FR and the OCC FR.²²⁴

The FDIC’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.²²⁵ The FDIC 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.²²⁶ 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.

²²⁴ On September 20, 2016, the FDIC adopted a separate final rule (the Final QMNA Rule), following the earlier notice of proposed rulemaking issued in January 2015, see 80 FR 5063 (Jan. 30, 2015), covering amendments to the definition of “qualifying master netting agreement” in the FDIC’s capital and liquidity rules and related definitions in its capital rules. The Final QMNA Rule is designed to prevent similar unintended effects from implementation of special resolution regimes in non-U.S. jurisdictions, or by parties’ adherence to the ISDA Protocol. The amendments contained in the Final QMNA Rule also are similar to revisions that the FRB and the OCC made in their joint 2014 interim final rule to ensure that the regulatory capital and liquidity rules’ treatment of certain financial contracts is not affected by the implementation of special resolution regimes in foreign jurisdictions. See 79 Fed. Reg. 78287 (Dec. 30, 2014).

²²⁵ See 12 CFR 324.34(a)(2).

²²⁶ See the definition of “qualifying master netting agreement” in 12 CFR 324.2 (capital rules) and 329.3 (liquidity rules).

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 final rule would impose on the QFCs of covered FSIs. Thus, a master netting agreement that is compliant with this final rule would not qualify as a qualifying master netting agreement. This would result in considerably higher capital and liquidity requirements for QFC counterparties of covered FSIs, which is not an intended effect of this final rule.

Accordingly, the final rule would amend the definition of “qualifying master netting agreement” so that a master netting agreement could qualify for such treatment 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 to the extent necessary to comply with the requirements of this final rule. This revision maintains the existing treatment for these contracts under the FDIC’s capital and liquidity rules by accounting for the restrictions that the final rule, or the substantively identical rules of issued by the FRB and expected from the OCC, would place on default rights related to covered FSIs’ QFCs. The FDIC does not believe that the disqualification of master netting agreements that would result in the absence of this 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 final rule would similarly revise certain other definitions in the regulatory capital rules to make analogous conforming changes designed to account for this final rule'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 FDIC's capital rules. Specifically, the final rule 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 final rule without unintended adverse impacts under the FDIC's capital rules.

The interagency 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."²²⁷ Thus, it may also be appropriate to amend the definition of "eligible master netting agreement" to account for the restrictions on covered FSI's QFCs. Because the FDIC issued the swap margin rule jointly with other U.S. regulatory agencies, however, the FDIC is consulting with the other agencies before proposing amendments to that rule's definition of "eligible master netting agreement."

Certain commenters requested technical modifications to the proposed modifications to the definitions to better distinguish the requirements of section 252.84 and the provisions of Section 2 of the Universal Protocol from provisions regarding "opt in" to special resolution regimes. In response to this comment, the final rule establishes an independent exception

²²⁷ 80 Fed. Reg. 74840, 74861–74862 (November 30, 2015). The FDIC's definition of "eligible master netting agreement" for purposes of the swap margin rule is codified at 12 CFR 349.2.

addressing the requirements of section 382.4 and the provisions of Section 2 of the Universal Protocol and makes other minor clarifying edits.

One commenter requested that the definitions of the terms “collateral agreement,” “eligible margin loan,” “qualifying master netting agreement,” and “repo-style transaction” include references to stays in state resolution regimes (such as insurance receiverships). The commenters did not identify, and the FDIC is not aware of, any state resolution regime that currently includes QFC stays similar to those of the U.S. Special Resolution Regimes. Neither the nature of the potential laws nor the extent of their effect on the regulatory capital requirements of FDIC-regulated institutions is known. Therefore, the final rule does not reference state resolution regimes.

One commenter argued that neither the current nor the proposed definition of qualifying master netting agreement comports with section 302(a) of the Business Risk Mitigation and Price Stabilization Act of 2015, which exempts certain types of counterparties from initial and variation margin requirements, and that the proposed amendments to the definition add unnecessary complexity to the existing rules and therefore make compliance more difficult. Section 302(a) of that act is not relevant to the definition of qualifying master netting agreement because the definition does not require initial or variation margin. Rather, the definition of qualifying master netting agreement requires that margin provided under the agreement, if any, be able to be promptly liquidated or set off under the circumstances specified in the definition. The FDIC continues to believe that the amendments are necessary and do not substantially add to the complexity of the FDIC’s rules.

VI. Regulatory Analysis

A. Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act of 1995, 44 U.S.C. 3501 through 3521 (PRA), the FDIC 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. Section 382.5 of the proposed rule contains “collection of information” requirements within the meaning of the PRA. OMB has assigned the following control numbers to this information collection: 3064-AE46.

