

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Parts 3, 47 and 50

[Docket ID OCC–2016–0009]

RIN 1557–AE05

Mandatory Contractual Stay Requirements for Qualified Financial Contracts

AGENCY: Office of the Comptroller of the Currency, Treasury (OCC).

ACTION: Final rule.

SUMMARY: The OCC is adopting a final rule that adds a new part to its rules to enhance the resilience and the safety and soundness of federally chartered and licensed financial institutions by addressing concerns relating to the exercise of default rights of certain financial contracts that could interfere with the orderly resolution of certain systemically important financial firms. Under the final rule, a covered bank is required to ensure that a covered qualified financial contract contains a contractual stay-and-transfer provision analogous to the statutory stay-and-transfer provision imposed under Title II of the Dodd-Frank, Wall Street Reform and Consumer Protection Act and in the Federal Deposit Insurance Act, and limits the exercise of default rights based on the insolvency of an affiliate of the covered bank. In addition, this final rule makes conforming amendments to the Capital Adequacy Standards and the Liquidity Risk Measurement Standards in its regulations. The requirements of this final rule are substantively identical to those adopted in the final rules issued by the Board of Governors of the Federal Reserve System and by the Federal Deposit Insurance Corporation.

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

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I. Introduction

In the wake of the financial crisis of 2007–2008, U.S. and international financial regulators have placed increased focus on improving the resolvability of large, complex financial institutions that operate in multiple jurisdictions, which are often referred to as global systemically important banking organizations (GSIBs). In connection with these ongoing efforts, the Office of the Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (FRB) worked jointly to develop and issue two separate notice of proposed rulemakings (NPRMs). The FRB issued an NPRM on May 3, 2016 (FRB Proposed Rule); the OCC issued an

NPRM on August 19, 2017 (OCC Proposed Rule).¹ The FRB Proposed Rule and the OCC Proposed Rule were substantively identical, with any differences generally relating to differences in the types of entities supervised by the FRB and OCC—the FRB Proposed Rule primarily addressed entities at the bank holding company level, while the OCC Proposed Rule addressed entities at the bank level (specifically, national banks, Federal savings associations (FSAs), and Federal branches and agencies). The Federal Deposit Insurance Corporation (FDIC) issued an NPRM on October 26, 2016, which paralleled the FRB Proposed Rule and the OCC Proposed Rule.² The OCC, FRB, and FDIC issued these NPRMs (hereinafter collectively referred to as the “Agencies’ NPRMs”) as part of their ongoing efforts to improve the resolvability of U.S. GSIBs and Foreign GSIBs that operate in the United States.³

The OCC received 21 comments on the proposed rule,⁴ representing comments from banks and other financial institutions, trade associations, and individuals. Most of the comments submitted to the OCC were also submitted to the FRB and FDIC. As part of the effort to coordinate development of the final rules, all comments were shared among the Federal banking agencies (OCC, FRB, and FDIC).

The OCC has carefully reviewed all of the comments received. The proposed rule and the comments are discussed in Section III (Discussion of the Final Rule) of the preamble. The OCC notes that many of the comments submitted to the OCC also included attachments with the comments submitted to the FRB and FDIC. The OCC further notes that to the degree applicable, all comments submitted as attachments were treated

¹ 81 FR 29169 (May 11, 2016) (Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions) (FRB Proposed Rule); 81 FR 55381 (August 19, 2017) (Mandatory Contractual Stay Requirements for Qualified Financial Contracts) (OCC Proposed Rule).

² 81 FR 74326 (October 26, 2016) (Restrictions on Qualified Financial Contracts of Certain FDIC-Supervised Institutions; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions) (FDIC Proposed Rule).

³ While the focus of the discussion in this preamble is on the impact of the OCC Proposed Rule specifically on national banks, FSAs, Federal branches and agencies, and generally on the national banking system, in light of the parallel nature of the OCC, FRB, and FDIC NPRMs, portions of the discussion in this preamble may be equally applicable to the FRB Proposed Rule and FDIC Proposed Rule.

⁴ Unless otherwise noted, any reference to the “proposed rule” in this preamble is intended to refer to the OCC Proposed Rule.

as comments on the OCC Proposed Rule. As such, for discussion purposes these comments may be recharacterized or otherwise paraphrased in this preamble to reflect the points applicable to this final rule. In some instances, however, the preamble may discuss a comment that is not directly relevant to this final rule but illustrates the interaction between this final rule and the final rules of the FRB and FDIC. This is likely to be the case with respect to comments submitted to the FRB that address broad policy issues, such as the systemic risk of GSIBs.

A. Shared Policy Concerns of the Federal Banking Agencies

At the most basic level, the collective purpose of Agencies' NPRMs is to address a common supervisory concern raised by the resolvability of large, complex financial institutions in the United States that operate in multiple jurisdictions and that are subject to different supervisory authorities.⁵ The Agencies' NPRMs reflected the coordinated efforts by the Federal banking agencies to develop a comprehensive U.S. regulatory framework, designed to be implemented by the OCC, FRB, and FDIC to apply to all entities of a GSIB in the United States to address the threat to financial stability posed by the disorderly exercise of default rights contained in certain qualified financial contracts (QFCs).

The threat to financial stability arises because all GSIBs are interconnected with other financial firms, including other GSIBs, through large volumes of QFCs. The failure of one entity within a GSIB can trigger disruptive terminations of these contracts if the counterparties of both the failed entity and its affiliates exercise their contractual rights to terminate the contracts and liquidate collateral. These terminations, especially if many counterparties lose confidence in the GSIB quickly, can destabilize the financial system and potentially spark a financial crisis through several channels. For example, such terminations can destabilize the failed entity's otherwise solvent affiliates, causing them to weaken or fail with adverse consequences to their counterparties that can result in a chain reaction that ripples through the financial system. They also may result in "fire sales" of large volumes of financial assets, in particular, the

collateral that secures the contracts, which can in turn weaken and cause stress for other firms by depressing the value of similar assets that they hold.

The Agencies' NPRMs, generally would require banking organizations that are covered by the NPRMs to ensure that their covered QFCs: (1) Contain a contractual stay-and-transfer provision analogous to the statutory stay-and-transfer provision imposed under Title II of the Dodd-Frank, Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),⁶ and in the Federal Deposit Insurance Act (FDI Act),⁷ and (2) limit the exercise of default rights based on the insolvency of an affiliate of the financial firm.

In the United States, the FDI Act and the Dodd-Frank Act create special resolution frameworks for failed financial firms that provide that the rights of a failed financial firm's counterparties to terminate their QFCs are temporarily stayed when the financial firm enters a resolution proceeding to allow for the transfer of the relevant obligations under the QFC to a solvent entity. By requiring covered QFCs to contain a contractual stay-and-transfer provision analogous to the statutory stay-and-transfer provision imposed under the FDI Act and Title II of the Dodd-Frank Act, the counterparties of QFCs have essentially contractually opted into the FDI Act and Title II of the Dodd-Frank Act temporary stay-and-transfer treatment. In this way, the Agencies' NPRMs address the concern that the statutory stay-and-transfer treatment would be challenged by a QFC counterparty, and might not be enforced by a court in a foreign jurisdiction.

With respect to the default rights based on the insolvency of an affiliate, the Agencies' NPRMs required covered QFCs to contain mandatory contractual provisions that would prohibit the counterparties of the QFCs from exercising default rights related, directly or indirectly, to the entry into resolution of an affiliate of the banking organizations covered by the NPRMs (cross-default rights), subject to certain creditor protection exceptions.

B. Specific Policy Concerns Affecting National Banks, FSAs and Federal Branches and Agencies

While the OCC shares many of the overall policy concerns discussed in Section I–A with the FRB and FDIC

with respect to the resolvability of large, complex financial institutions in the United States, the primary focus of this final rule is specifically on the safety and soundness of national banks, FSAs, and Federal branches and agencies, as well as the overall stability of the Federal banking system,⁸ as posed by the disorderly exercise of default rights contained in QFCs. As the primary regulator for national banks, FSAs, and Federal branches and agencies (generally referred to as "OCC-supervised institutions"), the OCC has a strong safety and soundness interest in preventing such a disorderly termination of QFCs upon a GSIB's entry into resolution proceedings. QFCs are typically entered into by various operating entities in the GSIB group, which will often include a large depository institution that is subject to the OCC's supervision. These OCC-supervised institutions typically are some of the largest entities by asset size in the GSIB group, and often a party to large volumes of QFCs, making these institutions highly interconnected with other large financial firms.⁹ The exercise of default rights against an otherwise healthy national bank, FSA, or Federal branch or agency resulting from the failure of its affiliate, for example its top-tier U.S. holding company, may cause it to weaken or fail, and in turn spread contagion throughout the U.S. financial system, including the national banking system, by causing a chain of failures by other financial institutions—including other national banks, FSAs, or Federal branches or agencies—that are its QFC counterparties. Furthermore, if an OCC-supervised institution were to fail, it is imperative that the default rights triggered by such an event are exercised in an orderly manner, both by domestic and foreign counterparties, to ensure that financial contagion does not spread to other federally chartered and licensed institutions and beyond, throughout the Federal banking system.

Accordingly, OCC-supervised institutions that are affiliates or branches of U.S. GSIBs or Foreign GSIBs are exposed, through the interconnectedness of their QFCs and the QFCs of their affiliates, to destabilizing effects if their counterparties or the counterparties of their affiliates exercise default rights upon the entry into resolution of the

⁵ This section is only intended to give a general overview of the NPRMs issued by the OCC, FRB, and FDIC. Please refer to the NPRMs and final rules of each of the Federal banking agencies for any specific issues.

⁶ 12 U.S.C. 5390(c)(9) (empowering the FDIC to transfer QFCs); 12 U.S.C. 5390(c)(10)(B)(i)(I) (providing for a temporary stay that generally lasts until 5:00 p.m. eastern time on the business day following the appointment of the FDIC as receiver).

⁷ See 12 U.S.C. 1821(e)(8)–(10).

⁸ The term "Federal banking system" refers to all OCC-supervised institutions, including national banks, FSAs, and Federal branches and agencies.

⁹ 81 FR 29619, 29172 ("From the standpoint of financial stability, the most important of these operating subsidiaries are generally a U.S. insured depository institution, a U.S. broker-dealer, and similar entities organized in other countries.").

OCC-supervised institution or any affiliate of the OCC-supervised institution. These potential destabilizing effects are best addressed by requiring all GSIB entities to amend their QFCs to include contractual provisions designed to avoid such destabilization. As the primary supervisor of national banks, FSAs, and Federal branches and agencies, the OCC has a significant interest in preventing or mitigating these destabilizing effects on the safety and soundness of not just the OCC-supervised institutions within a GSIB group, but to all OCC-supervised institutions in the Federal banking system. Measures to improve financial stability and the probability of a successful resolution of a GSIB likely will affect the operations of the OCC-supervised institutions that are within the GSIB group.

The OCC believes that each of the Federal banking agencies share a collective interest to insure the orderly resolution of all entities that make up a GSIB group. This final rule represents the OCC's effort to help address this systemic issue with respect to OCC-supervised institutions. Consequently, for the reasons discussed in this preamble, the OCC is issuing this final rule, which imposes substantively identical requirements on national banks, FSAs, and Federal branches and agencies as those imposed by the FRB and FDIC final rules.¹⁰

II. Background

The following background discussion describes in detail the financial contracts that are the subject of this final rule, the default rights often contained in such contracts, and impacts on financial stability resulting from the exercise of such default rights. This section also provides in more detail background information on the resolution strategies for GSIBs and how they fit within the resolution frameworks in the United States.

A. Qualified Financial Contracts, Default Rights, and Financial Stability

The final rule covers QFCs, which include swaps, other derivative contracts, repurchase agreements (repos)

and reverse repos, and securities lending and borrowing agreements. GSIB entities enter into QFCs to borrow money to finance their investments, to lend money, to manage risk, to attempt to profit from market movements, and to enable their clients and counterparties to perform these financial activities.

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 may pose a threat to financial stability in times of stress. The final rule focuses on one of the most serious threats to both a global systemically important bank holding company (BHC) and its covered banks' subsidiaries—the failure of a GSIB that is party to large volumes of QFCs, which are likely to include QFCs with counterparties that are themselves systemically important. By contract, a party to a QFC generally has the right to take certain actions if its counterparty defaults on the QFC (that is, if it fails to meet certain contractual obligations). Common default rights include the right to suspend performance of the non-defaulting party's obligations, the right to terminate or accelerate the contract, the right to set off amounts owed between the parties, and the right to seize and liquidate the defaulting party's collateral. In general, default rights allow a party to a QFC to reduce the credit risk associated with the QFC by granting it the right to exit the QFC and thereby reduce its exposure to its counterparty upon the occurrence of a specified condition, such as its counterparty's entry into resolution proceedings.

This final rule focuses on two distinct scenarios in which a non-defaulting party to a QFC is commonly able to exercise default rights. These two scenarios involve a default that occurs when either the defaulting party to the QFC or an affiliate of that party enters a resolution proceeding.¹¹

¹¹ This preamble uses phrases such as “entering a resolution proceeding” and “going into resolution” to refer to the concept of “becoming subject to a receivership, insolvency, liquidation, resolution, or similar proceeding.” These phrases refer to proceedings established by law to deal with a failed legal entity. In the context of the failure of a global systemically important BHC, the most relevant types of resolution proceeding include: (1) For most US-based legal entities, the bankruptcy process established by the U.S. Bankruptcy Code (Title 11, United States Code); (2) for U.S. insured depository institutions, a receivership administered by the FDIC under the FDI Act (12 U.S.C. 1821); (3) 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, (4) for entities based outside the United States, resolution proceedings created by foreign law.

The first scenario occurs when a legal entity that is itself a party to the QFC enters a resolution proceeding. This final rule refers to such a scenario as a “direct default” and refers to the contractual default rights that arise from a direct default as “direct default rights.”¹²

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

Direct default rights and cross-default rights are referred to collectively in this final rule as “default rights.”

As noted in the OCC Proposed Rule, if a significant number of QFC counterparties exercise their default rights precipitously and in a manner that would impede an orderly resolution of a GSIB, all QFC counterparties and the broader financial system, including institutions supervised by the OCC, may potentially be worse off and less stable.

The destabilization can occur in several ways. First, counterparties' exercise of default rights may drain liquidity from the troubled GSIB, forcing it to sell off assets at depressed prices, both because the sales must be done in a short timeframe and because the elevated supply will push prices down. These asset “fire sales” may cause or deepen balance-sheet insolvency at the GSIB, reducing the amount that its other creditors can recover and thereby imposing losses on those creditors and threatening their solvency (and, indirectly, the solvency of their own creditors, and so on). The GSIB may also respond by withdrawing liquidity that it had offered to other firms, forcing them to engage in asset fire sales. Alternatively, if the GSIB's QFC counterparty itself liquidates the QFC collateral at fire sale prices, the effect will again be to weaken the GSIB's balance sheet, because the debt satisfied by the liquidation would be less than

¹² For convenience, this preamble uses the general term “default” to refer specifically to a default that occurs when a QFC party or its affiliate enters a resolution proceeding.

¹⁰ “Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions,” 82 FR 42882 (September 12, 2017) (FRB Final Rule). See also 12 U.S.C. 5365(b)(4) (requiring the FRB to consult with each Financial Stability Oversight Council (FSOC) member that primarily supervises any subsidiary when any prudential standard is likely to have a “significant impact” on such subsidiary).

what the value of the collateral would have been outside the fire sale context. The counterparty's set-off rights may allow it to further drain the GSIB's capital and liquidity by withholding payments owed to the GSIB. The GSIB may also have rehypothecated collateral that it received from QFC counterparties, for instance in back-to-back repo or securities lending transactions, in which case demands from those counterparties for the early return of their rehypothecated collateral could be especially disruptive.

The asset fire sales can also spread contagion throughout the financial system by increasing volatility and by lowering the value of similar assets held by other financial institutions, potentially causing them to suffer diminished market confidence in their own solvency, mark-to-market losses, margin calls, and creditor runs (which could lead to further fire sales, thereby worsening the contagion). Finally, the early terminations of derivatives upon which the defaulting GSIB relied on to hedge its risks could leave major risks unhedged, increasing the GSIB's probable losses going forward.

Where there are significant simultaneous terminations and these effects occur contemporaneously, such as upon the failure of a GSIB that is party to a large volume of QFCs, they may pose a substantial risk to financial stability. In short, QFC continuity is important for the orderly resolution of a GSIB so that the instability caused by asset fire sales can be avoided.¹³

As will be discussed further, the final rule is primarily concerned only with default rights that run against a GSIB—that is, direct default rights and cross-default rights that arise from the entry into resolution of a GSIB. The final rule would not affect contractual default rights that a GSIB (or any other entity)

may have against a counterparty that is not a GSIB. The OCC believes that this limited scope is appropriate because the risk posed to financial stability by the exercise of QFC default rights is greatest when the defaulting counterparty is a GSIB.

