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Opening Statement on the Proposed Rule to Restrict Qualified Financial Contracts
by Governor Daniel K. Tarullo

The proposed regulation before us today represents another step forward in our efforts to make financial firms resolvable without either injecting public capital or endangering the overall stability of the financial system.

An important difference between large financial firms and most non-financial firms is that the former usually are party to large numbers of qualified financial contracts ("QFCs"), which are by statute exempted from the automatic stay provisions of bankruptcy law that govern most other kinds of contracts and that allow firms entering bankruptcy to continue operations even as creditors' rights are determined in judicial proceedings. A financial firm entering bankruptcy is thus subject to an immediate and potentially destabilizing unwinding of derivatives, repo, and other instruments included within the definition of QFCs even if the firm or its affiliates continue to perform on the contracts. The consequences can include loss of important funding sources and firesales of the collateral underlying these contracts.

The FDIC's bank resolution authority under the Federal Deposit Insurance Act and the orderly liquidation authority included in Title II of the Dodd-Frank Act provide for a one-business-day stay on the unwinding of QFCs, during which the resolution authority can choose which QFCs to have transferred to a solvent affiliate of the firm or a third party. However, there could be some question as to whether a foreign jurisdiction would recognize the exercise of this authority with respect to QFCs previously executed by a now insolvent U.S. financial firm or its subsidiaries in that jurisdiction.

To address both of these impediments to orderly resolution of large financial firms, the Federal Reserve joined a number of its international counterparts in working with the International Swaps and Derivatives Association (ISDA) to develop a protocol that allows the QFCs of the most systemically important firms to include provisions effectively extending the Title II QFC stay-and-transfer provisions to a range of resolution scenarios initiated under insolvency proceedings involving these firms. The eight U.S. firms that we have identified as carrying global systemic importance have already adhered to this protocol as part of their resolution planning process.

The regulation proposed by staff today would follow through on this work first by completing the regulatory process contemplated in the ISDA protocol and, second, by extending its requirements beyond transactions among systemically important banking organizations to transactions of these firms with *all* counterparties. In approving this proposal for comment and, eventually, adopting a final regulation, we have the opportunity to consolidate the substantial progress made in containing the risks to financial stability that can arise from QFCs. Nonetheless, if Congress at some point addresses bankruptcy provisions applicable to financial firms, it could be useful to reconsider the breadth of collateral types that currently are eligible for QFC treatment.