This information collection consists of amendments to covered QFCs and, in some cases, approval requests prepared and submitted to the FDIC regarding modifications to enhanced creditor protection provisions (in lieu of adherence to the ISDA Protocol). Section 382.5(b) of the final rule would require a covered FSI to request the FDIC to approve as compliant with the requirements of sections 382.3 and 382.4 of this part, 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. A covered FSI making a request must provide (1) an analysis of the proposal under each consideration of paragraph 382.5(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 relevant information that the FDIC requests.

Covered FSIs would also have recordkeeping associated with proposed amendments to their covered QFCs. However, much of the recordkeeping associated with amending the covered QFCs is already expected from a covered FSI. Therefore, the FDIC would expect minimal additional burden to accompany the initial efforts to bring all covered QFCs into compliance.

The existing burden estimates for the information collection associated with section 382.5 are as follows:

TITLE	TIMES/YEAR	RESPONDENTS	HOURS PER RESPONSE	TOTAL BURDEN HOURS
Paperwork for proposed revisions	On occasion	6	40	240
Total Burden				240

The FDIC received no comments on the PRA section of the proposal or the burden estimates. However, the FDIC has an ongoing interest in public comments on its burden estimates. Any such comments should be sent to the Paperwork Reduction Act Officer, FDIC Legal Division, 550 17th Street, NW., Washington, DC 20503. Written comments should address the accuracy of the burden estimates and ways to minimize burden, as well as other relevant aspects of the information collection request.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601 *et seq.*, requires that each federal agency either certify that a proposed rule will not, if promulgated, have a significant economic impact on a substantial number of small entities or prepare and make available for public comment an initial regulatory flexibility analysis of the proposal.²²⁸ For the reasons provided below, the FDIC hereby certifies pursuant to 5 U.S.C. 605(b) that the final rule will not have a significant economic impact on a substantial number of small entities.

The final rule would only apply to FSIs that form part of GSIB organizations, which include the largest, most systemically important banking organizations and certain of their

²²⁸ See 5 U.S.C. 603, 605.

subsidiaries. More specifically, the proposed rule would apply to any covered FSI that is a subsidiary of a U.S. GSIB or foreign GSIB—regardless of 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 FDIC estimates that the final rule would apply to approximately eleven FSIs. As of June 30, 2017, only eight of the eleven covered FSIs have derivatives portfolios that could be affected. None of these eight banking organizations would qualify as a small entity for the purposes of the RFA.²²⁹ In addition, the FDIC anticipates that any small subsidiary of a GSIB that could be affected by the final rule would not bear significant additional costs as it is likely to rely on its parent GSIB, or a large affiliate, that will be subject to similar reporting, recordkeeping, and compliance requirements.²³⁰ The final rule complements the FRB FR and OCC FR. It is not designed to duplicate, overlap with, or conflict with any other federal regulation.

This regulatory flexibility analysis demonstrates that the proposed rule would not, if promulgated, have a significant economic impact on a substantial number of small entities, and the FDIC so certifies.²³¹

C. Riegle Community Development and Regulatory Improvement Act of 1994

The Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA), 12 U.S.C. 4701, requires that the FDIC, in determining the effective date and

²²⁹ Under regulations issued by the Small Business Administration, small entities include banking organizations with total assets of \$550 million or less.

²³⁰ See FRB FR, 82 Fed. Reg. 42882 (Sept. 12, 2017) and OCC NPRM, 81 Fed. Reg. 55381 (August 19, 2016).

²³¹ 5 U.S.C. 605.

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, subject to certain exceptions, new regulations that impose additional reporting, disclosures, or other new requirements on insured depository institutions 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. In accordance with these provisions and as discussed above, the FDIC considered any administrative burdens, as well as benefits, that the final rule would place on depository institutions and their customers in determining the effective date and administrative compliance requirements of the final rule. The final rule will be effective no earlier than the first day of a calendar quarter that begins on or after the date on which the final rule is published.

D. Solicitation of Comments on the Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act, 12 U.S.C. 4809, requires the FDIC to use plain language in all proposed and final rules published after January 1, 2000. The FDIC has presented the final rule in a simple and straightforward manner.

E. Small Business Regulatory Enforcement Fairness Act

The Office of Management and Budget has determined that this final rule is a “major rule” within the meaning of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801, et seq.) (“SBREFA”). As required by the SBREFA, the FDIC will file the appropriate reports with Congress and the Government Accountability Office so that the Final Rule may be reviewed.