B. QFC Default Rights and GSIB Resolution Strategies

Under the Dodd-Frank Act, many complex GSIBs are required to submit resolution plans to the FRB and the FDIC, detailing how the company can be resolved in a rapid and orderly manner in the event of material financial distress or failure of the company. In response to these requirements, these firms have developed resolution strategies that, broadly speaking, fall into two categories: The single-point-of-entry (SPOE) strategy and the multiple-point-of-entry (MPOE) strategy. As noted in the FRB Proposed Rule, cross-default rights in QFCs pose a potential obstacle to the implementation of either of these strategies.

In an SPOE resolution, only a single legal entity—the GSIB's top-tier BHC—would enter a resolution proceeding. The losses that led to the GSIB's failure would be passed up from the operating subsidiaries that incurred the losses to the holding company and would then be imposed on the equity holders and unsecured creditors of the holding company through the resolution process. This strategy is designed to help ensure that the GSIB's subsidiaries remain adequately capitalized. An SPOE resolution could thereby prevent those operating subsidiaries from failing or entering resolution themselves and allow them to instead continue normal operations. 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 QFC counterparties), reducing their incentive to engage in potentially destabilizing funding runs or margin calls and thus lowering the risk of asset fire sales.

An SPOE proceeding can avoid the need for covered banks to be placed into receivership or similar proceedings, as they would continue to operate as going concerns, only 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 based on an affiliate's entry into resolution proceedings, enables the SPOE strategy, and in turn, would assist in stabilizing both the covered bank and the Federal banking system.

This final rule is also intended to yield benefits for resolution under the MPOE strategy. Unlike the SPOE strategy, an MPOE strategy involves several entities in the GSIB group entering proceedings. For example, an MPOE strategy might involve a Foreign GSIB's U.S. intermediate holding company going into resolution or a GSIB's U.S. insured depository institution entering resolution under the FDI Act. Similar to the benefits associated with the SPOE strategy, this final rule would help support the continued operation of affiliates of an entity experiencing resolution to the extent the affiliate continues to perform on its QFCs.

C. Default Rights and Relevant Resolution Laws

In order to understand the connection between direct defaults, cross-defaults, the SPOE and MPOE resolution strategies, and the threats to financial stability discussed previously, it is necessary to understand how QFCs, and the default rights contained therein, are treated when an entity enters resolution. The following sections discuss the treatment of QFCs in greater detail under three U.S. resolution laws: The Bankruptcy Code, the Orderly Liquidation Authority (OLA), and the FDI Act. As discussed in these sections, each of these resolution laws has special provisions detailing the treatment of QFCs upon an entity's entry into such proceedings.

U.S. Bankruptcy Code. While covered banks themselves are not subject to resolution under the Bankruptcy Code, in general, if a BHC were to fail, it would be resolved under the Bankruptcy Code. When an entity goes into resolution under the Bankruptcy Code, attempts by the creditors of the debtor 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, which generally persists throughout the bankruptcy proceeding.¹⁴ 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. As a result, the automatic stay addresses the collective action problem, in which the creditors' individual incentives to race to recover as much from the debtor as possible

¹³ The FRB and the FDIC identified the exercise of default rights in financial contracts as a potential obstacle to orderly resolution in the context of resolution plans filed pursuant to § 165(d) of the Dodd-Frank Act, and accordingly, instructed the most systemically important firms to demonstrate that they are “amending, on an industry-wide and firm-specific basis, financial contracts to provide for a stay of certain early termination rights of external counterparties triggered by insolvency proceedings.” FRB and FDIC, “Agencies Provide Feedback on Second Round Resolution Plans of ‘First-Wave’ Filers” (August 5, 2014), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20140805a.htm>. See also FRB and FDIC, “Agencies Provide Feedback on Resolution Plans of Three Foreign Banking Organizations” (March 23, 2015), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20150323a.htm>; 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 (April 15, 2013), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20130415c2.pdf>.

¹⁴ See 11 U.S.C. 362.

before other creditors can do so, collectively cause a value-destroying disorderly liquidation of the debtor.¹⁵

The Bankruptcy Code, however, largely exempts QFC counterparties of the debtor from the automatic stay through special “safe harbor” provisions.¹⁶ Under these provisions, any contractual rights that a QFC counterparty has to terminate the contract, set off obligations, or liquidate collateral in response to a direct default or cross-default are not subject to the stay and may be exercised at any time.¹⁷

Where the failed firm is a GSIB’s holding company with covered banks that are going concerns and are party to large volumes of QFCs, the mass exercise of default rights under the QFCs based on the affiliate default represents a significant impediment to the SPOE resolution strategy.¹⁸ This is because the failure of a covered bank’s affiliate will trigger the mass exercise of cross-default rights against the covered bank, which will not be stayed by the affiliate’s entry into bankruptcy proceedings. This can in turn lead to fire sales that could threaten the ongoing viability of the covered bank and the successful resolution of the particular GSIB—and thus could also pose a threat to the Federal banking system and broader financial system.

Special Resolution Regimes Under U.S. Law. For purposes of this final rule, there are two special resolution regimes under U.S. law: Title II of the Dodd-Frank Act and the Orderly Liquidation Authority and the FDI Act. While these regimes both impose certain limitations on the ability of counterparties to exercise default rights—thus mitigating the potential for disorderly resolution due to the exercise by counterparties of such default rights—these limitations may not be applicable or clearly enforceable in certain contexts.

Title II of the Dodd-Frank Act and the Orderly Liquidation Authority. Title II of

the Dodd-Frank Act establishes an alternative resolution framework intended “to provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard.”¹⁹

As noted, although a failed BHC would generally be resolved under the Bankruptcy Code, Congress recognized that a U.S. 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 therefore authorizes the Secretary of the Treasury, upon the recommendation of other government agencies and a determination that several preconditions are met, to place a U.S. financial company into a receivership conducted by the FDIC as an alternative to bankruptcy.

Title II empowers the FDIC, when it acts as receiver in an OLA resolution, to protect financial stability against the QFC-related threats discussed previously. Title II addresses direct default rights in a number of ways. Title II empowers the FDIC to transfer the QFCs to a bridge financial company or some other financial company that is not in a resolution proceeding and should therefore be capable of performing under the QFCs.²⁰ To give the FDIC time to effect this transfer, Title II temporarily stays QFC counterparties of the failed entity from exercising termination, netting, and collateral liquidation rights “solely by reason of or incidental to” the failed entity’s entry into OLA resolution, its insolvency, or its financial condition.²¹ Once the QFCs are transferred in accordance with the statute, Title II permanently stays the exercise of those direct default rights based on the prior event of default and receivership.²²

Title II addresses cross-default rights through a similar procedure. It empowers the FDIC “to enforce contracts of subsidiaries or affiliates” of

the failed 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 counterparty’s interests by the end of the business day following the company’s entry into OLA resolution.²³

These stay-and-transfer provisions of the Dodd-Frank Act go far to mitigate the threat posed by QFC default rights by preventing mass closeouts against the entity that has entered into OLA proceedings or its going concern affiliates. At the same time, they allow for appropriate protections for QFC counterparties of the failed financial company. They only 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 brief, unless the FDIC transfers the QFCs to another financial company that is not in resolution and should therefore be capable of performing under the QFCs.

Federal Deposit Insurance Act. Under the FDI Act, a failing insured depository institution would generally enter a receivership administered by the FDIC. 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 as discussed.²⁴ However, the FDI Act does not address cross-default rights, leaving the QFC counterparties of the failed depository institution’s affiliates free to exercise any contractual rights they may have to terminate, net, and liquidate collateral based on the depository institution’s entry into resolution.

III. Discussion of the Final Rule

A. Overview, Purpose, and Authority

As discussed previously, the exercise of default rights by counterparties of a failed GSIB can have a significant impact on financial stability. This financial stability concern is necessarily intertwined with the safety and soundness of covered banks and the Federal banking system—the disorderly exercise of default rights can produce a sudden, contemporaneous threat to the safety and soundness of individual institutions throughout the system,

¹⁵ See, e.g., *Aiello v. Provident Financial Corp.*, 239 F.3d 876, 879 (7th Cir. 2001).

¹⁶ 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. See 11 U.S.C. 362(b)(6), (7), (17), (27), 362(o), 555, 556, 559, 560, and 561.

¹⁷ The Bankruptcy Code does not itself confer any default rights upon QFC counterparties; it merely permits QFC counterparties to exercise certain contractual rights that they have under the terms of the QFC. This final rule does not restrict the exercise of any default rights that fall within the Bankruptcy Code’s safe harbor provisions, which are described here to provide context.

¹⁸ As noted previously, the MPOE strategy will similarly benefit from the override of cross-defaults. The SPOE strategy is used here for illustrative purposes only.

¹⁹ 12 U.S.C. 5384(a) (section 204(a) of the Dodd-Frank Act).

²⁰ 12 U.S.C. 5390(c)(9).

²¹ 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.

²² If the QFCs are transferred to a solvent third party before the stay expires, the counterparty is permanently enjoined from exercising such rights based upon the appointment of the FDIC as receiver of the financial company (or the insolvency or financial condition of the financial company), but is not stayed from exercising such rights based upon other events of default. 12 U.S.C. 5390(c)(10)(B)(i)(II).

²³ 12 U.S.C. 5390(c)(16); 12 CFR 380.12.

²⁴ See 12 U.S.C. 1821(e)(8)–(10).

which in turn threatens the system as a whole. Accordingly, national banks, FSAs, and Federal branches and agencies are affected by financial instability—even if such instability is precipitated outside the Federal banking system—and can themselves also be sources of financial destabilization due to the interconnectedness of these institutions to each other and to other entities within the financial system. Thus, safety and soundness of individual national banks, FSAs, and Federal branches and agencies, the Federal banking system, and financial stability of the system as a whole are interconnected.

The purpose of this final rule is to enhance the safety and soundness of covered banks and the Federal banking system, thereby also bolstering financial stability generally, by addressing the two main issues raised by covered QFCs with the orderly resolution of these covered banks as generally previously described.

While Title II and the FDI Act empower the use of the QFC stay-and-transfer provisions, a court in a foreign jurisdiction may decline to enforce these important provisions. The final rule directly improves the safety and soundness of covered banks by clarifying the applicability of U.S. special resolution regimes to all counterparties, whether they are foreign or domestic. Although domestic entities are clearly subject to the temporary stay provisions of OLA and the FDI Act, these stays may be difficult to enforce in a cross-border context. As a result, domestic counterparties of a failed U.S. financial institution may be disadvantaged relative to foreign counterparties, as the domestic counterparties would be subject to the stay, and accompanying potential market volatility, while if the stay was not enforced by foreign authorities, foreign counterparties could close out immediately. Furthermore, a mass close out by such foreign counterparties would likely exacerbate market volatility, which in turn would likely magnify harm to the stayed U.S. counterparties' positions, which are likely to include other national banks and FSAs. This final rule would eliminate the potential for these adverse consequences by requiring covered banks to condition the exercise of default rights in covered contracts on the stay provisions of OLA and the FDI Act.

In spite of the QFC stay-and-transfer provisions in Title II and the FDI Act, the affiliates of a global systemically important BHC that goes into resolution under the Bankruptcy Code may face

disruptions to their QFCs as their counterparties exercise cross-default rights. Thus, a healthy covered bank whose parent BHC entered resolution proceedings could fail due to its counterparties exercising cross-default rights. This is both a safety and soundness concern for the otherwise healthy covered bank, but it also has the additional negative effect of defeating the orderly resolution of the GSIB, since a key element of SPOE resolution in the United States is ensuring that critical operating subsidiaries—such as covered banks—continue to operate on a going concern basis. This final rule would address this issue by generally restricting the exercise of cross-default rights by counterparties against a covered bank.

Moreover, a disorderly resolution of the kind described could jeopardize not just the covered bank and the orderly resolution of its failed parent BHC, but all surviving counterparties, many of which are likely to be other national banks and other FSAs, regardless of size or interconnectedness, by harming the overall condition of the Federal banking system and the financial system as a whole. A disorderly resolution could result in additional defaults, fire sales of collateral, and other consequences likely to amplify the systemic fallout of the resolution of a covered bank.

The final rule is designed to minimize such disorder, and therefore enhance the safety and soundness of all individual national banks, FSAs, and Federal branches and agencies, the Federal banking system, and the broader financial system. This is particularly important because financial institutions are more sensitive than other firms to the overall health of the financial system.²⁵

The final rule covers the OCC-supervised operations of foreign banking organizations (FBOs) designated as systemically important, including national bank and FSA subsidiaries, as well as Federal branches and agencies, of these FBOs. As with a national bank or FSA subsidiary of a U.S. global systemically important BHC, the OCC believes that this final rule should apply to a national bank or FSA

subsidiary of a global systemically important FBO for essentially the same reasons. While the national bank or FSA may not be considered systemically important itself, as part of a GSIB, the disorderly resolution of the covered national banks and FSAs could have a significant negative impact on the Federal banking system and on the U.S. financial system, in general.

Specifically, the final rule is designed to prevent the failure of a global systemically important FBO from disrupting the ongoing operations or orderly resolution of the covered bank by protecting the healthy national bank or FSA from the mass triggering of default rights by the QFC counterparties. Additionally, the application of this final rule to the QFCs of these national bank and FSA subsidiaries should avoid creating what may otherwise be an incentive for counterparties to concentrate QFCs in these firms because they are subject to fewer counterparty restrictions. Similarly, it is important to cover certain QFCs entered into by any Federal branch or agency of a global systemically important FBO in order to ensure the orderly resolution of these entities if the parent FBO were to be placed into resolution in its home jurisdiction.

The OCC is issuing this final rule under its authorities under the National Bank Act (12 U.S.C. 1 *et seq.*), the Home Owners' Loan Act (12 U.S.C. 1461 *et seq.*), and the International Banking Act of 1978 (12 U.S.C. 3101 *et seq.*), including its general rulemaking authorities.²⁶ The OCC views the final rule as consistent with its overall statutory mandate of assuring the safety and soundness of entities subject to its supervision, including national banks, FSAs, and Federal branches and agencies.²⁷

In developing this final rule, the OCC reviewed and carefully considered all comments received on the OCC Proposed Rule as part of the notice and comment process. In addition, in light of the closely connected nature between BHC supervision and the supervision of national banks, FSAs, and Federal branches and agencies, and in order to maintain substantive consistency with the FRB Proposed Rule and FDIC Proposed Rule, the OCC reviewed comments received by the FRB and FDIC on their proposed rules to the degree such comments were relevant to

²⁵ The OCC, along with the FDIC and FRB, recently made this point in the swap margin notice of proposed rulemaking. 79 FR 57348, 57361 (September 24, 2014) ("Financial firms present a higher level of risk than other types of counterparties because the profitability and viability of financial firms is more tightly linked to the health of the financial system than other types of counterparties. Because financial counterparties are more likely to default during a period of financial stress, they pose greater systemic risk and risk to the safety and soundness of the covered swap entity.").

²⁶ See 12 U.S.C. 93a, 1463(a)(2), and 3108(a).

²⁷ See 12 U.S.C. 1. This primary responsibility is also defined in various provisions throughout the OCC's express statutory authorities with respect to each institution type under their respective statutes.

the substance of this final rule. In characterizing comments and the OCC responses to the commenters in this preamble, the OCC may reference and discuss comments received by the FRB and FDIC as comments to the OCC to the extent applicable to the substance of the OCC final rule.

B. Covered Banks (§ 47.3(a), (b), and (c))

*OCC Proposed Rule.*²⁸ The proposed rule applied to “covered banks.” The term “covered bank” was defined to include (i) any national bank or FSA that is a subsidiary of a global systemically important BHC that has been designated pursuant to subpart I of 12 CFR part 252 (FRB Regulation YY); or (ii) any national bank or FSA subsidiary, or Federal branch or agency of a global systemically important FBO that has been designated pursuant to subpart I of 12 CFR part 252 (FRB Regulation YY).

The proposed rule defined global systemically important BHC and global systemically important FBO by cross-reference to newly added subpart I of 12 CFR part 252 of the FRB Proposed Rule. The list of banking organizations that meet the methodology proposed in the FRB Proposed Rule is currently the same set of banking organizations that meet the Basel Committee on Banking Supervision (BCBS) definition of a GSIB.²⁹

Under the proposed rule, the term covered bank also included any subsidiary of a national bank, FSA, or Federal branch or agency. The definition of “subsidiary of covered bank” in the proposed rule was intended to mirror the definition of subsidiary in the FRB Regulation YY (12 CFR 252.82(b)(2) and (3)), and it was intended to be substantially the same as the FRB definition with respect to a subsidiary of a covered bank.³⁰

²⁸ References in this preamble to the “proposed rule” refer to the OCC Proposed Rule unless otherwise specified.

