The Federal Reserve Board on Friday adopted a final rule to enhance financial stability by requiring U.S. global systemically important banking institutions (GSIBs) and the U.S. operations of foreign GSIBs to amend qualified financial contracts to prevent their immediate cancellation or termination if the firm enters bankruptcy or a resolution process.

Qualified financial contracts (QFCs) include derivatives, securities lending, and short-term funding transactions such as repurchase agreements. Given the large volume of QFCs to which GSIBs are a party, the mass termination of QFCs in the event of financial distress or failure of a GSIB may lead to the disorderly failure of the firm, spark asset fire sales, and transmit financial distress across the U.S. financial system. The final rule contains two key requirements. First, the final rule requires QFCs of GSIBs, including those with foreign counterparties, to clarify that U.S. resolution laws providing for a temporary stay to prevent mass terminations apply to the contracts. Second, the final rule prohibits the QFCs of GSIBs from allowing the exercise of default rights that could spread the bankruptcy of one GSIB entity to its solvent affiliates.

"The final rule will reduce the threat that a disorderly unraveling of QFCs would pose to our financial system and the broader economy," said Governor Jerome H. Powell.

GSIBs may comply with the final rule by using the International Swaps and Derivatives Association (ISDA) 2015 Universal Resolution Stay Protocol or a similar resolution stay protocol described in the final regulation to amend their QFCs.

In response to comments, the Board tailored the transition period based on the type of counterparty. The final rule requires GSIBs to conform their QFCs with other GSIBs within one year and within 18 months for QFCs with most other financial counterparties. Additionally, GSIBs would have two years to conform QFCs with community banks and all other counterparties. The final rule also excludes QFCs that do not contain default rights or restrictions that could undermine the orderly resolution of a GSIB.

Compliance will phase in beginning on January 1, 2019.

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