12 CFR Chapter III

Authority and Issuance

For the reasons stated in the Supplementary Information, the FDIC amends 12 CFR parts 324 and 329 as follows:

PART 324—CAPITAL ADEQUACY OF FDIC-SUPERVISED INSTITUTIONS

1. The authority citation for part 324 continues to read as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; 5371; 5412; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 2355, as amended by Pub. L. 103-325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102-242, 105 Stat. 2236, 2386, as amended by Pub. L. 102-550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note); Pub. L. 111-203, 124 Stat. 1376, 1887 (15 U.S.C. 78o-7 note).

2. Section 324.2 is amended by revising the definition of “collateral agreement” to read as follows:

§ 324.2 Definitions.

* * * * *

Collateral agreement means a legal contract that specifies the time when, and circumstances under which, a counterparty is required to pledge collateral to an FDIC-supervised institution for a single financial contract or for all financial contracts in a netting set and confers upon the FDIC-supervised 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 FDIC-supervised 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 FDIC-supervised institution's exercise of rights under the agreement may be stayed or avoided

(1) 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 similar⁴ to the U.S. laws referenced in this paragraph

(1)(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 (1)(i) of this definition; or

(2) Other than to the extent necessary for the counterparty to comply with the requirements of part 382 of this title, subpart I of part 252 of this title or part 47 of this title, as applicable.

* * * * *

3. Section 324.2 is further amended by revising the definition of "Eligible margin loan" to read as follows:

* * * * *

Eligible margin loan means:

(1) An extension of credit where:

(i) The extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, or gold;

⁴ The FDIC expects to evaluate jointly with the Federal Reserve and the OCC whether foreign special resolution regimes meet the requirements of this paragraph.

(ii) The collateral is marked to fair value daily, and the transaction is subject to daily margin maintenance requirements; and (iii) The extension of credit is conducted under an agreement that provides the FDIC-supervised 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,

(A) Any exercise of rights under the agreement will not 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,⁵ or laws of foreign jurisdictions that are substantially similar⁶ to the U.S. laws referenced in this paragraph

(1)(iii)(A)(1) in order to facilitate the orderly resolution of the defaulting counterparty; or

(2) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (1)(iii)(A)(1) of this definition; and (B) The agreement may limit 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 to the extent

necessary for the counterparty to comply with the requirements of part 382 of this title, subpart I

of part 252 of this title or part 47 of this title, as applicable.

⁵ 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).

⁶ The FDIC expects to evaluate jointly with the Federal Reserve and the OCC whether foreign special resolution regimes meet the requirements of this paragraph.

(2) In order to recognize an exposure as an eligible margin loan for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of §324.3(b) with respect to that exposure.

* * * * *

4. Section 324.2 is further amended by revising the definition of “qualifying master netting agreement” to read as follows:

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 FDIC-supervised 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,

(i) 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, or laws of

foreign jurisdictions that are substantially similar⁷ to the U.S. laws referenced in this paragraph (2)(i)(A) in order to facilitate the orderly resolution of the defaulting counterparty; or

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

(ii) The agreement may limit 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 to the extent necessary for the counterparty to comply with the requirements of part 382 of this title, subpart I of part 252 of this title or part 47 of this title, as applicable;

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of §324.3(d) with respect to that agreement.

* * * * *

5. Section 324.2 is further amended by revising the definition of “Repo-style transaction” to read as follows:

Repo-style transaction means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the FDIC-

⁷ The FDIC expects to evaluate jointly with the Federal Reserve and the OCC whether foreign special resolution regimes meet the requirements of this paragraph.

supervised institution acts as agent for a customer and indemnifies the customer against loss, provided that:

(1) The transaction is based solely on liquid and readily marketable securities, cash, or gold;

(2) The transaction is marked-to-fair value daily and subject to daily margin maintenance requirements;

(3)(i) The transaction is a “securities contract” or “repurchase agreement” under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act, or a netting contract between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve's Regulation EE (12 CFR part 231); or

(ii) If the transaction does not meet the criteria set forth in paragraph (3)(i) of this definition, then either:

(A) The transaction is executed under an agreement that provides the FDIC-supervised 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,

(1) 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 similar⁸ to the U.S. laws referenced in this paragraph (3)(ii)(A)(1)(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 (3)(ii)(A)(1)(i) of this definition; and(2) The agreement may limit 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 to the extent necessary for the counterparty to comply with the requirements of part 382 of this title, subpart I of part 252 of this title or part 47 of this title, as applicable;

or

(B) The transaction is:

- (1) Either overnight or unconditionally cancelable at any time by the FDIC-supervised institution; and
- (2) Executed under an agreement that provides the FDIC-supervised 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 counterparty default; and
- (4) In order to recognize an exposure as a repo-style transaction for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of §324.3(e) of this part with respect to that exposure.