²⁹ In November 2015, the Financial Stability Board and BCBS published a list of banks that meet the BCBS definition of a global systemically important bank (BCBS G-SIB) based on year-end 2014 data. A list based on year-end 2014 data was published November 3, 2015 (available at <http://www.fsb.org/wp-content/uploads/2015-update-of-list-of-global-systemically-important-banks-G-SIBs.pdf>). The U.S. top-tier BHCs that are currently identified as a BCBS G-SIB are Bank of America Corporation, Bank of New York Mellon Corporation, Citigroup Inc., Goldman Sachs Group, Inc., JP Morgan Chase & Co., Morgan Stanley, State Street Corporation, and Wells Fargo & Company.

³⁰ The Bank Holding Company Act (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. 12 U.S.C. 1841.

Comments. While commenters overall supported the purpose of the proposed rule, a few commenters urged the OCC not to expand the scope of covered banks to include non-GSIBs. The definition of covered bank in the proposed rule only applied to a national bank, FSA, or Federal branch or agency that is under a global systemically important BHC or FBO as designated by the FRB final rule. However, the OCC requested comment on whether an additional threshold should be added to the definition of covered bank to cover a national bank or FSA that is not under a BHC but may have total assets sufficiently large to require application of the final rule. As discussed further in the following section, the OCC has decided to add an additional provision to the definition of covered bank to capture a national bank or FSA that has more than \$700 billion in total assets as reported on its most recent Consolidated Reports of Condition and Income (Call Report).

A number of commenters urged the OCC to move to a financial consolidation standard to define a “subsidiary of a covered bank” instead of the BHC Act control standard set forth in the FRB Regulation YY.³¹ These commenters asserted that, under U.S. generally accepted accounting principles (GAAP), 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 pointed out 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 pointed out 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 raised concerns 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 are unlikely to raise the types of concerns for the orderly resolution of GSIBs targeted by the proposed rule. Commenters also noted that the International Swaps and Derivatives Association (ISDA) master agreements and Universal Protocol define “affiliate” by reference to ownership of a majority of the voting power of an entity or person. For these reasons, commenters urged the OCC to define the term “subsidiary” of a covered bank based on financial consolidation under the final rule.

Commenters generally urged that regardless of whether financial consolidation is adopted for the purpose of defining “subsidiary,” the final rule should exclude any entities over which the covered bank does not exercise operational control. Specifically, with respect to comments to the FRB Proposed Rule, commenters noted that such entities could include 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 covered entity 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).³²

Similarly, OCC commenters also requested that covered banks should exempt entities over which a covered bank does not exercise operational control. The OCC notes that with respect to covered banks, such entities would include DPC subsidiaries,³³ as well as a covered bank’s investment in community development corporations (CDCs) or small business investment corporations (SBICs).³⁴ These entities potentially present similar issues of operational control as in merchant banking, sponsored funds, and joint ventures.

In terms of foreign GSIBs, some commenters believed that FBO subsidiaries for which the FBO has been given special relief by FRB order not to hold the subsidiary under an intermediate holding company (IHC) should not be included in the definition

³² See, e.g., 12 U.S.C. 1842(a)(A)(ii), 1843(c)(2); 12 CFR 225.12(b), 225.22(d)(1).

³³ See 12 U.S.C. 29; 12 CFR 5.34; and 12 U.S.C. 1464 (FSA DPC authority).

³⁴ National banks may own or make controlling or minority investments in SBICs as defined under 13 CFR 107.50, CDCs pursuant to 12 U.S.C. 24(Eleventh), or other public welfare investments pursuant to 12 U.S.C. 24(Seventh). FSAs may also make such controlling or minority investments in SBICs and CDCs pursuant to their general lending authority under 12 U.S.C. 1464(c).

³¹ Commenters generally expressed a similar view with respect to the definition of “affiliate” of a covered bank as the term is used in §§ 47.4 and 47.5 of the proposed rule which was likewise defined by reference to BHC Act control.

of covered bank, even if such entities would be consolidated under financial consolidation principles.³⁵ These commenters asserted that since neither the covered bank nor the Foreign GSIB parent would provide credit support to these entities or name such entities in a cross-default provision in a QFC or related agreement, the failure of any of these types of entities would be unlikely to affect QFCs entered into by the covered bank or any other affiliate. These commenters further noted that the few such requests that have been granted by the FRB often involved situations in which the FBO did not have sufficient operational control over the entity to ensure its compliance. Commenters also requested that U.S. Federal branches and agencies of FBOs be excluded from the definition of “covered bank” where the FBO’s home country legal framework imposes similar requirements of the final rule on the FBO and the Federal branch or agency. These commenters asserted that the requirements of the final rule would be duplicative of the requirements with respect to such Federal branches and agencies if their QFCs are already subject to existing and substantially equivalent resolution powers in the home country, without a proportionate incremental benefit to their resolvability or reduction in risk to U.S. financial stability.³⁶

Final Rule. Under the final rule, a “covered bank” is generally defined to include (1) a national bank or FSA not under a BHC and that has more than \$700 billion in total assets as reported on their most recent Call Report, (2) a national bank or FSA that is a subsidiary of a global systemically important BHC that has been designated pursuant to subpart I of 12 CFR part 252 of this title (FRB Regulation YY); or (3) is a national bank or FSA subsidiary, or Federal branch or agency of a global systemically important FBO designated pursuant to subpart I of 12 CFR part 252 of this title (FRB Regulation YY) that has been designated pursuant to FRB Regulation YY.

The final rule generally adopts the definition of covered bank as proposed

with the exception of the addition of a provision to include a national bank or FSA not under a BHC and that has more than \$700 billion in total assets as reported on their most recent Call Report. This provision is intended to address the OCC’s concern that a national bank or FSA, not under a BHC, with a sufficient number of large total assets would be subject to the requirement of the final rule. While currently a null set, the OCC believes that any national bank or FSA that has total assets that exceed \$700 billion would raise similar concerns with respect to interconnectedness and financial contagion.

As in the proposed rule, a covered bank includes the OCC-regulated subsidiaries of entities identified as U.S. GSIB top-tier holding companies under the FRB GSIB surcharge rule.³⁷ U.S. GSIBs generally enter into QFCs through subsidiary legal entities rather than through the top-tier holding company.³⁸ Therefore, in order to increase GSIB resilience and resolvability by addressing the potential obstacles to orderly resolution posed by QFCs, it is necessary to apply the proposed restrictions to the U.S. GSIBs’ subsidiaries. In particular, to facilitate the resolution of a GSIB under an SPOE strategy, in which only the top-tier holding company would enter a resolution proceeding while its subsidiaries would continue to meet their financial obligations, or an MPOE strategy where an affiliate of an entity that is otherwise performing under a QFC enters resolution, it is necessary to ensure that those subsidiaries or affiliates do not enter into QFCs that contain cross-default rights that the counterparty could exercise based on the holding company’s or 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 of a U.S. GSIB as a covered bank should help ensure that such cross-default rights do not affect the ability of performing and solvent entities of a GSIB—regardless of jurisdiction—to remain outside of resolution proceedings.

The term “subsidiary” in the final rule continues to be defined by reference to BHC Act control as does the

definition of “affiliate.”³⁹ The final rule does not define covered banks to include only those subsidiaries of GSIBs that are financially consolidated subsidiaries 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 a 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.⁴⁰ Therefore, maintaining consistent definitions of subsidiary and affiliate with Title II should better ensure that QFC stays may be effected in a resolution under a U.S. Special Resolution Regime. As covered banks, as well as their subsidiaries and affiliates, are typically subsidiaries of BHCs, which are in turn subject to the activity restrictions and other requirements of the BHC Act, they should already know all of their BHC Act controlled subsidiaries and be familiar with BHC Act control principles.⁴¹ Moreover, GSIBs should be able to rely on governance rights and other negotiated mechanisms to ensure that such subsidiaries conform their QFCs to the final rule’s requirements.

The final rule excludes from the scope of covered bank DPC subsidiaries, portfolio companies held under the

³⁹ See 12 CFR 252.2.

⁴⁰ 12 U.S.C. 5390(c)(16).

⁴¹ For example, under the FRB final rule a covered entity may own more than five percent (and less than 25 percent) of the voting shares of a registered investment company for which the covered entity provides investment advisory, administrative, and other services and has a number of director and officer interlocks, without controlling the fund for purposes of the BHC Act. See letter to H. Rodgin Cohen, Esq., Sullivan & Cromwell (First Union Corp.), from Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (June 24, 1999) (finding that a bank holding company does not control a mutual fund for which it provides investment advisory and other services and that complies with the limitations of section 4(c)(7) of the BHC Act (12 U.S.C. 1843(c)(7)), so long as (i) the BHC reduces its interest in the fund to less than 25 percent of the fund’s voting shares after a six-month period, and (ii) a majority of the fund’s directors are independent of the BHC and the BHC cannot select a majority of the board); see also 12 CFR 225.86(b)(3) (authorizing a financial holding company to organize, sponsor, and manage a mutual fund so long as (i) the fund does not exercise managerial control over the entities in which the fund invests, and (ii) the financial holding company reduces its ownership in the fund, if any, to less than 25 percent of the equity of the fund within one year of sponsoring the fund or such additional period as the FRB permits).

³⁵ FRB orders granting such approvals to FBOs that have requested such treatment can be found at Regulation YY Foreign Banking Organization Requests, available at <https://www.federalreserve.gov/supervisionreg/regulation-yy-foreign-banking-organization-requests.htm>.

³⁶ In the alternative, these commenters requested that the requirements only apply to U.S. Federal branches and agencies of Foreign GSIBs insofar as the home resolution regime and group resolution strategy would not adequately ensure that early termination rights, including cross-default rights against the U.S. IHC or subsidiaries, will not be triggered in resolution.

³⁷ 12 CFR 217.402; 80 FR 49106 (Aug. 14, 2015). See the FRB final rule § 252.82(a)(1).

³⁸ Under the clean holding company component of the FRB’s recent Total Loss-Absorbing Capacity (TLAC) final rule, the top-tier holding companies of U.S. GSIBs would be prohibited from entering into direct QFCs with third parties. See 82 FR 8266, 8298 (December 15, 2016).

Small Business Investment Act of 1956, and certain companies engaged in the business of making public welfare investments. In general, there are legal restrictions and other limitations on the involvement of the GSIB in the operations of these kinds of subsidiaries. Moreover, it is unlikely that the disorderly unwind of the QFCs of these subsidiaries would impair the orderly resolution of the GSIB. Therefore, the impact of these exclusions should be relatively small while responding to commenter's concerns and reducing burden.

Finally, covered banks include almost all U.S. operations of Foreign GSIBs—their national banks, Federal savings associations, Federal branches, Federal agencies, or subsidiaries of such entities. The final rule, like the proposed rule, covers only the U.S. operations of Foreign GSIBs. To provide the same treatment for foreign GSIBs and U.S. GSIBs, the final rule also excludes DPC subsidiaries, portfolio companies held under the Small Business Investment Act of 1956, and public welfare investments of foreign GSIBs.⁴²

The final rule does not exempt U.S. Federal branches and agencies of Foreign GSIBs or U.S. subsidiaries of Foreign GSIBs that are not held under an IHC pursuant to a FRB order, as requested by certain commenters. As with the coverage of subsidiaries of U.S. GSIBs, coverage of the U.S. operations of foreign GSIBs will enhance the prospects for an orderly resolution of the Foreign GSIB and its U.S. operations. In particular, covering QFCs that involve any U.S. subsidiary or Federal branch or agency of a Foreign GSIB will reduce the potentially disruptive cancellation of those QFCs if the Foreign GSIB or any of its subsidiaries enters resolution, including resolution under the U.S. Bankruptcy Code or the U.S. Special Resolution Regimes.⁴³

C. Covered QFCs (Sections 47.4(a), 47.5(a), 47.7, and 47.8)

1. General Definition

Proposal. The proposed rule required covered banks to ensure that each “covered QFC” conforms to the requirements of sections 47.4 and 47.5. These sections required that a covered QFC (1) contain contractual stay-and-transfer provisions similar to those

imposed under Title II of the Dodd-Frank Act and the FDI Act, and (2) limit the exercise of default rights based on the insolvency of an affiliate of the covered bank. A “covered QFC” was generally defined as any QFC that a covered bank enters, executes, or otherwise becomes party to. A party to a QFC included a party acting as agent under the QFC. “Qualified financial contract” or “QFC” was defined to have the same meaning as in Section 210(c)(8)(D) of Title II of the Dodd-Frank Act and would include derivatives, swaps, repurchase, reverse repurchase, and securities lending and borrowing transactions.⁴⁴

Comments. The application of the proposed rule's requirements to a “covered QFC” was one of the most commented upon aspects of the proposed rule. 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 urged the OCC to exclude a variety of types of QFCs from the requirements of the final rule. In particular, a number of commenters urged the OCC to exclude 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 named several examples of contracts that fall into this category, including cash market securities transactions, certain spot foreign exchange (FX) transactions (including securities conversion transactions), retail brokerage agreements, retirement/Individual Retirement Account (IRA) account agreements, margin agreements, options agreements, FX forward master agreements, and delivery versus 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 pointed out 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 urged the OCC to exclude 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;⁴⁵ 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.⁴⁶ In these cases, commenters contended that remediation of these agreements would be burdensome with no meaningful resolution benefits.

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 the OCC to exclude 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. Although warrants issued in capital markets may contain direct default and cross-default rights as well

⁴⁵ However, some commenters noted that underwriting, purchase, subscription, or placement agency agreements may contain rights that could be construed as direct default rights or cross-default rights.

⁴⁶ 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) financial market utilities through expansion of the proposed 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.

⁴² See final rule § 47.3(b)(3)(ii)-(iv).

⁴³ The laws and regulations imposed in non-U.S. jurisdictions that commenters noted were similar to the requirements of the proposed rule do not address resolution under U.S. insolvency or the U.S. Special Resolution Regimes.

⁴⁴ 81 FR 55381, 55399 (August 19, 2016); 12 U.S.C. 5390(c)(8)(D).

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 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.⁴⁷ 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.⁴⁸ 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 on time. Commenters also contended that agreements with power operators governed by regulatory tariffs would be difficult, if not impossible, to remediate.⁴⁹

Final Rule. The final rule applies to any “covered QFC,” which generally is defined as any “in-scope QFC” that a covered entity enters into, executes, or to which the covered entity otherwise becomes a party.⁵⁰ As under the proposed rule, “qualified financial

agreements and futures account agreements); and (vi) public utility contracts.

⁴⁸ 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 § 47.5 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, § 47.5 of the final rule does not prevent a covered entity from entering into a covered QFC that allows the counterparty to exercise default rights once a covered entity that is a direct party either enters bankruptcy or fails to pay or perform under the QFC.

⁴⁹ 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 § 47.5 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 § 47.2 (defining “default right”). Therefore, § 47.5 does not restrict the ability of QFCs, including overnight repos, to terminate at the end of the term of the contract.

⁵⁰ See final rule § 47.3(c).

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.⁵¹ Parties that enter into contracts with covered entities 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, 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.

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 subject to the rule to those QFCs that explicitly restrict the transfer of a QFC from a covered bank or explicitly provide default rights that may be exercised against a covered bank (in-scope QFCs).⁵² This change addresses a major concern raised by commenters regarding the overbreadth of the definition of “covered QFC” in the proposed rule. The change also mitigates the burden of complying with the proposed rule without undermining its purpose by not requiring covered banks to conform contracts that do not contain the types of default rights and transfer restrictions that the final rule is intended to address. The OCC has declined, however, to 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 entity or its affiliate.

The final rule provides that a covered bank is not required to conform certain investment advisory contracts described by commenters (i.e., investment advisory contracts with retail advisory customers⁵³ of the covered bank that

⁵¹ See final rule § 47.2. See also 12 U.S.C. 5390(c)(8)(D).

⁵² See final rule § 47.3(d).

⁵³ See final rule § 47.8(c)(1). The final rule defines retail customer or counterparty by reference to the Board’s Regulation WW. See 12 CFR 249.3; see also FR 2052a, <https://www.federalreserve.gov/>

⁴⁷ 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

only contain the transfer restrictions required by Section 205(a) of the Investment Advisers Act). The final rule also exempts existing warrants evidencing a right to subscribe or to otherwise acquire a security of a covered bank or its affiliate.⁵⁴ The final rule excludes these types of agreements since 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 orderly resolution of a GSIB.⁵⁵

The final rule also provides the OCC with authority to exempt one or more covered banks from conforming certain contracts or types of contracts to the final rule after considering, in addition to any other factor the OCC deems relevant, the burden the exemption would relieve and the potential impact of the exemption on the resolvability of the covered bank or its affiliates.⁵⁶ Covered banks that request that the OCC exempt additional contracts from the final rule should be prepared to provide information in support of their requests. The OCC expects to consult as appropriate with the FRB and FDIC during its consideration of any such request.