* * * * *

PART 329—LIQUIDITY RISK MEASUREMENT STANDARDS

6. The authority citation for part 329 continues to read as follows:

Authority: 12 U.S.C. 12 U.S.C. 1815, 1816, 1818, 1819, 1828, 1831p-1, 5412.

⁸ The FDIC expects to evaluate jointly with the Federal Reserve and the OCC whether foreign special resolution regimes meet the requirements of this paragraph.

7. Section 329.3 is amended by revising the definition of “qualifying master netting agreement” to read as follows:

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

(2) The agreement provides the FDIC-supervised 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,

(1) 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, or laws of foreign jurisdictions that are substantially similar⁴ to the U.S. laws referenced in this paragraph (2)(i)(A) in order to facilitate the orderly resolution of the defaulting counterparty;

⁴ The FDIC expects to evaluate jointly with the Federal Reserve and the OCC whether foreign special resolution regimes meet the requirements of this paragraph.

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

(ii) The agreement may limit 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 to the extent necessary for the counterparty to comply with the requirements of part 382 of this title, subpart I of part 252 of this title or part 47 of this title, as applicable;

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of §329.4(a) with respect to that agreement.

* * * * *
12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the Supplementary Information, the Federal Deposit Insurance Corporation proposes to amend chapter III of title 12 of the Code of Federal Regulations as follows:

8. Add part 382 to read as follows:

PART 382—RESTRICTIONS ON QUALIFIED FINANCIAL CONTRACTS.

Sec.

382.1 Definitions.

382.2 Applicability.

382.3 U.S. Special resolution regimes.

382.4 Insolvency proceedings.

382.5 Approval of enhanced creditor protection conditions.

382.6 [Reserved.]

382.7 Exclusion of certain QFCs.

Authority: 12 U.S.C. 1816, 1818, 1819, 1820(g) 1828, 1828(m), 1831n, 1831o, 1831p–l, 1831(u), 1831w

Restrictions on Qualified Financial Contracts

§ 382.1 Definitions.

Affiliate has the same meaning as in section 12 U.S.C. 1813(w).

Central counterparty (CCP) has the same meaning as in section 324.2 of the FDIC’s Regulations (12 CFR 324.2).

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

Consolidated affiliate means an affiliate of another company that

(1) Either consolidates the other company, or is consolidated by the other company, on financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles, the International Financial Reporting Standards, or other similar standards;

(2) Is, along with the other company, consolidated with a third company on a financial statement prepared in accordance with principles or standards referenced in paragraph (1) of this definition; or

(3) For a company that is not subject to principles or standards referenced in paragraph (1), if consolidation as described in paragraph (1) or (2) of this definition would have occurred if such principles or standards had applied.

Control has the same meaning as in section 3(w) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)).

Covered bank has the same meaning as in Part 47.3 of the Office of the Comptroller's Regulations (12 CFR 47.3).

Covered entity has the same meaning as in section 252.82(a) of the Federal Reserve Board's Regulation YY (12 CFR 252.82).

Covered QFC means a QFC as defined in sections 382.2 of this part.

Credit enhancement means a QFC of the type set forth in §§ 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 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)).

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 382.4, 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.

Financial counterparty means a person that is

(1) (i) A bank holding company or an affiliate thereof; a savings and loan holding company as defined in section 10(n) of the Home Owners' Loan Act (12 U.S.C. 1467a(n)); a U.S. intermediate holding company that is established or designated for purposes of compliance with 12 CFR 252.153; or a nonbank financial institution supervised by the Board of Governors of the Federal Reserve System under Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5323);

(ii) A depository institution as defined, in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)); an organization that is organized under the laws of a foreign country and that engages directly in the business of banking outside the United States; a Federal credit union or State credit union as defined in section 2 of the Federal Credit Union Act (12 U.S.C. 1752(1) and (6)); an institution that functions solely in a trust or fiduciary capacity as described in section 2(c)(2)(D) of the Bank Holding Company Act (12 U.S.C. 1841 (c)(2)(D)); an industrial loan company, an industrial bank, or other similar institution described in section 2(c)(2)(H) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(H));

(iii) An entity that is state-licensed or registered as;

(A) A credit or lending entity, including a finance company; money lender; installment lender; consumer lender or lending company; mortgage lender, broker, or bank; motor vehicle title pledge lender; payday or deferred deposit lender; premium finance company; commercial

finance or lending company; or commercial mortgage company; except entities registered or licensed solely on account of financing the entity's direct sales of goods or services to customers;

(B) A money services business, including a check casher; money transmitter; currency dealer or exchange; or money order or traveler's check issuer;

(iv) A regulated entity as defined in section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended (12 U.S.C. 4502(20)) or any entity for which the Federal Housing Finance Agency or its successor is the primary federal regulator;

(v) Any institution chartered in accordance with the Farm Credit Act of 1971, as amended, 12 U.S.C. 2001 *et seq.* that is regulated by the Farm Credit Administration;

(vi) Any entity registered with the Commodity Futures Trading Commission as a swap dealer or major swap participant pursuant to the Commodity Exchange Act of 1936 (7 U.S.C. 1 *et seq.*), or an entity that is registered with the U.S. Securities and Exchange Commission as a security-based swap dealer or a major security-based swap participant pursuant to the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*);

(vii) A securities holding company within the meaning specified in section 618 of the Dodd-Frank Wall Street Reform and Consumer Protection act (12 U.S.C. 1850a); a broker or dealer as defined in sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(45)); an investment adviser as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)); an investment company registered with the U.S. Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a-1*et seq.*); or a company that has elected to be regulated as a business development company pursuant to section 54(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-53(a));

(viii) A private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)); an entity that would be an investment company under section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3) but for section 3(c)(5)(C); or an entity that is deemed not to be an investment company under section 3 of the Investment Company Act of 1940 pursuant to Investment Company Act Rule 3a-7 (17 CFR 270.3a-7) of the U.S. Securities and Exchange Commission;

(ix) A commodity pool, a commodity pool operator, or a commodity trading advisor as defined, respectively, in section 1a(10), 1a(11), and 1a(12) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(10), 1a(11), and 1a(12)); a floor broker, a floor trader, or introducing broker as defined, respectively, in 1a(22), 1a(23) and 1a(31) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(22), 1a(23), and 1a(31)); or a futures commission merchant as defined in 1a(28) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(28));

(x) An employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002);

(xi) An entity that is organized as an insurance company, primarily engaged in writing insurance or reinsuring risks underwritten by insurance companies, or is subject to supervision as such by a State insurance regulator or foreign insurance regulator; or

(xii) An entity that would be a financial counterparty described in paragraph (1)(i)-(xi) of this definition, if the entity were organized under the laws of the United States or any State thereof.

(2) The term “financial counterparty” does not include any counterparty that is:

- (i) A sovereign entity;
- (ii) A multilateral development bank; or

(iii) The Bank for International Settlements.

Financial market utility (FMU) means any person, regardless of the jurisdiction in which the person is located or organized, that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person, but does not include (i) designated contract markets, registered futures associations, swap data repositories, and swap execution facilities registered under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*), or national securities exchanges, national securities associations, alternative trading systems, security-based swap data repositories, and swap execution facilities registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*), solely by reason of their providing facilities for comparison of data respecting the terms of settlement of securities or futures transactions effected on such exchange or by means of any electronic system operated or controlled by such entities, provided that the exclusions in this clause apply only with respect to the activities that require the entity to be so registered; or (ii) any broker, dealer, transfer agent, or investment company, or any futures commission merchant, introducing broker, commodity trading advisor, or commodity pool operator, solely by reason of functions performed by such institution as part of brokerage, dealing, transfer agency, or investment company activities, or solely by reason of acting on behalf of a FMU or a participant therein in connection with the furnishing by the FMU of services to its participants or the use of services of the FMU by its participants, provided that services performed by such institution do not constitute critical risk management or processing functions of the FMU.

Investment advisory contract means any contract or agreement whereby a person agrees to act as investment adviser to or to manage any investment or trading account of another person.

Master agreement means a QFC of the type set forth in sections 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 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)).

Person has the same meaning as in 12 CFR 225.2.

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)).

Retail customer or counterparty has the same meaning as in section 329.3 of this chapter.

Small financial institution means a company that

(1) Is organized as a bank, as defined in section 3(a) of the Federal Deposit Insurance Act, the deposits of which are insured by the Federal Deposit Insurance Corporation; a savings association, as defined in section 3(b) of the Federal Deposit Insurance Act, the deposits of which are insured by the Federal Deposit Insurance Corporation; a farm credit system institution chartered under the Farm Credit Act of 1971; or an insured Federal credit union or State-chartered credit union under the Federal Credit Union Act; and

(2) Has total assets of \$10,000,000,000 or less on the last day of the company's most recent fiscal year.

State means any state, commonwealth, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, or the United States Virgin Islands.

Subsidiary of a covered FSI means any subsidiary of a covered FSI as defined in 12 U.S.C. 1813(w).

U.S. agency has the same meaning as the term “agency” in 12 U.S.C. 3101.

U.S. branch has the same meaning as the term “branch” in 12 U.S.C. 3101.

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.

§ 382.2 Applicability.

(a) General requirement. A covered FSI must ensure that each covered QFC conforms to the requirements of sections 382.3 and 382.4 of this part.