2. Definition of Counterparty

Proposal. As noted above, the proposed rule applied to any “covered QFC,” generally defined as a QFC that a covered entity enters after the effective date and a QFC entered earlier, but only if the covered entity or its affiliate enters a new QFC with the same person or an affiliate of the same person.⁵⁷ “Affiliate” in the proposed rule 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.⁵⁸ 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.⁵⁹

reportforms/forms/FR_2052a20161231_f.pdf. Covered entities should be familiar with this definition and its application.

⁵⁴ See final rule § 47.8(c)(2). Warrants issued after the effective date of the final rule are not excluded from the requirements of the final rule.

⁵⁵ These exemptions are not interpretations of the definition of QFC.

⁵⁶ See final rule § 47.8(d).

⁵⁷ See proposed rule § 47.4(a). For convenience, this preamble generally refers to “a covered entity’s QFCs” or “QFCs to which a covered entity is party” as shorthand to encompass this definition. [EDIT]

⁵⁸ See 12 CFR 252.2 (defining “affiliate”).

⁵⁹ See 12 U.S.C. 1841(k).

Comments. Commenters argued that requiring remediation by a covered bank of an existing QFC if any entity in the GSIB group entered into a new QFC with an affiliate of the counterparty would make compliance with the proposed rule overly burdensome.⁶⁰ Commenters pointed out that this requirement would demand that the GSIB and the covered bank 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 entity or its affiliate entered 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 BHCs and would be unfamiliar with BHC Act control. Some 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 bank or an affiliate.

Final Rule. The final rule’s definition of “covered QFC” has been substantially modified to address the concerns raised by commenters with respect to the remediation of existing QFCs. In particular, the final rule provides that a covered QFC includes a QFC that the covered bank entered, executed, or otherwise became a party to before January 1, 2019, if the covered bank or any affiliate that is a covered entity (under the FRB final rule), covered bank, or covered FSI (under the FDIC final rule) 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, 2019.⁶¹

With respect to counterparties, the final rule has been changed to define “consolidated affiliate” by reference to

⁶⁰ 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.

⁶¹ See final rule § 47.3(c).

financial consolidation principles, as generally reflected by U.S. GAAP or International Financial Reporting Standards (IFRS)⁶² instead of by reference to the BHC Act. As commenters pointed out, counterparties will already track and monitor financially consolidated affiliates under either U.S. GAAP or IFRS. 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 bank or an affiliate of the covered bank that is either a covered bank, covered entity under FRB final rule, or a covered FSI under the FDIC final rule). As a consequence, modifying the coverage of affiliates in this manner addresses concerns raised by commenters regarding burden while still providing sufficient incentives to remediate existing covered QFCs.

As discussed, 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. 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.

3. Exclusion of Cleared QFCs and Financial Market Utilities

Proposal. The proposed rule excluded from the definition of “covered QFC” all QFCs that are cleared through a central counterparty (CCP). The proposed rule, however, did not exclude from the definition of “covered QFC” QFCs that are cleared, processed, or settled through the facilities of a financial market utility (FMU). The proposed rule noted that the OCC was continuing to consider the appropriate treatment of centrally cleared QFCs, in light of differences between cleared and uncleared QFCs with respect to contractual arrangements, counterparty credit risk, default management, and supervision.

Comments. Commenters generally expressed support for the exclusion of QFCs that are cleared through a CCP, but some commenters requested that the OCC broaden this exclusion in the final rule. In particular, a number of commenters urged the OCC to exclude the “client-facing leg” of a cleared swap

⁶² See final rule § 47.2.

where a clearing member faces a CCP on one leg of the transaction and faces the client on an otherwise identical offsetting transaction.⁶³ One commenter requested the OCC confirm its understanding that “FCM agreements,” which the commenter defined as futures and cleared swaps agreements with a futures commission merchant (FCM), 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 [a]greements are also excluded.”⁶⁴ The commenter requested, in the alternative, that the final rule expressly exclude such agreements.

A few commenters requested that the OCC modify the definition of “central counterparty,” which was defined by reference to the FRB Regulation YY⁶⁵ 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 proposed rule.⁶⁶ These commenters

⁶³ 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 covered bank or covered entity (under the FRB Proposed Rule), 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 is necessary 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 OCC to adopt the same approach taken under § 2 of the Universal Protocol, which allows the client-facing leg of the cleared swap with the clearing member that is a covered bank or covered entity 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 bank or covered entity client and its clearing member (as opposed to transactions where the covered bank or covered entity 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 bank or covered entity is a clearing member or a client. A covered QFC—generally a QFC to which a covered bank or covered entity is a party—is exempted from the requirements of the final rule if a CCP is also a party.

⁶⁴ Letter to Legislative and Regulatory Affairs Division, Office of the Comptroller of the Currency, from James M. Cain, Sutherland Asbill & Brennan LLP, writing on behalf of the eleven Federal Home Loan Banks, at 2–3 (October 18, 2016).

⁶⁵ In order to minimize the number of cross references in the definition section, where feasible, the rule replaces cross references with the actual text of the definition.

⁶⁶ 12 CFR 217.2.

argued that a CCP does far more than “facilitate” or “guarantee” trades and that a CCP “interposes itself between counterparties to contacts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer and thereby ensuring the performance of open contracts.”⁶⁷ As an alternative definition of CCP, these commenters suggested the final rule should define CCP 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.”⁶⁸

Commenters also urged the OCC 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 Act,⁶⁹ or that are entered into subject to the rules of an FMU.⁷⁰ 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 covered bank 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 entity 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 generally should be excluded for the same reasons as CCPs and that a broader

⁶⁷ Letter to Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, from Walt L. Lukken, President and CEO, Futures Industry Association, at 8 (October 17, 2016) (citing Principles of Financial Market Infrastructures (April 2012), published by the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions, at 9).

⁶⁸ *Id.* at 9.

⁶⁹ 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.*

⁷⁰ As discussed, 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 the proposed rule, requested this treatment in the alternative.

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 regulation adopted by the United Kingdom (U.K.) and Germany. 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.⁷¹ 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.

Final Rule. 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, the OCC continues to believe 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 OCC 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 entity 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 that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts, which is a broad definition used in the regulatory

⁷¹ Letter to Legislative and Regulatory Affairs Division, Office of the Comptroller of the Currency, from Larry E. Thompson, Vice Chairman and General Counsel, The Depository Trust & Clearing Corporation, at 2 (October 17, 2016); Letter to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, from Larry E. Thompson, Vice Chairman and General Counsel, The Depository Trust & Clearing Corporation, at 6 (August 5, 2016).

capital rules⁷² that should be familiar to market participants.

The final rule also makes clear that, if one or more FMUs are the only counterparties to a covered QFC, the covered bank is not required to conform the covered QFC to the final rule.⁷³ 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 banks engage in a bilateral QFC that is facilitated by an FMU, and in the course of this facilitation each covered entity maintains a QFC solely with the FMU, then the final rule would not apply to each QFC between the FMU and each covered bank but the requirements of the final rule would apply to the bilateral QFC between the two covered banks. This approach ensures that QFCs that are directly with FMUs are treated in a manner similar to transactions between covered entities and CCPs, but also ensures that QFCs conducted by covered banks 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 FCM, as requested by a commenter. The nature and scope of the 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 other clarifications and exemptions that may help address the

commenter's concern regarding FCM agreements.

4. Exclusion of Certain QFCs Under Foreign Bank Multi-Branch Master Agreements

Proposed Rule. To avoid imposing unnecessary restrictions on QFCs that are not closely connected to the United States, the proposed rule excluded from the definition of "covered QFC" certain QFCs of Foreign GSIBs that lack a close connection to the Foreign GSIB's U.S. operations.⁷⁴ The proposed definition of "QFC" included master agreements that apply to QFCs.⁷⁵ Master agreements are contracts that contain general terms that the parties wish to apply to multiple transactions between them; having executed the master agreement, the parties can then include those terms in future contracts through reference to the master agreement. Moreover, the Dodd-Frank Act's definition of "qualified financial contract," which was proposed, treats master agreements for QFCs together with all supplements to the master agreement (including underlying transactions) as a single QFC.⁷⁶

Foreign GSIBs have master agreements that permit transactions to be entered into both at a Federal branch or agency of the Foreign GSIB and at a non-U.S. location of the Foreign GSIB (such as a foreign branch). Notwithstanding the proposed rule's general treatment of a master agreement and all QFCs thereunder as a single QFC, the proposed rule would have excluded QFCs under such a "multi-branch master agreement" that are not booked at a covered bank and for which no payment or delivery may be made at a covered bank.⁷⁷ Under the proposed rule, a multi-branch master agreement was a covered QFC with respect to QFC transactions that are booked at a covered

bank or for which payment or delivery may be made at a covered bank.

Comments. Commenters expressed support for this exclusion, but requested that the requirement exclude from the definition of covered QFC those transactions under master agreements where payments and deliveries may be made by or to the Federal branch or agency so long as the transactions or assets are not booked in the Federal branch or agency. These commenters argued that the ability to make payments or deliveries alone does not make a QFC sufficiently closely connected to the United States to raise the concerns about resolution that the proposed rule was intended to address. Commenters also argued that the requirement to include new contractual terms in a QFC where payment or delivery may occur in the United States would require Foreign GSIBs to amend many additional QFCs booked abroad, many of which must also be amended to comply with contractual stay requirements of the Foreign GSIBs' home country regulatory regimes. Commenters argued that amending such QFCs under multi-branch master agreements that are not booked in the United States would require some Foreign GSIBs to amend thousands of contracts at significant cost and would impose a disproportionate burden on Foreign GSIBs as compared to U.S. GSIBs. These commenters argued this would impose a significant burden on non-U.S. covered banks with no benefit to U.S. financial stability, as these QFCs would not be expected to be subject to a U.S. resolution regime.

One commenter also recommended that multi-branch master agreements be treated as a single QFC, rather than requiring the application of different requirements to different transactions thereunder, so as to align the proposed rule's requirements with current industry-standard documentation and to avoid additional implementation hurdles and costs. The commenter recommended that the entirety of a multi-branch master agreement and underlying transactions be a covered QFC if a new QFC with the counterparty or its consolidated affiliates is booked to the Federal branch or agency after the compliance date or if a new QFC is entered into with an affiliate of the Federal branch or agency that is also subject to the requirements.

Final Rule. The final rule has been modified to address the concerns raised by commenters. In particular, the final rule is modified to provide that, with respect to a Federal branch or agency of a Foreign GSIB, a Foreign GSIB multi-branch master agreement that is a

⁷² See final rule § 47.2. The proposed rule defined CCP by cross reference to the definition in the FRB Proposed Rule, which in turn cross referenced the definition in the FRB Regulation Q (Capital Adequacy Regulations). The definition in Regulation Q (12 CFR 217.2) is the common definition of CCP also used in the OCC capital adequacy rule (12 CFR 3.2). For ease of reference, the final rule replaces these cross references with the text of the definition of CCP used in 12 CFR 3.2 and 217.2.

⁷³ See final rule § 47.8(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., FCMs).

⁷⁴ See proposed rule § 47.8.

⁷⁵ See proposed rule § 47.2.

⁷⁶ 12 U.S.C. 5390(c)(8)(D)(viii); see also 12 U.S.C. 1821(e)(8)(D)(vii); 109 H. Rpt. 31, Pt. 1 (April 8, 2005) (explaining that a "master agreement for one or more securities contracts, commodity contracts, forward contracts, repurchase agreements or swap agreements will be treated as a single QFC under the [FDI Act] or the [Federal Credit Union Act] (but only with respect to the underlying agreements are themselves QFCs)").

⁷⁷ See proposed rule § 47.8. With respect to a Federal branch or agency of a Foreign GSIB, a multi-branch master agreement that is a covered QFC solely because the master agreement permits agreements or transactions that are QFCs to be entered into at one or more Federal branches or agencies of the Foreign GSIB was considered a covered QFC for purposes of the proposed rule only with respect to such agreements or transactions booked at such Federal branches and agencies or for which a payment or delivery may be made at such Federal branches or agencies.

covered QFC solely because the master agreement permits agreements or transactions that are QFCs to be entered into at one or more Federal branches or agencies of the Foreign GSIB will be considered a covered QFC for purposes of this final rule only with respect to such agreements or transactions booked at such Federal branches and agencies.⁷⁸ The final rule does not provide that such an agreement will be a covered QFC solely because payment or delivery may be made at such Federal branch or agency. These modifications will avoid imposing unnecessary restrictions on QFCs that are not closely connected to the United States and will mitigate burden and reduce costs on Foreign GSIBs without undermining the purpose of the final rule. The purpose of this exclusion is to help ensure that, where a Foreign GSIB has a multi-branch master agreement, the Foreign GSIB will only have to conform those QFCs entered into under the multi-branch master agreement that could have the most direct effect on the covered Federal branch or agency of the Foreign GSIB and that could therefore have the most direct effect on the resolution of the Foreign GSIB and the financial stability of the United States.

The final rule does not, as requested by one commenter, deem the entirety of a multi-branch master agreement to be a covered QFC if a new QFC with the counterparty (or its consolidated affiliate) is booked to the covered entity or its affiliate. Many commenters supported excluding transactions from multi-branch master netting agreements that are not closely connected to the United States. In contrast to the proposed rule and these comments, the modification requested by this commenter would require transactions that are not booked in the United States or otherwise connected to the United States to be conformed to the requirements of the final rule. The commenter's concerns regarding costs associated with potentially breaking netting sets may nonetheless be addressed through adherence to the Universal Protocol or the U.S. Protocol, which are discussed below.

5. QFCs With Central Banks and Sovereign Entities

Proposed Rule. Section 47.7 of the proposed rule provided that a covered bank would not be required to conform covered QFCs to which a CCP was a party. However, central banks and sovereign entities are not included in the proposed rule's definition of CCP consistent with Title II of the Dodd-

Frank Act and the FDI Act. Therefore, covered QFCs entered into with sovereign entities and central banks would be required to adhere to the conformance requirements of § 47.6 of the proposed rule.

Comments. Commenters urged the OCC 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.⁷⁹ 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.

Final Rule. The OCC continues to believe that covering QFCs with sovereign entities and central banks under the final rule is an important requirement and has not modified the final rule to address the requests made by commenters. Excluding QFCs with sovereign entities 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 banks two years to conform covered QFCs with sovereign entities and central banks (as well as certain other counterparties, as discussed below). This additional time should provide covered banks sufficient time to develop separate conformance

mechanisms for sovereign entities and central banks, if necessary.

D. Definition of "Default Right"

Proposed Rule. As discussed previously, 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 which is the right to reduce the total amount that the non-defaulting party must pay by the amount that its defaulting counterparty owes. A second common default right is the right to liquidate pledged collateral and use the proceeds to pay the defaulting party's net obligation to the non-defaulting party. Other common rights include the ability to suspend or delay the non-defaulting party's performance under the contract or to accelerate the obligations of the defaulting party.

Finally, the non-defaulting party typically has the right to terminate the QFC, meaning that the parties would not make payments that would have been required under the QFC in the future. The phrase "default right" in § 47.2 of the proposed rule was broadly defined to include these common rights as well as "any similar rights." Additionally, the definition included all such rights regardless of source, including rights existing under contract, statute, or common law.

However, the proposed definition 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."⁸⁰ 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.⁸¹ The effect of these exclusions was to leave such rights unaffected by the proposed rule. The exclusions were appropriate because the proposed rule is intended to improve resolvability by addressing default rights that could disrupt an orderly resolution, and not to interrupt the parties' business-as-usual dealings under a QFC.

However, certain QFCs are also commonly subject to rights that would increase the amount of collateral or margin that the defaulting party (or a guarantor) must provide upon an event

⁷⁹ 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 proposed rule's requirements to QFCs with these entities creates a significant disincentive for these entities to enter into QFCs with covered banks, resulting in the loss of valuable counterparties in a way that will hinder market liquidity and covered entity risk management.

⁸⁰ See Proposed Rule § 47.2.

⁸¹ See *id.*

⁷⁸ See final rule § 47.7.

of default. The financial impact of such default rights on a covered bank could be similar to the impact of the liquidation and acceleration rights discussed previously. 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).⁸²

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” for purposes the proposed rule’s restrictions on cross-default rights (§ 47.5 of the proposed rule).⁸³ This was consistent with the proposed rule’s objective of restricting only default rights that are related, directly or indirectly, to the entry into resolution of an affiliate of the covered bank, while leaving other default rights unrestricted.

Comments. 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 urged that, if the OCC’s goal is to provide that a party cannot enforce a provision that requires more margin because of a credit downgrade but 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 proposed rule would permit a defaulting covered bank to

demand collateral from its QFC counterparty as margin due to a market price change, but would not allow the non-covered counterparty to demand collateral from the covered bank.

Final Rule. The final rule retains the same definition of “default right” as that of the proposed rule.⁸⁴ The OCC 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.⁸⁵

“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. 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 arise before a covered bank or its affiliate enters 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.

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

E. Required Contractual Provisions Related to U.S. Special Resolution Regimes (§ 47.4)

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 collateralizing it) from the covered bank to a transferee would be effective to the same extent as it would be under the U.S. Special Resolution Regimes if the covered QFC were governed by the laws of the United States or of a state of the United States and (b) that default rights with respect to the covered QFC that could be exercised against a covered bank 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.⁸⁶ The proposed rule would define the term “U.S. Special Resolution Regimes” to mean the FDI Act⁸⁷ and Title II of the Dodd-Frank Act,⁸⁸ along with regulations issued under those statutes.⁸⁹

Comments. A number of commenters noted that the wording of these requirements in proposed § 47.4 was confusing and could be read to be inconsistent with the intent of the section. In response to these comments, the final rule makes clearer that the substantive restrictions apply only in the event the covered bank (or, in the case of the requirement regarding default rights, its affiliate) becomes subject to a proceeding under a U.S. Special Resolution Regime.⁹⁰

A number of commenters argued that QFCs should be exempt from the requirements of § 47.4 of the proposed rule 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 § 47.4 would be redundant and would not provide any material resolution benefit, but would significantly increase the remediation burden on covered banks.

Other commenters suggested a three-prong test of “nexus with the United States” for purposes of recognizing an exclusion from the express acknowledgment of the requirements of § 47.4 of the proposed rule. In

⁸² See *id.*

⁸³ See Proposed Rule §§ 47.2 and 47.5.

⁸⁴ See final rule § 47.2.

⁸⁵ See final rule § 47.5(b).

⁸⁶ See Proposed Rule § 47.4.

⁸⁷ 12 U.S.C. 1811–1835a.

⁸⁸ 12 U.S.C. 5381–5394.

⁸⁹ See Proposed Rule § 47.2.

⁹⁰ See *id.*

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 U.S. custodian or depository pursuant to an account agreement governed by U.S. law.⁹¹ 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.

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 OCC to do so through this final rule.

Final Rule. 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 bank 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.⁹² 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 would deter counterparties of covered banks, covered entities (under the FRB final rule), or covered FSIs (under the FDIC final rule), from attempting to exercise such rights.

In response to comments, the final rule exempts from the requirements of § 47.4 a covered QFC that meets two requirements.⁹³ First, the covered QFC must state that it is governed by the laws of the United States or a State of the United States.⁹⁴ 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.⁹⁵ 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 QFC counterparty to the covered bank must be organized under the laws of the United States or a State,⁹⁶ have its principal place of business⁹⁷ located in the United States, or be a Federal branch or agency.⁹⁸

Resolution Actions" (November 3, 2015), <http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf>.

⁹³ See final rule § 47.4(a).

⁹⁴ 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).

⁹⁵ 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.").

⁹⁶ The final rule defines "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. *See* final rule § 47.2.

⁹⁷ *See Hertz Corp. v. Friend*, 559 U.S. 77 (2010) (describing the appropriate test for principal place of business).

⁹⁸ *See* final rule § 47.4(a).

Similarly, a counterparty that is an individual must be domiciled in the United States.⁹⁹ 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 Regimes.¹⁰⁰ 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.¹⁰¹ 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.¹⁰² Additionally, the Swiss

⁹⁹ *See id.*

¹⁰⁰ *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).

¹⁰¹ *See* PRA Rulebook: CRR Firms and Non-Authorised Persons: Stay in Resolution Instrument 2015, (November 12, 2015), <http://www.bankofengland.co.uk/prd/Documents/publications/ps/2015/ps2515app1.pdf>; *see also* Bank of England, Prudential Regulation Authority, "Contractual stays in financial contracts governed by third-country law" (PS25/15), (Nov. 2015), <http://www.bankofengland.co.uk/prd/Documents/publications/ps/2015/ps2515.pdf>. These PRA rules apply to PRA-authorized banks, building societies, PRA-designated investment firms, and their qualifying parent undertakings, including U.K. financial holding companies and U.K. mixed financial holding companies.

¹⁰² *See* Gesetz zur Sanierung und Abwicklung von Instituten und Finanzgruppen, Sanierungs- und Abwicklungsgesetz [SAG] [German Act on the Reorganisation and Liquidation of Credit Institutions], December 10, 2014, § 60a, <https://www.gesetze-im-internet.de/bundesrecht/sag/gesamt.pdf>, as amended by Gesetz zur Anpassung

⁹¹ These commenters noted 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.

⁹² *See generally* Financial Stability Board, "Principles for Cross-border Effectiveness of

Federal Council requires that banks “ensure at both the individual institution and group level that new agreements or amendments to existing agreements which are subject to foreign law or envisage a foreign jurisdiction are agreed only if the counterparty recognizes a postponement of the termination of agreements in accordance with” the Swiss special resolution regime.¹⁰³ 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.¹⁰⁴

As discussed in Section III.A. of this preamble, the OCC believes it is appropriate to adopt this final rule in order to promote the safety and soundness of the Federal banking system, and as a consequence, U.S. financial stability, by improving the resolvability and resilience of national banks, FSAs, and Federal branches and agencies, pursuant to its existing statutory authorities. Because of the current risk that the stay-and-transfer provisions of U.S. Special Resolution Regimes may not be recognized under the laws of other jurisdictions, § 47.4 of the final rule requires similar contractual recognition to help ensure that courts in foreign jurisdictions will recognize these provisions.

This requirement advances the goal of the final rule of removing QFC-related obstacles to the orderly resolution of covered banks, and by extension their associated GSIBs. As discussed above, restrictions on the exercise of QFC default rights are an important prerequisite for an orderly GSIB resolution. Congress recognized the importance of such restrictions when it enacted the stay-and-transfer provisions of the U.S. Special Resolution Regimes. As demonstrated by the 2007–2009

financial crisis, the modern financial system is global in scope, and covered banks 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 § 47.4 of the final rule would ensure that the stay-and-transfer provisions apply as a matter of contract to all covered QFCs, wherever the transaction. This will advance the resolvability goals of the Dodd-Frank Act and the FDI Act and improve the resiliency of covered banks subject to the requirements.

F. Prohibited Cross-Default Rights (§ 47.5)

1. Definitions

Proposed Rule and Final Rule. Section 47.5 of the final rule, like the proposed rule, pertains to cross-default rights in QFCs between covered banks and their counterparties, many of which are subject to credit enhancements (such as guarantees) provided by an affiliate of the covered bank. Because credit enhancements on 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 precisely describe the relationships to which this section applies. These definitions are the same as under the proposed rule since no comments were received on these definitions.

First, the final rule distinguishes between a credit enhancement and a “direct QFC,” which is defined as any QFC that is not a credit enhancement. The final rule also defines “direct party” to mean a covered bank that itself is a party to the direct QFC, as distinct from an entity that provides a credit enhancement. In addition, the final rule defines “affiliate credit enhancement” to mean “a credit enhancement that is provided by an affiliate of the party to the direct QFC that the credit enhancement supports,” as distinct from a credit enhancement provided by either the direct party itself or by an unaffiliated party. Moreover, the final rule defines “covered affiliate credit enhancement” to mean an affiliate credit enhancement provided by a covered bank, or a covered entity under the FRB final rule, and defines “covered affiliate support provider” to mean the

affiliate of the covered bank that provides the covered affiliate credit enhancement. 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).

2. General Prohibition

Proposed Rule. Subject to certain exceptions discussed below, the proposed rule generally prohibited a covered bank from being a 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 bank. The proposed rule also generally prohibited a covered bank from being party to a covered QFC that would prohibit the transfer of any credit enhancement applicable to the QFC (such as another entity’s guarantee of the covered bank’s obligations under the QFC), along with associated obligations or collateral, upon the entry into resolution of an affiliate of the covered bank.¹⁰⁵

Comments. One commenter expressed strong support for these provisions.¹⁰⁶ Another commenter expressed support for this provision as currently limited in scope under the proposed rule to prohibited cross-default rights and requested that the scope not be expanded.

A number of commenters representing counterparties to covered banks objected to § 47.5 of the proposed rule and requested the elimination of this provision. These commenters expressed concern about limitations on counterparties’ exercise of default rights during 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

des nationalen Bankenabwicklungsrechts an den Einheitlichen Abwicklungsmechanismus und die europäischen Vorgaben zur Bankenabgabe, November 2, 2015, Artikel 1(17).

¹⁰³ 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] April 30, 2014, SR 952.02, art. 12 paragraph 2bis, translation at <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 (November 25, 2015) (providing commentary).

¹⁰⁴ See Section III–11 of Comprehensive Guidelines for Supervision of Major Banks, etc., <http://www.fsa.go.jp/common/law/guide/city.pdf>.

¹⁰⁵ This prohibition would be subject to an exception that would allow supported parties to exercise default rights with respect to a QFC if the supported party would be prohibited from being the beneficiary of a credit enhancement provided by the transferee under any applicable law, including the Employee Retirement Income Security Act of 1974 and the Investment Company Act of 1940. This exception is substantially similar to an exception to the transfer restrictions in section 2(f) of the ISDA 2014 Resolution Stay Protocol (2014 Protocol) and the ISDA 2015 Universal Resolution Stay Protocol, which was added to address the concerns expressed by asset managers during the drafting of the 2014 Protocol.

¹⁰⁶ This commenter also expressed support for Congressional amendment of the U.S. Bankruptcy Code.

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 appropriate measures to strengthen the financial condition and creditworthiness of a failing GSIB during and after the temporary stay are taken, the stay will only expose QFC counterparties to an additional 48 hours of credit risk exposure without achieving the orderly resolution goals of the proposed 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 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).¹⁰⁷

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 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 bank counterparties may challenge the legality of contractual stays on the exercise of default rights if a GSIB becomes distressed. Certain commenters

also questioned the OCC's ability to rely on its authority under the National Bank Act in imposing these requirements over QFC counterparties not subject to its supervision and argued that making Title II resolution possible under the U.S. Bankruptcy Code was not an appropriate justification for the proposed rule. 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 the proposed rule's requirements to remediate cross-default rights, these commenters expressed the view that, if the OCC adopts the proposed rule as final, the final rule should at least contain those minimum creditor protections established by the Universal Protocol. Certain commenters also argued that this provision in the proposed rule 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.¹⁰⁸ Certain commenters also urged the OCC to provide a limited exception to these restrictions, if retained in the final rule, to help ensure the continued functioning of physical commodities markets.¹⁰⁹

¹⁰⁸ 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 this proposal. As discussed later, the rule seeks to facilitate the resolution of a GSIB outside of U.S. Special Resolution Regimes, including under the U.S. Bankruptcy Code, and is intended to facilitate other approaches to GSIB resolution. Therefore, the final rule applies these provisions in the same way as the proposed rule. 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 § 47.5(f).

¹⁰⁹ In particular, these commenters requested that, when a covered bank defaults on any physical delivery obligation to any counterparty following the insolvency of an affiliate of a covered bank, its counterparties with obligations to 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 bank. The final rule, like the proposed rule, allows covered QFCs to permit a counterparty to exercise its default rights under a covered QFC if the covered bank has failed to pay or perform its obligations under the covered QFC. See final rule § 47.5(d). The final rule, like the proposed rule, also allows covered QFCs to permit a counterparty to exercise its default rights under

Some commenters argued that the OCC 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.

Final Rule. The final rule retains the same scope as the proposed rule. A primary purpose of the proposed restrictions is to facilitate the resolution of a GSIB outside of Title II, including under the U.S. Bankruptcy Code. As discussed in the Background section, the potential for the mass exercise of QFC default rights is a major reason why the failure of a global systemically important BHC could have a severe negative impact on financial stability and on the Federal banking system. In the context of an SPOE resolution, if the global systemically important BHC's entry into resolution triggers the mass exercise of cross-default rights by the subsidiaries' QFC counterparties of the covered QFCs against the covered bank, then the national bank or FSA could themselves experience financial distress or failure. Moreover, the mass exercise of covered QFC default rights would entail asset fire sales, which could affect other U.S. financial companies and undermine financial stability of the U.S. financial system. Similar disruptive results can occur with an MPOE resolution of an affiliate of an otherwise performing covered bank that triggers default rights on QFCs against the performing covered bank.

In an SPOE resolution, this damage can be avoided if actions of the following two types are prevented: The exercise of direct default rights against the top-tier holding company that has entered resolution, and the exercise of cross-default rights against the national bank and FSA subsidiaries and other operating subsidiaries based on their parent BHC entry into resolution. Direct default rights against the national bank or FSA subsidiary would not be exercisable, because that subsidiary

a covered QFC if the covered bank 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 entity 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 bank.

¹⁰⁷ 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.

would continue normal operations and would not enter resolution. In an MPOE resolution, this damage occurs from the exercise of default rights against a performing entity based on the failure of an affiliate.

Title II of the Dodd-Frank Act's stay-and-transfer provisions would address both direct default rights and cross-default rights. But, as explained in the Background section, no similar statutory provisions would apply to a resolution under the U.S. Bankruptcy Code. The final rule attempts to address these obstacles to orderly resolution under the U.S. Bankruptcy Code by extending the stay-and transfer-provisions to any type of resolution. 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 banks 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.

Accordingly, 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 similar resolution proceedings. In doing so, the proposed rule would advance the Dodd-Frank Act's goal of making the orderly resolution of a covered bank workable under the U.S. Bankruptcy Code.¹¹⁰

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, under-inclusive, and easy to evade. Similarly, a stay of default rights that are only directly related to the resolution of an affiliate could increase the likelihood of litigation to determine if 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' rights under the U.S. Bankruptcy Code. As explained above, the final rule does not prohibit a covered QFC from permitting the exercise of default rights against a covered entity that has entered bankruptcy proceedings.¹¹¹ Therefore, counterparties to a covered entity in bankruptcy would be able to exercise their existing contractual 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 could also prevent the disorderly failure of the national bank or FSA subsidiary and allow it to continue normal operations. In addition, while it may be in the individual interest of any given counterparty to exercise any available contractual rights to run on the national bank or FSA subsidiary, the mass exercise of such rights could harm the collective interest of all the counterparties by causing the subsidiary to fail. Therefore, like the automatic stay in bankruptcy, which also serves to maximize creditors' ultimate recoveries by preventing a disorderly liquidation of the debtor, the proposed rule would mitigate this collective action problem to the benefit of the creditors and counterparties of covered banks by preventing a disorderly resolution. And because many of these counterparties and creditors are themselves covered banks, or other systemically important financial firms, improving outcomes for these creditors and counterparties would further protect the safety and soundness of the Federal banking system and financial stability of the United States.

3. General Creditor Protections

Proposed Rule and Final Rule. While the proposed restrictions would facilitate orderly resolution, they would also have the effect of diminishing the ability of the counterparties of the covered banks to include protections for themselves in covered QFCs. In order to reduce this effect, the final rule, like the proposed rule, includes several significant exceptions to the proposed restrictions. These permitted creditor protections are intended to allow creditors to exercise cross-default rights outside of an orderly resolution of a GSIB, and therefore would not be expected to undermine such a resolution.

First, in order to ensure that the proposed prohibitions would apply only to cross-default rights (and not direct default rights), the final rule would provide that a covered QFC may permit

the exercise of default rights based on the direct party's entry into a resolution proceeding.¹¹² 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 bank's subsidiary or affiliate 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 covered QFCs to permit the exercise of default rights based on the failure of (1) the direct party, (2) a covered affiliate support provider, or (3) a transferee that assumes a credit enhancement to satisfy its payment or delivery obligations under the direct QFC or credit enhancement. Moreover, the final rule would allow covered QFCs to permit the exercise of a default right in one QFC that is triggered by the direct party's failure to satisfy its payment or delivery obligations under another contract between the same parties. This exception takes appropriate account of the interdependence that exists among the contracts in effect between the same counterparties.

As explained in the proposed rule, the exceptions in the final rule for the

¹¹² See final rule § 47.5(d)(1). The proposed rule exempted from this creditor protection provision proceedings under a U.S. or foreign special resolution regime. As explained in the proposed rule, 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 OCC revise this provision to clarify that default rights based on a covered bank 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 OCC 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 § 47.5. 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.

¹¹⁰ See 12 U.S.C. 5365(d).

¹¹¹ See final rule § 47.5(d)(1).

creditor protections described are intended to help ensure that the proposed rule permits a covered bank'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 bank'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 bank's counterparty would be permitted to exercise its default rights, such as by liquidating collateral. These exceptions are generally consistent with the treatment of payment and delivery obligations under the U.S. Special Resolution Regimes.¹¹³

These exceptions also help to ensure that the counterparties of a covered bank's 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 because 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.