(b) Covered FSI. For purposes of this part a covered FSI means

(1) Any state savings association or state non-member bank (as defined in the Federal Deposit Insurance Act, 12 U.S.C. 1813(e)(2)) that is a direct or indirect subsidiary of (i) a global systemically important bank holding company that has been designated pursuant to section 252.82 (a)(1) of the Federal Reserve Board’s Regulation YY (12 CFR Part 252.82); or (ii) a global systemically important foreign banking organization that has been designated pursuant to Subpart I of 12 CFR Part 252 (FRB Regulation YY), and

(2) Any subsidiary of a covered FSI other than,

(i) A subsidiary that is owned in satisfaction of debt previously contracted in good faith;

(ii) A portfolio concern that is a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), or that has received from the

Small Business Administration notice to proceed to qualify for a license as a Small Business Investment Company, which notice or license has not been revoked; or

(iii) A subsidiary designed to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), including the welfare of low- to moderate-income communities or families (such as providing housing, services, or jobs).

(c) Covered QFCs. For purposes of this part, a covered QFC is:

(1) With respect to a covered FSI that is a covered FSI on January 1, 2018, an in-scope QFC that the covered FSI:

(i) Enters, executes, or otherwise becomes a party to on or after January 1, 2019; or

(ii) Entered, executed, or otherwise became a party to before January 19, 2019, if the covered FSI or any affiliate that is a covered entity, covered bank, or covered FSI also enters, executes, or otherwise becomes a party to a QFC with the same person or a consolidated affiliate of the same person on or after January 1, 2019.

(2) With respect to a covered FSI that becomes a covered FSI after January 1, 2018, an in-scope QFC that the covered FSI:

(i) Enters, executes, or otherwise becomes a party to on or after the later of the date the covered FSI first becomes a covered FSI and January 1, 2019; or

(ii) Entered, executed, or otherwise became a party to before the date identified in paragraph (c)(2)(i) of this § 382.2 with respect to the covered FSI, if the covered FSI or any affiliate that is a covered entity, covered bank or covered FSI also enters, executes, or otherwise becomes a party to a QFC with the same person or consolidated affiliate of the same person on or after the date identified in paragraph (c)(2)(i) with respect to the covered FSI.

(d) In-scope QFCs. An in-scope QFC is a QFC that explicitly:

(1) Restricts the transfer of a QFC (or any interest or obligation in or under, or any property securing, the QFC) from a covered FSI; or

(2) Provides one or more default rights with respect to a QFC that may be exercised against a covered FSI.

(e) Rules of construction. For purposes of this part,

(1) A covered FSI does not become a party to a QFC solely by acting as agent with respect to the QFC; and

(2) 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.

(f) Initial applicability of requirements for covered QFCs. (1) With respect to each of its covered QFCs, a covered FSI that is a covered FSI on January 1, 2018 must conform the covered QFC to the requirements of this part by:

(i) January 1, 2019, if each party to the covered QFC is a covered entity, covered bank, or covered FSI.

(ii) July 1, 2019, if each party to the covered QFC (other than the covered FSI) is a financial counterparty that is not a covered entity, covered bank or covered FSI; or

(iii) January 1, 2020, if a party to the covered QFC (other than the covered FSI) is not described in paragraphs (f)(1)(i) or (f)(1)(ii) of this § 382.2 or if, notwithstanding paragraph (f)(1)(ii), a party to the covered QFC (other than the covered FSI) is a small financial institution.

(2) With respect to each of its covered QFCs, a covered FSI that is not a covered FSI on January 1, 2018 must conform the covered QFC to the requirements of this part by:

(i) The first day of the calendar quarter immediately following 1 year after the date the covered FSI first becomes a covered FSI if each party to the covered QFC is a covered entity, covered bank, or covered FSI;

(ii) The first day of the calendar quarter immediately following 18 months from the date the covered FSI first becomes a covered FSI if each party to the covered QFC (other than the covered FSI) is a financial counterparty that is not a covered entity, covered bank or covered FSI; or

(iii) The first day of the calendar quarter immediately following 2 years from the date the covered FSI first becomes a covered FSI if a party to the covered QFC (other than the covered FSI) is not described in paragraphs (f)(2)(i) or (f)(2)(ii) of this § 382.2 or if, notwithstanding paragraph (f)(2)(ii), a party to the covered QFC (other than the covered FSI) is a small financial institution.

(g) Rights of receiver unaffected. Nothing in this part shall in any manner limit or modify the rights and powers of the FDIC as receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Act, including, without limitation, the rights of the receiver to enforce provisions of the Federal Deposit Insurance Act or Title II of the Dodd-Frank Act that limit the enforceability of certain contractual provisions.

§ 382.3 U.S. Special Resolution Regimes.

(a) Covered QFCs not required to be conformed. (1) Notwithstanding § 382.2 of this part, a covered FSI is not required to conform a covered QFC to the requirements of this § 382.3 if:

(i) The covered QFC designates, in the manner described in paragraph (a)(2) of this § 382.3, the U.S. special resolution regimes as part of the law governing the QFC; and

- (ii) Each party to the covered QFC, other than the covered FSI, is
 - (A) An individual that is domiciled in the United States, including any State;
 - (B) A company that is incorporated in or organized under the laws of the United States or any State;
 - (C) A company the principal place of business of which is located in the United States, including any State; or
 - (D) A U.S. branch or U.S. agency.
- (2) A covered QFC designates the U.S. special resolution regimes as part of the law governing the QFC if the covered QFC:
 - (i) Explicitly provides that the covered QFC is governed by the laws of the United States or a state of the United States; and
 - (ii) Does not explicitly provide that one or both of the U.S. special resolution regimes, or a broader set of laws that includes a U.S. special resolution regime, is excluded from the laws governing the covered QFC.
- (b) Provisions required. A covered QFC must explicitly provide that:
 - (1) In the event the covered FSI becomes subject to a proceeding under a U.S. special resolution regime, the transfer of the covered QFC (and any interest and obligation in or under, and any property securing, the covered QFC) from the covered FSI will be effective to the same extent as the transfer would be effective under the U.S. special resolution regime 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
 - (2) In the event the covered FSI or an affiliate of the covered FSI becomes subject to a proceeding under a U.S. special resolution regime, default rights with respect to the covered

QFC that may be exercised against the covered FSI are permitted to be exercised to no greater extent than the default rights could be exercised under the U.S. special resolution regime if the covered QFC were governed by the laws of the United States or a state of the United States.

(c) Relevance of creditor protection provisions. The requirements of this section apply notwithstanding paragraphs (d), (f), and (h) of § 382.4.

§ 382.4 Insolvency Proceedings.

This section 382.4 does not apply to proceedings under Title II of the Dodd-Frank Act.

(a) Covered QFCs not required to be conformed. Notwithstanding paragraph § 382.2 of this part, a covered FSI is not required to conform a covered QFC to the requirements of this § 382.4 if the covered QFC:

(1) Does not explicitly provide 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; and

(2) Does not explicitly 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 or following an affiliate of the direct party becoming subject to a receivership, insolvency, liquidation, resolution, or similar proceeding or would prohibit such a transfer only if 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.

(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 or following 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, covered bank, or covered FSI 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) 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;

(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.

(e) Definitions relevant to the general creditor protections.

(1) Covered direct QFC. Covered direct QFC means a direct QFC to which a covered entity, covered bank, or covered FSI is a party.

(2) Covered affiliate credit enhancement. Covered affiliate credit enhancement means an affiliate credit enhancement in which a covered entity, covered bank, or covered FSI 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.

(f) Additional creditor protections for supported QFCs. Notwithstanding paragraph (b) of this § 382.4, 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 after the stay period that is related, directly or indirectly, to the covered affiliate support provider becoming subject to a receivership, insolvency, liquidation, resolution, or similar proceeding 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 (h) 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 (f)(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 (f)(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.

(g) 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 resolution, restructuring, or reorganization involving the covered affiliate support provider.

(h) Creditor protections related to FDI Act proceedings. Notwithstanding paragraphs (d) and (f) of this section, which are inapplicable to FDI Act proceedings, and 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 only in the following circumstances:

(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.

(i) 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.

§ 382.5 Approval of Enhanced Creditor Protection Conditions.

(a) Protocol compliance. (1) Unless the FDIC determines otherwise based on the specific facts and circumstances, a covered QFC is deemed to comply with this part if it is amended by the universal protocol or the U.S. protocol.

(2) A covered QFC will be deemed to be amended by the universal protocol for purposes of paragraph (a)(1) of this § 382.5 notwithstanding the covered QFC being amended by one or more Country Annexes, as the term is defined in the universal protocol.

(3) For purposes of paragraphs (a)(1) and (a)(2) of this § 382.5:

(i) The universal protocol means 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;

(ii) The U.S. protocol means a protocol that is the same as the universal protocol other than as provided in paragraphs (a)(3)(ii)(A)-(F) of this § 382.5.