4. Additional Creditor Protections for Supported QFCs

Proposed Rule and Final Rule. The final rule, like the proposed rule, 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 bank that is also a covered bank under the final rule or a covered entity under the FRB final rule. The final rule would allow these creditor protections in recognition of the supported party's interest in receiving the benefit of its credit enhancement. The OCC, FRB, and FDIC believe that these creditor protections would not undermine an SPOE resolution of a GSIB.¹¹⁴

Where a covered QFC is supported by a covered affiliate credit enhancement,¹¹⁵ the covered QFC and

the credit enhancement would be permitted to allow the exercise of default rights under the circumstances after the expiration of a stay period. Under the final rule, the applicable stay period would begin when the credit support provider enters resolution and would end at the later of 5:00 p.m. (eastern time) on the next business day and 48 hours after the entry into resolution. This portion of the final rule is similar to the stay treatment provided in a resolution under the OLA or the FDI Act.¹¹⁶

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.¹¹⁷ Covered 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 a resolution proceeding, protecting the supported party from a transfer of the credit enhancement to a transferee that is unable to meet its financial obligations.

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 direct party and affiliates of the direct party's QFC counterparty. Such creditor protections are permitted to prevent the support provider or the transferee from "cherry picking" by

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 bank or covered entity.

¹¹⁶ See U.S.C. 1821(e)(10)(B)(I), 5390(c)(10)(B)(i), 5390(c)(16)(A). While the 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.

¹¹⁷ 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.

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 contain similar provisions to prevent cherry picking.

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

Comments. Commenters generally expressed strong support for these exclusions but also requested that these exclusions be broadened in a number of ways. Some commenters urged the OCC 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 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). Some 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 OCC should include in § 47.5: (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-

¹¹³ 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).

¹¹⁴ See 81 FR 29169 (May 11, 2016).

¹¹⁵ Note that the final rule would not apply with respect to credit enhancements that are not covered affiliate credit enhancements. In particular, it

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.

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 proposed rule 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.¹¹⁸ 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 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 47.5 of the final rule permits QFCs to include provisions allowing a counterparty to exercise its default rights against a direct party that enters resolution under the FDI Act or Title II of the Dodd-Frank Act, other than the limited case contemplated by § 47.5(h) of the final rule. The OCC is not adopting the proposed additional creditor protection because it would defeat in large part the purpose of § 47.5 and potentially create confusion regarding the requirements and purposes of sections 47.4 and 47.5 of the final rule.¹¹⁹

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. As the FRB Proposed Rule explained, “[s]uch 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 by allowing for the exercise of default rights against a covered entity [or in the case of the OCC Proposed Rule, the covered bank].”¹²⁰

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. In general, covered banks may be entities organized or operating in the United States or, with respect to U.S. GSIBs, abroad. The final rule, like the proposed rule, is limited to QFCs to which a covered bank is a party. Section 47.5 of the final rule generally prohibits QFCs to which a covered bank is a party from allowing the exercise of cross-default rights of the covered QFC, regardless of whether the affiliate entering resolution and/or the credit support provider is organized or operates in the United States.

Another commenter expressed concern that the proposed § 47.5(g)(3) (§ 47.5(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 entity 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 § 47.5, 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 proposed § 47.5(g) (§ 47.5(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 final rule as requested would largely defeat the purpose of § 47.5 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 covered bank 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 covered bank 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).

5. Creditor Protections Related to FDI Act Proceedings

Proposed Rule and Final Rules. 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 Act¹²¹ only under the following circumstances: (a) After the FDI Act stay period,¹²² if the credit enhancement is not transferred under the relevant provisions of the FDI Act¹²³ 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

¹²⁰ 81 FR 29169, 29180 n.92 (May 11, 2016) (“Note that the exception in § 252.84(g) of the [FRB 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 [F]oreign GSIB, which would not be a covered entity under the proposal. Such credit enhancements would be excluded in order to help ensure that the resolution of a non-U.S. entity would not negatively affect the financial stability of the United States by allowing for the exercise of default rights against a covered entity.”). See also FRB final rule § 252.84(f).

¹²¹ As discussed, 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.

¹²² 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).

¹²³ 12 U.S.C. 1821(e)(9)–(10).

¹¹⁸ See 81 FR 55381, 55394 (August 19, 2016).

¹¹⁹ 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 § 47.5 of the final rule and those available under the Universal Protocol and U.S. Protocol, discussed below.

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. This provision is intended to ensure that a QFC counterparty of a subsidiary of a covered bank that goes into FDI Act receivership can receive the same level of protection that the FDI Act provides to QFC counterparties of the covered bank itself. No comments were received on this aspect of the proposed rule, and the final rule remains unchanged.

6. Prohibited Terminations

Proposed Rule. In case of a legal dispute as to a party's right to exercise a default right under a covered QFC, the proposed rule required 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 shall bear 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,¹²⁴ or a more demanding standard.

This proposed requirement was intended to prevent QFC counterparties from circumventing the limitations on resolution-related default rights in this proposal by exercising other contractual default rights in instances where such QFC counterparty cannot demonstrate that the exercise of such other contractual default rights is unrelated to the affiliate's entry into resolution.

Comments. 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 entities, 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 prohibits counterparties from exercising any default rights during the stay period. These commenters argued that it is inappropriate for the OCC by regulation 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 adopt a rebuttable presumption that the non-defaulting counterparty's exercise of default rights is permitted under the QFC unless the defaulting covered entity demonstrates otherwise. One commenter requested that the burden of proof not apply to the exercise of direct default rights.

Final Rule. 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 of 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 entity 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.

7. Agency Transactions

Proposed Rule. In addition to entering into QFCs as principal, GSIBs may engage in QFCs as agent for other principals. For example, a GSIB subsidiary may enter into a master securities lending arrangement with a foreign bank as agent for a U.S.-based pension fund. The GSIB would document its role as agent for the

pension fund, often through an annex to the master agreement, and would generally provide to its customer (the principal party) a securities replacement guarantee or indemnification for any shortfall in collateral in the event of the default of the foreign bank.¹²⁵ A covered bank may also enter into a QFC as principal where there is an agent acting on its behalf or on behalf of its counterparty.

The proposed rule would have applied to a covered QFC regardless of whether the covered bank or the covered bank's direct counterparty is acting as a principal or as an agent. The proposed rule did not distinguish between agents and principals with respect to default rights or transfer restrictions applicable to covered QFCs. The proposed rule would have limited default rights and transfer restrictions that the principal and its agent may have against a covered bank consistent with the U.S. Special Resolution Regimes. The proposed rule would have ensured that, subject to the enumerated creditor protections, neither the agent nor the principal could exercise cross-default rights under the covered QFC against the covered bank based on the resolution of an affiliate of the covered bank.¹²⁶

Comments. Commenters argued that the provisions of sections 47.4 and 47.5 that relate to transactions entered into by the covered bank as agent should exclude QFCs where the covered bank 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 bank acts as agent for a counterparty whose transactions are excluded from the requirements of the final rule.¹²⁷ 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

¹²⁵ The definition of QFC under Title II of the Dodd-Frank Act includes security agreements and other credit enhancements as well as master agreements (including supplements). 12 U.S.C. 5390(c)(8)(D).

¹²⁶ Under the proposed rule, if a covered bank (acting as agent) is a direct party to a covered QFC, then the general prohibitions of § 47.5(d) would only affect the substantive rights of the agent's principal(s) to the extent that the covered QFC provides default rights based directly or indirectly on the entry into resolution of an affiliate of the covered bank (acting as agent).

¹²⁷ 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.

¹²⁴ The reference to a "similar" burden of proof is intended to allow covered QFCs to provide for the application of a standard that is analogous to clear and convincing evidence in jurisdictions that do not recognize that particular standard. A covered QFC would not be permitted to provide for a lower standard.

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 proposed rule 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 contracts with covered entities. Commenters also requested clarification that conformance is not required of contracts between a covered entity as agent on behalf of a non-U.S. affiliate of a Foreign GSIB that would not be a covered bank under the proposed rule, 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 be exempt from the final 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.

Final Rule. 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 bank

does not become a party to a QFC solely by acting as agent to a QFC.¹²⁸ Therefore, an in-scope QFC would not be a covered QFC solely because a covered bank was acting as the agent of a principal with respect to the QFC.¹²⁹ For example, the final rule would not require a covered bank 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 bank 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 bank acting as agent with respect to a master securities lending agreement, if the covered entity 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 bank 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.

8. Enforceability

Proposed Rule and Final Rule. 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 requirements of the final rule, similar to assurances provided in respect of the U.K. rule and German legislation. The enforceability of a contract is beyond the scope of this final rule.

¹²⁸ See final rule § 47.3(e)(1).

¹²⁹ Such a QFC would nonetheless be a covered QFC with respect to a principal that also was a covered entity. In response to comments, the OCC notes that covered banks do not include non-U.S. subsidiaries of a Foreign GSIB.

9. Interaction With Other Regulatory Requirements

Proposed Rule and Final Rule. Certain commenters requested clarification that amending covered QFCs as required by this final rule should not trigger other regulatory requirements for covered banks, such as the swap margin requirements issued by the OCC, other prudential regulators (FRB, FDIC, 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 final rule as they relate to the requirements of another rule issued by the OCC jointly with the other prudential regulators, as well as a rule issued by the CFTC. As commenters pointed out, 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 of the Dodd-Frank Act. However, as the proposed rule noted, the OCC 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.¹³⁰ The OCC does not expect that compliance with this final rule would trigger the swap margin requirements for non-cleared swaps.

10. Compliance With the Universal Protocol

Proposed Rule. The proposed rule allowed covered banks to conform covered QFCs to the requirements of the proposed rule through adherence to the Universal Protocol. The Universal Protocol has two primary operative provisions, 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 § 47.4 of the proposed rule. Under Section 2, adhering parties essentially forego, subject to the creditor protections of Section 2, cross-default rights and

¹³⁰ See 81 FR 55381, 55396 (August 19, 2016).

transfer restrictions on affiliate credit enhancements. Therefore, Section 2 is generally responsive to the concerns addressed in § 47.5 of the proposed rule.

The proposed rule 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 proposed rule, and the Universal Protocol provides a number of creditor protection provisions that would not otherwise have been available under the proposed rule, the Universal Protocol includes a number of desirable features that the proposed rule lacked. The proposed rule explained that “when an entity (whether or not it is a covered bank) adheres to the [Universal] Protocol, it necessarily adheres to the [Universal] Protocol with respect to all covered entities that have also adhered to the [Universal] Protocol rather than one or a subset of covered entities (as the [proposed rule] may otherwise permit). . . . By allowing for all covered QFCs to be modified by the same contractual terms, this ‘all-or-none’ feature would promote transparency, predictability and equal treatment with respect to default rights of non-defaulting parties.”¹³¹ This “all-or-none” feature is referred to as “universal adherence” in the remainder of this preamble. The proposed rule explained that the Universal Protocol included other favorable features, which include 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 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 differences from § 47.5 of the proposed rule.

Comments and Final Rule.

Commenters generally supported the proposed rule’s provisions to allow covered banks to comply with the requirements of the proposed rule through adherence to the Universal Protocol. For the reasons discussed in this preamble and in the proposed rule, the final rule continues to allow covered

banks to comply with the rule through adherence to the Universal Protocol and makes other modifications to the proposed rule 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 § 47.4. 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.¹³² By clarifying § 47.6(a), the final rule confirms (1) that adherence to the Universal Protocol is deemed to satisfy the requirements of § 47.4 of the final rule (as well as § 47.5) and (2) 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 entity counterparties do not have ISDA master agreements for physically-settled forward and commodity contracts and, therefore, compliance with the proposed rule’s requirements through adherence to the Universal Protocol would entail substantial time and educational effort. As in the proposed rule, the final rule simply permits adherence to the Universal Protocol as one method of compliance with the final rule’s requirements, and parties may meet the final 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

¹³² “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 (August 5, 2016). This commenter noted that incorporation by reference was consistent with the proposed rule and asked that the text of the final rule be clarified. *Id.* at 9. Given the OCC’s intent to ensure that the substantive requirements of its final rule are consistent with those of the FRB and FDIC, the OCC has reviewed this letter to the extent applicable to the OCC’s final rule.

identified in the proposed and final rule, are designed to amend QFCs that are not ISDA master agreements.

11. Compliance With the U.S. Protocol

Proposed Rule and Comments. In addition to the Universal Protocol, many commenters argued that the final rule should allow compliance with the final 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.¹³³ 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.

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 proposed rule did not include any Country Annex for any Protocol-eligible Regime.¹³⁴

¹³³ Commenters argued that approval of the approved U.S. JMP should not require satisfaction of the administrative requirements of § 47.6, since the OCC has already conducted that analysis in deciding to provide a safe harbor for the Universal Protocol.

¹³⁴ The proposed rule 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

Continued

¹³¹ 81 FR 55381, 55394 (August 19, 2016).

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 would force counterparties to give up default rights in jurisdictions where that is not yet legally required.¹³⁵ 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.¹³⁶

With respect to the universal adherence feature of the Universal Protocol, commenters argued that universal adherence imposed significant monitoring burdens 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 entities under the final rule (to be identified on a “static list”) and would adhere to new covered entities on an entity-by-entity basis. This static list, commenters argued,

Derivatives Association, Inc., as of May 3, 2016, and minor or technical amendments thereto.” See proposed rule § 47.6(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 proposed rule, 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 § 47.6(a)(2).

¹³⁵ 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.

¹³⁶ One commenter requested clarification that a QFC of a covered bank with a non-U.S. credit support provider for the covered bank complies with the requirements of the final rule to the extent the covered bank 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.

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 bank was not a party. Certain commenters argued that adhering with respect to any counterparty would also be inconsistent with their fiduciary duties.

Final Rule. In response to comments and to further facilitate compliance, 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 to the covered QFCs to the requirements of the final rule.¹³⁷ 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.¹³⁸ Therefore, the reasons for deeming covered QFCs amended by the Universal Protocol to conform to the final rule, discussed above and in the proposed rule, apply to the U.S. Protocol.

Consistent with the proposed rule¹³⁹ 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 banks.¹⁴⁰ 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 substantively identical final rules issued by the FRB and FDIC, and not also QFCs outside the scope of the final rules of the OCC, FRB, and FDIC

¹³⁷ The final rule also provides that the OCC may determine otherwise based on specific facts and circumstances. See final rule § 47.6(a).

¹³⁸ 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, the final rule does not exempt a QFC solely because the QFC explicitly states that it is governed by U.S. law. Moreover, such a limited application would reduce the desirable additional benefits of the Universal Protocol as discussed.

¹³⁹ The proposed rule 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 or covered banks would be consistent with the current proposal.”

¹⁴⁰ 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 § 47.6(a)(3)(ii)(E).

(i.e., QFCs between parties that are not covered entities, covered banks, or covered FSIs).

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.¹⁴¹ As noted, the Universal Protocol, as defined in the proposed rule, 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 proposed rule, were the U.S. Special Resolution Regimes and the other Identified Regimes. As explained in the proposed rule, inclusion of the Identified Regimes should help facilitate the resolution of a GSIB across a broader range of circumstances. 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.¹⁴² 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 final rule does not permit the U.S. Protocol to 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 primary benefits of the Universal Protocol: universal adherence. Similarly, the final rule does not permit adherence to a “static list” of all current covered entities, which other commenters requested.¹⁴³ Although the static list

¹⁴¹ See final rule § 47.6(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 to the U.S. Protocol to the substantive differences allowed or required from the Universal Protocol. See final rule § 47.6(a)(3)(ii)(E).

¹⁴² See final rule § 47.6(a)(3)(ii)(A).

¹⁴³ The final rule, however, does not prohibit the creation of a dynamic list identifying all current

would initially provide for universal adherence, the static list would not provide for universal adherence with respect to entities that became covered entities 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.¹⁴⁴ The Universal Protocol refers to these provisions as "opt-outs." The proposed rule 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 proposed rule would have required that a covered QFC be conformed regardless of the method the covered bank and counterparty chooses to conform the QFC.¹⁴⁵

Consistent with the basic purposes of the final rule, the U.S. Protocol must require that opt-outs exercised by its adherents will only be effective to the extent that the 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 banks to ensure that their covered QFCs continue to conform to the requirements of the final 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)¹⁴⁶ 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 substantively identical

rules expected to be issued by the FRB and FDIC, should prevent exercise of the Sunset Opt-out 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 proposed rule, does not exempt the client-facing leg of a cleared transaction. Therefore, the U.S. Protocol must not include the exemption in Section 2 of the Universal Protocol regarding the client-facing leg of the transaction.¹⁴⁷

G. Process for Approval of Enhanced Creditor Protections (§ 47.6)

1. Requests for Approval of Enhanced Creditor Protections

Proposed Rule. As discussed previously, the proposed restrictions would leave many creditor protections that are commonly included in QFCs unaffected. The proposed rule would have also allowed any covered bank to submit to the OCC a request to approve as compliant with the proposed rule one or more QFCs that contain additional creditor protections—that is, creditor protections that would be impermissible under the proposed restrictions set forth previously. A covered bank making such a request would have been required to explain how its request is consistent with the purposes of the proposed rule, including an analysis of the contractual terms for which approval is requested in light of a range of factors that are laid out by the proposed rule and intended to facilitate the OCC's consideration of whether permitting the contractual terms would be consistent with the proposed restrictions. The proposed rule noted that the OCC expected to consult with the FDIC and FRB during its consideration of a request under this section.