(A) The provisions of Section 1 of the attachment to the universal protocol may be limited in their application to covered entities, covered banks, and covered FSIs and may be limited with respect to resolutions under the Identified Regimes, as those regimes are identified by the universal protocol;

(B) The provisions of Section 2 of the attachment to the universal protocol may be limited in their application to covered entities, covered banks, and covered FSIs;

(C) The provisions of Section 4(b)(i)(A) of the attachment to the universal protocol must not apply with respect to U.S. special resolution regimes;

(D) The provisions of Section 4(b) of the attachment to the universal protocol may only be effective to the extent that the covered QFCs affected by an adherent's election thereunder would continue to meet the requirements of this part;

(E) The provisions of Section 2(k) of the attachment to the universal protocol must not apply; and

(F) The U.S. protocol may include minor and technical differences from the universal protocol and differences necessary to conform the U.S. protocol to the differences described in paragraphs (a)(3)(ii)(A)-(E) of this § 382.5.

(iii) Amended by the universal protocol or the U.S. protocol, with respect to covered QFCs between adherents to the protocol, includes amendments through incorporation of the terms of the protocol (by reference or otherwise) into the covered QFC; and

(iv) The attachment to the universal protocol means the attachment that the universal protocol identifies as "ATTACHMENT to the ISDA 2015 UNIVERSAL RESOLUTION STAY PROTOCOL."

(b) Proposal of enhanced creditor protection conditions. (1) A covered FSI may request that the FDIC approve as compliant with the requirements of §§382.3 and § 382.4 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 § 382.4(b) of this part that is different than that of paragraphs (d), (f), and (h) of § 382.4.

(3) A covered FSI 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 FDIC requests.

(c) FDIC approval. The FDIC may approve, subject to any conditions or commitments the FDIC may set, a proposal by a covered FSI under paragraph (b) of this section if the proposal, as compared to a covered QFC that contains only the limited exemptions in paragraphs (d), (f), and (h) of § 382.4 or that is amended as provided under paragraph (a) of this section, would promote the safety and soundness of covered FSIs by mitigating the potential destabilizing effects of the resolution of a global significantly important banking entity that is an affiliate of the covered FSI to at least the same extent.

(d) Considerations. In reviewing a proposal under this section, the FDIC 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 FSIs during distress or increase the impact on U.S. financial stability were one or more of the covered FSIs to fail;

(2) Whether, and the extent to which, the proposal would materially decrease the ability of a covered FSI, or an affiliate of a covered FSI, 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 FSIs;

(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 FSIs;

(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.

§ 382.6 [Reserved.]

§ 382.7 Exclusion of Certain QFCs.

(a) Exclusion of QFCs with FMUs. Notwithstanding § 382.2 of this part, a covered FSI is not required to conform to the requirements of this part a covered QFC to which:

(1) A CCP is party; or

(2) Each party (other than the covered FSI) is an FMU.

(b) Exclusion of certain covered entity and covered bank QFCs. If a covered QFC is also a covered QFC under part 252 or part 47 of this title that an affiliate of the covered entity is also required to conform pursuant to part 252 or part 47 and the covered FSI is:

(1) The affiliate credit enhancement provider with respect to the covered QFC, then the covered FSI is required to conform the credit enhancement to the requirements of this part but is not required to conform the direct QFC to the requirements of this part; or

(2) The direct party to which the covered entity or covered bank is the affiliate credit enhancement provider, then the covered FSI is required to conform the direct QFC to the requirements of this part but is not required to conform the credit enhancement to the requirements of this part.

(c) Exclusion of certain contracts. Notwithstanding § 382.2, a covered FSI is not required to conform the following types of contracts or agreements to the requirements of this part:

(1) An investment advisory contract that:

(i) Is with a retail customer or counterparty;

(ii) Does not explicitly restrict the transfer of the contract (or any QFC entered into pursuant thereto or governed thereby, or any interest or obligation in or under, or any property securing, any such QFC or the contract) from the covered FSI except as necessary to comply with section 205(a)(2) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-5(a)(2)); and

(iii) Does not explicitly provide a default right with respect to the contract or any QFC entered pursuant thereto or governed thereby.

(2) A warrant that:

(i) Evidences a right to subscribe to or otherwise acquire a security of the covered FSI or an affiliate of the covered FSI; and

(ii) Was issued prior to January 1, 2018.

(d) Exemption by order. The FDIC may exempt by order one or more covered FSI(s) from conforming one or more contracts or types of contracts to one or more of the requirements of this part after considering:

(1) The potential impact of the exemption on the ability of the covered FSI(s), or affiliates of the covered FSI(s), 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;

(2) The burden the exemption would relieve; and

(3) Any other factor the FDIC deems relevant.

Dated at Washington, D.C., this 27th day of September, 2017.

By order of the Board of Directors

Federal Deposit Insurance Corporation.

Valerie J. Best

Assistant Executive Secretary.