The first two factors concerned the potential impact of the requested

creditor protections on GSIB resilience and resolvability. The next four concerned the scope of the covered bank's request: 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 banks. 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 banks would increase the chance that all of a GSIB's QFC counterparties would be treated the same way during a resolution of that GSIB and may improve the prospects for an orderly resolution of that GSIB. By contrast, covered bank requests that would expand counterparties' rights beyond those afforded under existing QFCs would conflict with the proposed rule's goal of reducing the risk of mass unwinds of GSIB QFCs. The proposed rule also included three factors that focus on the creditor protections specific to supported parties. The proposed rule noted that the OCC 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 bank requesting that the OCC approve enhanced creditor protections would have been 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 OCC.

Under the proposed rule, the OCC could have approved a request for an alternative set of creditor protections if the terms of that QFC, as compared to a covered QFC containing only the limited exceptions discussed previously, would promote the orderly resolution of federally chartered or licensed institutions or their affiliates, prevent or mitigate risks to the financial stability of the United States or the Federal banking system that could arise from the failure of a global systemically important BHC or global systemically important FBO, and protect the safety and soundness of covered banks to at least the same extent. The proposed request-and-approval process improved flexibility by allowing for an industry-proposed alternative to the set of creditor protections permitted by the proposed rule while ensuring that any

¹⁴⁴ "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 § 47.6(a)(3)(ii)(E) (allowing minor and technical differences from the Universal Protocol).

¹⁴⁵ Section 4(b) of the Universal Protocol.

¹⁴⁶ Under the final rule, if an adherent to the Universal Protocol or U.S. Protocol exercises an available opt-out, covered banks with covered QFCs affected by the exercise would be required to otherwise conform the covered QFCs to the requirements of the final rule.

¹⁴⁷ See § 4(b)(i)(A) of the Universal Protocol.

¹⁴⁷ 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 proposed rule'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 § 47.6(a)(3)(ii)(D).

approved alternative would serve the proposed rule's policy goals to at least the same extent.

Comments. 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 OCC would approve or deny a request. Certain commenters urged that counterparties and trade groups, in addition to covered banks, should be permitted to make such requests. One commenter noted that the proposed rule's approval process would have created a free-rider problem, where parties that submit enhanced creditor protection conditions for OCC 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.¹⁴⁸ Additionally, commenters urged that the provision should be broadened to allow approvals of provisions not directly related to enhanced creditor protections.

Final Rule. The final rule clarifies that the OCC could approve an alternative proposal of additional creditor protections as compliant with sections 47.4 and 47.5 of the final rule, but the OCC 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 banks, and thus only covered banks are eligible to submit requests pursuant to these provisions. In response to commenters' concerns, the OCC notes that the final rule does not prevent multiple covered banks from presenting one request and does not prevent covered banks 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.

2. Compliance With the International Swaps and Derivatives Association (ISDA) 2015 Universal Resolution Stay Protocol and U.S. Protocol

Proposed Rule and Final Rule. In lieu of the process for the approval of enhanced creditor protections that are described previously, a covered bank would be permitted to comply with the proposed rule by amending a covered QFC through adherence to the ISDA 2015 Universal Resolution Stay Protocol (including immaterial amendments to the Protocol).¹⁴⁹ The Protocol "enables parties to amend the terms of their financial contracts to contractually recognize the cross-border application of special resolution regimes applicable to certain financial companies and support the resolution of certain financial companies under the [U.S.] Bankruptcy Code."¹⁵⁰ The Protocol amends ISDA Master Agreements, which are used for derivatives transactions. Market participants also may amend their master agreements for securities financing transactions by adhering to the Securities Financing Transaction Annex¹⁵¹ to the Protocol and may amend all other QFCs by adhering to the Other Agreements Annex. Thus, a covered bank would be able to comply with the proposed rule with respect to all of its covered QFCs

¹⁴⁹ International Swaps and Derivatives Association, Inc., "ISDA 2015 Universal Resolution Stay Protocol" (November 4, 2015), available at <http://assets.isda.org/media/ac6b533f-3/5a7c32f8-pdf/>. The Protocol was developed by a working group of member institutions of the ISDA, in coordination with the FRB, the FDIC, the OCC, and foreign financial supervisory agencies. ISDA is expected to supplement the Protocol with ISDA Resolution Stay Jurisdictional Modular Protocols for the United States and other jurisdictions. A U.S. module that is the same in all respects to the Protocol aside from exempting QFCs between adherents that are not covered banks would be consistent with the current proposed rule.

¹⁵⁰ Protocol Press Release at <http://www2.isda.org/functional-areas/protocol-management/protocol/22>.

¹⁵¹ The Securities Financing Transaction Annex was developed by the International Capital Markets Association, the International Securities Lending Association, and the Securities Industry and Financial Markets Association, in coordination with the ISDA.

through adherence to the Protocol and the annexes.

The Protocol has the same general objective as the proposed rule, which is to make GSIB entities more resolvable by amending their contracts to, in effect, contractually recognize the applicability of special resolution regimes (including the OLA and the FDI Act) and to restrict cross-default provisions to facilitate orderly resolution under the U.S. Bankruptcy Code. The provisions of the Protocol largely track the requirements of the proposed rule.¹⁵² However, the Protocol does have a narrower scope than the proposed rule,¹⁵³ and it allows for somewhat stronger creditor protections than would otherwise be permitted under the proposed rule.¹⁵⁴

The Protocol also includes a feature, not included in the proposed rule, that compensates for the Protocol's narrower scope and allowance for stronger creditor protections: When an entity

¹⁵² For example, sections 2(a) and 2(b) of the Protocol impose general prohibitions on cross-default rights based on the entry of an affiliate of the direct party into the most common U.S. resolution proceedings, including resolution under the U.S. Bankruptcy Code. By allowing the exercise of "Performance Default Rights" and "Unrelated Default Rights," as those terms are defined in § 6 of the Protocol, sections 2(a) and 2(b) also generally permit the creditor protections that would be allowed under the proposed rule. Section 2(f) of the Protocol overrides certain contractual provisions that would block the transfer of a credit enhancement to a transferee entity. Section 2(i), complemented by the Protocol's definition of the term "Unrelated Default Rights," provides that a party seeking to exercise permitted default rights must bear the burden of establishing by clear and convincing evidence that those rights may indeed be exercised.

¹⁵³ The restrictions on default rights imposed by section 2 of the Protocol apply only when an affiliate of the direct party enters "U.S. Insolvency Proceedings," which is defined to include proceedings under Chapters 7 and 11 of the Bankruptcy Code, the FDI Act, and the Securities Investor Protection Act. By contrast, § 47.4 of the proposed rule would apply broadly to default rights related to affiliates of the direct party "becoming subject to a receivership, insolvency, liquidation, resolution, or similar proceeding," which encompasses proceedings under State and foreign law.

¹⁵⁴ For example, the Protocol allows a non-defaulting party to exercise cross-default rights based on the entry of an affiliate of the direct party into certain resolution proceedings if the direct party's U.S. parent has not gone into resolution. See paragraph (b) of the Protocol's definition of "Unrelated Default Rights"; see also sections 1 and 3(b) of the Protocol. As another example, if the affiliate credit support provider that has entered bankruptcy remains obligated under the credit enhancement, rather than transferring it to a transferee, then the Protocol's restrictions on the exercise of default rights continue to apply beyond the stay period only if the Bankruptcy Court issues a "Creditor Protection Order." Such an order would, among other things, grant administrative expense status to the non-defaulting party's claims under the credit enhancement. See sections 2(b)(i)(B) and 2(b)(iii)(B) of the Protocol and the Protocol's definitions of "Creditor Protection Order" and "DIP Stay Conditions."

¹⁴⁸ 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.

(whether or not it is a covered bank) adheres to the Protocol, it necessarily adheres to the Protocol with respect to all covered entities that have also adhered to the Protocol.¹⁵⁵ Thus, if all covered banks adhere to the Protocol, any other entity that chooses to adhere will simultaneously adhere with respect to all covered entities and covered banks. By allowing for all covered QFCs to be modified by the same contractual terms, this “all-or-none” feature would promote transparency, predictability, and equal treatment with respect to counterparties’ default rights during the resolution of a GSIB entity and thereby advance the proposed rule’s objective of increasing the likelihood that such a resolution could be carried out in an orderly manner.

Like § 47.5 of the proposed rule, Section 2 of the Protocol was developed to increase GSIB resolvability under the Bankruptcy Code and other U.S. insolvency regimes. The Protocol does allow for somewhat broader creditor protections than would otherwise be permitted under the proposed rule, but, consistent with the Protocol’s purpose, those additional creditor protections would not materially diminish the prospects for the orderly resolution of a GSIB. And the Protocol carries the desirable all-or-none feature, which would further increase a GSIB entity’s resolvability and which the proposed rule otherwise lacks. For these reasons, and consistent with the broad policy objective of enhancing the stability of the U.S. financial system by increasing the resolvability of systemically important financial companies in the United States, this provision of the proposed rule is adopted by this final rule, to allow a covered bank to bring its covered QFCs into compliance by amending them through adherence to the Protocol (and, as relevant, the annexes to the Protocol).

H. Transition Periods (Sections 47.4 and 47.5)

Proposed Rule. Under the proposed rule, compliance would be required on the first day of the first calendar quarter that begins at least one year after the issuance of the final rule (effective date).¹⁵⁶ Moreover, the proposed rule

required a covered bank to bring preexisting covered QFCs entered into prior to the effective date into compliance with the proposed rule no later than the first date on or after the effective date on which the covered bank enters into a new covered QFC with the counterparty to the preexisting covered QFC or with an affiliate of that counterparty. Thus, under the proposed rule, a covered bank would not be required to conform a preexisting QFC if that covered bank (or any affiliate of that covered bank) does not enter into any new QFCs with the same counterparty or an affiliate of that counterparty on or after the effective date.

Comments. A number of commenters urged the OCC to adopt 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 final 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 to seek the OCC’s approval of 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 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 OCC confirm that entities that are acquired by a GSIB, and thereby become new covered banks, have until the first day of the first calendar quarter immediately following one year after becoming covered banks 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 bank and the affiliates of the covered bank to engage in corporate activities. These commenters also requested clarification that, during that conformance period, affiliates of covered banks would not be prohibited from entering into new transactions or QFCs with counterparties of the newly acquired entity if the existing covered banks otherwise comply with the final rule’s requirements.

Some commenters urged the OCC to exclude existing contracts from the final rule’s requirements and only apply the rule on a prospective basis. 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 pointed out that this treatment would be consistent with the final rules in the U.K. and the statutory requirements adopted by Germany.

Final Rule. The effective date for the final rule is January 1, 2018. However, in order to reduce the compliance burden of the final rule, the OCC has adopted a phased-in compliance schedule, as requested by commenters. The final rule provides that a covered bank must conform a covered QFC to

¹⁵⁵ Under section 4(a) of the Protocol, the Protocol is generally effective as between any two adhering parties, once the relevant effective date has arrived. Under section 4(b)(ii), an adhering party that is not a covered bank may choose to opt out of section 2 of the Protocol with respect to its contracts with any other adhering party that is also not a covered bank. However, the Protocol will apply to relationships between any covered bank that adheres and any other adhering party.

¹⁵⁶ Under section 302(b) of the Riegle Community Development and Regulatory Improvement Act of

1994, new 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).

the requirements of this final rule by the first day of the calendar quarter immediately following one year from the January 1, 2018, effective date of the final rule with respect to covered QFCs with other covered entities, covered banks, or covered FSIs (referred to as the “first compliance date” for the purposes of this preamble).¹⁵⁷ This provision allows the counterparties that should be most familiar with the requirements of the final rule over one year to conform with the final 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 January 1, 2018, effective date of the final rule, and many covered entities, covered banks, and covered FSIs 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 counterparties¹⁵⁸ (other than small financial institutions),¹⁵⁹ the final rule provides 18 months from the January 1, 2018, effective date of the final rule for compliance with its requirements, as requested by commenters.¹⁶⁰ For community banks and other non-financial counterparties, the final rule provides two years from the January 1, 2018, effective date of the final rule for compliance with its requirements, as requested by commenters.¹⁶¹ 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 for development of the U.S. Protocol or any other protocol

that would meet the requirements of the final rule.

The OCC is giving this additional time for compliance to respond to concerns raised by commenters. The OCC encourages covered banks to start planning and outreach efforts early in order to come into compliance with the final rule in the time frames provided. The OCC 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 final rule has been modified as described above to clarify that a covered bank does not become a party to a QFC solely by acting as agent with respect to the QFC.¹⁶²

National banks, FSAs, and Federal branches and agencies that are covered banks when the final rule is effective on January 1, 2018, would be required to comply with the requirements of the final rule beginning on the first compliance date. Thus, a covered bank would be required to ensure that covered QFCs entered into on or after the first compliance date comply with the final rule’s requirements but would be given more time to conform such covered QFCs with counterparties (or other parties to the QFC) that are not a covered entity, covered bank, or covered FSI.¹⁶³ Moreover, a covered bank would be required to bring an in-scope QFC entered into prior to the first compliance date into compliance with the final rule no later than the applicable date of the tiered compliance dates (discussed previously) if the covered bank 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 pre-existing covered QFC or a consolidated affiliate of the counterparty on or after the first compliance date.¹⁶⁴ Thus, consistent with the proposed rule, a covered bank would not be required to conform a pre-existing QFC if that covered bank and its affiliate that is a covered entity, covered bank, or covered FSI do not enter into any new QFCs with the same counterparty or its consolidated affiliates on or after the first compliance date.

In addition, a national bank, FSA or Federal branch or agency that becomes

a covered bank after the January 1, 2018, effective date of the final rule (referred to as a “new covered bank” for purposes of this preamble) generally has the same period of time to comply as a national bank, FSA, or Federal branch or agency that is a covered bank on the January 1, 2018, effective date (*i.e.*, compliance will phase in over a two-year period based on the type of counterparty).¹⁶⁵ The final rule also clarifies that a covered QFC, with respect to a new covered bank, means an in-scope QFC that the new covered bank becomes a party to (1) on the date the covered bank first becomes a covered bank, and (2) before that date, if the covered bank or one of its affiliates that is a covered entity, covered bank, or covered FSI 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.¹⁶⁶ Under the final rule, a national bank, FSA, or Federal branch or agency that is a covered bank on the January 1, 2018, effective date of the final rule (referred to as an “existing covered bank” for purposes of this preamble) and becomes an affiliate of a new covered bank generally must conform any existing but non-conformed in-scope QFC that the existing covered bank continues to have with a counterparty after the applicable initial compliance date by the date the new covered bank enters a QFC with the same counterparty (or any of its consolidated affiliates) or within a reasonable period thereafter. Acquisitions of new entities are planned in advance and should include preparing to comply with applicable laws and regulations.

The OCC 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 bank. 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.¹⁶⁷ Therefore, the final rule requires an existing QFC between a covered bank and a counterparty to be conformed to the requirements of the final rule if the covered bank (or an affiliate that is a covered entity, covered bank, or covered FSI) enters into another QFC with the

¹⁵⁷ See final rule § 47.3(f)(1)(i). The definition of covered QFC of the final rule has been revised to make clear that, consistent with the proposed rule, a covered QFC is a QFC that the covered bank becomes a party to on or after the first day of the calendar quarter immediately following one year from the January 1, 2018, effective date of this final rule. See final rule § 47.3(c). As discussed above, a covered bank’s in-scope QFC that is entered into before this date may also be a covered QFC if the covered bank or any affiliate that is a covered entity, covered bank, or covered FSI 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.*

¹⁵⁸ See final rule § 47.2 (defining “financial counterparty”).

¹⁵⁹ 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 § 47.2.

¹⁶⁰ See final rule § 47.3(f)(1)(ii).

¹⁶¹ See final rule § 47.3(f)(1)(iii).

¹⁶² See final rule § 47.3(e)(1).

¹⁶³ See final rule § 47.3(c)(1) and (f)(1).

¹⁶⁴ See *id.*

¹⁶⁵ See final rule § 47.3(f)(2).

¹⁶⁶ See final rule § 47.3(c)(2).

¹⁶⁷ The requirements of the final rule, particularly those of § 47.5, may have a different impact on netting, including close-out netting, than the U.K. and German requirements cited by commenters.

counterparty or its consolidated affiliate on or after the first day of the calendar quarter immediately following one year from the January 1, 2018, effective date of the final rule. Subject to any compliance date applicable to the covered bank, the OCC expects a covered bank to conform existing QFCs that become covered QFCs within a reasonable period.

By permitting a covered bank to remain a party to noncompliant QFCs entered into before the effective date unless the covered bank or any affiliate (that is also a covered entity, covered bank, or covered FSI) enters into new QFCs with the same counterparty or its affiliates, the final rule strikes a balance between ensuring QFC continuity if the GSIB were to fail and ensuring that covered banks 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 bank ensure that all existing QFCs with a particular counterparty and its affiliates are compliant before it or any affiliate of the covered bank (that is also a covered entity, covered bank, or covered FSI) enters into a new QFC with the same counterparty or its affiliates after the January 1, 2018, effective date will provide covered banks 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 January 1, 2018, 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.¹⁶⁸ The OCC will monitor covered banks' levels of noncompliant QFCs and evaluate the risk, if any, that they pose to the safety and soundness of the Federal banking system, and indirectly, to GSIBs or to U.S. financial stability.

I. Revisions to Certain Definitions in the OCC's Capital and Liquidity Rules

The regulatory capital rules, as implemented by the OCC, FRB, and FDIC, permit a bank 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," a collateral agreement, eligible margin loan, or repo-style transaction (collectively referred to as netting agreements) that provides for certain rights upon a counterparty default. With limited exception, to qualify for netting treatment, a qualifying netting agreement must permit a bank to terminate, apply close-out netting, and promptly liquidate or set-off collateral upon an event of default of the counterparty (default rights), thereby reducing its counterparty exposure and market risks. Measuring the amount of exposure of these contracts on a net basis, rather than a gross basis, results in a lower measure of exposure, and thus, a lower capital requirement.

An exception to the immediate close-out requirement is made for the stay of default rights if the financial company is in receivership, conservatorship, or resolution under Title II of the Dodd-Frank Act, or the FDI Act. Accordingly, transactions conducted under netting agreements where default rights may be stayed under Title II of the Dodd-Frank Act or the FDI Act would not be disqualified from netting treatment.

On December 30, 2014, the OCC and the FRB issued a joint interim final rule (effective January 1, 2015) that amended the definitions of "qualifying master netting agreement," "collateral agreement," "eligible margin loan," and "repo-style transaction," in the OCC and FRB regulatory capital rules, and "qualifying master netting agreement" in the OCC and FRB liquidity coverage ratio (LCR) rules to expand the exception to the immediate close-out requirement to ensure that the current netting treatment under the regulatory capital, liquidity, and lending limits rules¹⁶⁹ for over-the-counter (OTC) derivatives, repo-style transactions, eligible margin loans, and other

collateralized transactions would be unaffected by the adoption of various foreign special resolution regimes through the ISDA Protocol. In particular, the interim final rule amended these definitions to provide that a relevant netting agreement or collateral agreement may provide for a limited stay or avoidance of rights where the agreement is subject by its terms to, or incorporates, certain resolution regimes applicable to financial companies, including Title II of the Dodd-Frank Act, the FDI Act, or any similar foreign resolution regime that provides for limited stays substantially similar to the stay for qualified financial contracts provided in Title II of the Dodd-Frank Act or the FDI Act.

Section 47.4 of the proposed rule essentially limits the default rights exercisable against a covered bank to the same stay-and-transfer restrictions imposed under the U.S. Special Resolution Regime against a direct counterparty. Section 47.4 of the proposed rule mirrors the contractual stay-and-transfer restrictions reflected in the ISDA Protocol with one notable difference. While adoption of the ISDA Protocol is voluntary, covered banks subject to the proposed rule must conform their covered QFCs to the stay-and-transfer restrictions in § 47.4.

With respect to limitations on cross-default rights in proposed § 47.5, the OCC proposed additional conforming amendments in order to maintain the existing netting treatment for covered QFCs for purposes of the regulatory capital, liquidity, and lending limits rules. Specifically, the OCC is proposed to amend the definition of "qualifying master netting agreement," as well as to make conforming amendments to "collateral agreement," "eligible margin loan," and "repo-style transaction," in the regulatory capital rules in part 3, and "qualifying master netting agreement" in the LCR rules in part 50 to ensure that the regulatory capital, liquidity, and lending limits treatment of OTC derivatives, repo-style transactions, eligible margin loans, and other collateralized transactions would be unaffected by the adoption of proposed § 47.5. Without these proposed amendments, covered banks that amend their covered QFCs to comply with this final rule would no longer be permitted to recognize covered QFCs as subject to a qualifying master netting agreement or satisfying the criteria necessary for the current regulatory capital, liquidity, and lending limits treatment, and would be required to measure exposure from these contracts on a gross, rather than net,

¹⁶⁹ The impact of these amendments to these definition on the legal lending limits requirements for national banks and FSAs is indirect. The definition of qualifying master netting agreement used in the legal lending limit rules is defined by cross-reference to the definition in regulatory capital requirements. See 12 CFR 32.2(u) (Definition of "qualifying master netting agreement" cross-referencing 12 CFR 3.2); see also 79 FR 78287, 78292 (December 30, 2014).

¹⁶⁸ See final rule § 47.8(c).

basis. This result would undermine the proposed requirements in § 47.5. The OCC does not believe that the disqualification of covered QFCs from master netting agreements would accurately reflect the risk posed by these OTC derivatives transactions.

Although the proposed rule reformats some of the definitions in parts 3 and 50 to include the text from the interim final rule, the proposed amendments did not alter the substance or effect of the prior amendment adopted by the interim final rule.

The rule establishing margin and capital requirements for covered swap entities (swap margin rule) defines the term “eligible master netting agreement” in a manner similar to the definition of “qualifying master netting agreement.” Thus, it may also be appropriate to amend the definition of “eligible master netting agreement” to account for the proposed restrictions on covered entities’ QFCs.

IV. Regulatory Analysis

Effective Date

The APA requires that a substantive rule must be published not less than 30 days before its effective date, unless, among other things, the rule grants or recognizes an exemption or relieves a restriction.¹⁷⁰ Section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA) requires that regulations imposing additional reporting, disclosure, or other requirements on insured depository institutions take effect on the first day of the calendar quarter after publication of the final rule, unless, among other things, the agency determines for good cause that the regulations should become effective before such time.¹⁷¹ The January 1, 2018 effective date of this final rule meets both the APA and RCDRIA effective date requirements, as it will take effect at least 30 days after its publication date of November 29, 2017 and on the first day of the calendar quarter following publication, January 1, 2018.

Section 302 of the RCDRIA also requires the OCC to 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.¹⁷² The OCC has considered comment on these

matters in other sections of this **SUPPLEMENTARY INFORMATION** section.

Paperwork Reduction Act

In accordance with section 3512 of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–3521) (as amended), the OCC may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. Certain provisions of the final rule contain “collection of information” requirements within the meaning of the PRA. The information collection requirements contained in this final rule were submitted to OMB for review at the proposed rule stage. OMB instructed the OCC to (i) examine public comment in response to the information collection requirements found in the proposed rule; and (ii) describe in the supporting statement for the final rule any public comments received and why any recommendations were or were not incorporated. The OCC received no comments regarding the information collection requirements contained in the proposed rule.

Comments continue to be invited on:

(a) Whether the collections of information are necessary for the proper performance of the OCC’s functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collections, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments are solicited on aspects of this final rule that may affect reporting, recordkeeping, or disclosure requirements and burden estimates. Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments by email, if possible. Comments may be sent to: Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, Attention: 1557–0339, 400 7th Street SW., Suite 3E–218, Washington, DC 20219. In

addition, comments may be sent by fax to (571) 465–4326 or by electronic mail to prainfo@occ.treas.gov. You may personally inspect and photocopy comments at the OCC, 400 7th Street SW., Washington, DC 20219. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 649–6700 or, for persons who are deaf or hearing impaired, TTY, (202) 649–5597. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.

All comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not include any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

Additionally, please send a copy of your comments by mail to: OCC Desk Officer, 1557–0339, U.S. Office of Management and Budget, 725 17th Street NW., #10235, Washington, DC 20503 or by email to: oir_submission@omb.eop.gov.

Title of Information Collection: Mandatory Contractual Stay Requirements for Qualified Financial Contracts.

Affected Public: Businesses or other for-profit.

Respondents: National banks or FSAs that have more than \$700 billion in total assets as reported in their most recent Call Reports; national banks or FSAs (including any subsidiary of a national bank or FSA) that are subsidiaries of a global systemically important BHC that has been designated pursuant to 252.82 of the FRB’s Regulation YY; national banks or FSAs (including any subsidiary of a national bank or FSA) that are subsidiaries of a global systemically important FBO designated pursuant to section 252.87 of the FRB’s Regulation YY; and Federal branches and agencies (including any U.S. subsidiary of a Federal branch or agency) of a global systemically important FBO that has been designated pursuant to section 252.87 of the FRB’s Regulation YY.

Abstract: Section 47.6(b)(1) provides that a covered bank may request that the OCC approve as compliant with the requirements of §§ 47.4 and 47.5 provisions of one or more forms of covered QFCs, or amendments to one or more forms of covered QFCs, with enhanced creditor protection conditions. The request must include: (1) An analysis of the proposal under each consideration of the relevance of creditor protection provisions; (2) a

¹⁷⁰ 5 U.S.C. 553(d)(1).

¹⁷¹ 12 U.S.C. 4802.

¹⁷² 12 U.S.C. 4802.

written legal opinion verifying that proposed provisions or amendments would be valid and enforceable under applicable law of the relevant jurisdictions, including, in the case of proposed amendments, the validity and enforceability of the proposal to amend the covered QFCs; and (3) any additional information relevant to its approval that the OCC requests.

Burden Estimates:

Estimated Number of Respondents:

44.

Estimated Burden per Respondent: 40 hours.

Total Estimated Burden: 1,760 hours.

Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (RFA), an agency must prepare a regulatory flexibility analysis for all proposed and final rules that describes the impact of the rule on small entities.¹⁷³ Under section 605(b) of the RFA, this analysis is not required if the head of the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities and publishes its certification and a short explanatory statement in the **Federal Register** along with its rule.

The OCC currently supervises approximately 956 small entities.¹⁷⁴ The scope of the final rule is limited to large banks and their affiliates (covered banks). Therefore, the final rule will not have a direct impact on OCC-supervised small entities. The final rule may indirectly have an impact on OCC-supervised small entities that are a party to a QFC with a covered bank. The OCC expects that any costs associated with this will be minimal. Therefore, the OCC certifies that this final rule does not have a significant economic impact on a substantial number of small entities supervised by the OCC. Accordingly, a regulatory flexibility analysis is not required.

Unfunded Mandates Reform Act of 1995 Determination

The OCC has analyzed the final rule under the factors in the Unfunded

Mandates Reform Act of 1995 (UMRA).¹⁷⁵ Under this analysis, the OCC considered whether the final rule includes a Federal mandate that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year (adjusted annually for inflation). The UMRA does not apply to regulations that incorporate requirements specifically set forth in law.

The OCC finds that the rule does not trigger the UMRA cost threshold because we estimate that the UMRA cost is less than \$36 million. The OCC believes that the largest direct cost of implementing the final rule is the cost of amending contracts without an ISDA master agreement in place, which is estimated to range from approximately \$1.18 million to approximately \$35.4 million. Accordingly, the OCC has not prepared the written statement described in section 202 of the UMRA.

List of Subjects

12 CFR Part 3

Administrative practice and procedure, Capital, Federal savings associations, National banks, Reporting and recordkeeping requirements, Risk.

12 CFR Part 47

Administrative practice and procedure, Banks and banking, Bank resolution, Default rights, Federal savings associations, National banks, Qualified financial contracts, Reporting and recordkeeping requirements, Securities.

12 CFR Part 50

Administrative practice and procedure, Banks and banking, Liquidity, Reporting and recordkeeping requirements, Savings associations.

Authority and Issuance

For the reasons stated in the Supplementary Information, the Office of the Comptroller of the Currency is amending 12 CFR part 3, adding 12 CFR part 47, and amending 12 CFR part 50 as follows:

PART 3—CAPITAL ADEQUACY STANDARDS

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

Authority: 12 U.S.C. 93a, 161, 1462, 1462a, 1463, 1464, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907, 3909, and 5412(b)(2)(B).

■ 2. Section 3.2 is amended by:

- a. Revising the definition of “collateral agreement”;
- b. Revising paragraph (1)(iii) of the definition of “eligible margin loan”;
- c. Revising the definition of “qualifying master netting agreement”; and
- d. Revising paragraph (3)(ii)(A) of the definition of “repo-style transaction”.

The revisions are set forth below:

§ 3.2 Definitions.

* * * * *

Collateral agreement means a legal contract that specifies the time when, and circumstances under which, a counterparty is required to pledge collateral to a national bank or Federal savings association for a single financial contract or for all financial contracts in a netting set and confers upon the national bank or Federal savings association 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 national bank or Federal savings association 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 national bank's or Federal savings association'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 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 47, subpart I of part 252, and part 382 of this title 12, as applicable.

* * * * *

Eligible margin loan * * *

(1) * * *

(iii) The extension of credit is conducted under an agreement that provides the national bank or Federal

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

¹⁷³ See 5 U.S.C. 601 *et seq.*

¹⁷⁴ The OCC bases its estimate of the number of small entities on the Small Business Administration's size thresholds for commercial banks and savings institutions, and trust companies, which are \$550 million and \$38.5 million, respectively. Consistent with the General Principles of Affiliation 13 CFR 121.103(a), the OCC counts the assets of affiliated financial institutions when determining if the OCC should classify an OCC-supervised institution as a small entity. The OCC uses December 31, 2016, to determine size because a “financial institution's assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year.” See footnote 8 of the U.S. Small Business Administration's Table of Size Standards.

¹⁷⁵ 2 U.S.C. 1531 *et seq.*

savings association 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 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) in order to facilitate the orderly resolution of the defaulting counterparty; 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 47, subpart I of part 252, and part 382, of this title 12, as applicable.

* * * * *

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

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

(2) The agreement provides the national bank or Federal savings association 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 47, subpart I of part 252, and part 382, of this title 12, as applicable.

* * * * *

Repo-style transaction * * *

(3) * * *

(ii) * * *

(A) The transaction is executed under an agreement that provides the national bank or Federal savings association 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 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) in order to facilitate the orderly resolution of the defaulting counterparty; 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 47, subpart I of part 252, and part 382, of this title 12, as applicable; or

* * * * *

PART 47—MANDATORY CONTRACTUAL STAY REQUIREMENTS FOR QUALIFIED FINANCIAL CONTRACTS

■ 3. Add part 47 to read as follows:

PART 47—MANDATORY CONTRACTUAL STAY REQUIREMENTS FOR QUALIFIED FINANCIAL CONTRACTS

Sec.

47.1 Authority and purpose.

47.2 Definitions.

47.3 Applicability.

47.4 U.S. special resolution regimes.

47.5 Insolvency proceedings.

47.6 Approval of enhanced creditor protection conditions.

47.7 Foreign bank multi-branch master agreements.

47.8 Exclusion of certain QFCs.

Authority: 12 U.S.C. 1, 93a, 481, 1462a, 1463, 1464, 1467a, 1818, 1828, 1831n, 1831o, 1831p–1, 1831w, 1835, 3102(b), 3108(a), 5412(b)(2)(B), (D)–(F).

§ 47.1 Authority and purpose.

(a) *Authority.* 12 U.S.C. 1, 93a, 1462a, 1463, 1464, 1467a, 1818, 1828, 1831n, 1831p–1, 1831w, 1835, 3102(b), 3108(a), 5412(b)(2)(B), (D)–(F).

(b) *Purpose.* The purpose of this part is to promote the safety and soundness of federally chartered or licensed institutions by mitigating the potential destabilizing effects of the resolution of a global systemically important banking entity on an affiliate that is a covered bank (as defined by this part) by requiring covered banks to include in financial contracts covered by this part certain mandatory contractual provisions relating to stays on acceleration and close out rights and transfer rights.

§ 47.2 Definitions.

As used in this part:

Affiliate means an affiliate as defined in 12 U.S.C. 1841(k) (Bank Holding Company Act).

Central counterparty (CCP) means a counterparty (for example, a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts.

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

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

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

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

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) of this definition, 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 12 U.S.C. 1841 (Bank Holding Company Act).

Covered entity has the same meaning as in § 252.82(a) of this title (Federal Reserve Board Regulation YY) (12 CFR 252.82).

Covered FSI has the same meaning as in § 382.2(b) of this title (Federal Deposit Insurance Corporation) (12 CFR 382.2(b)).

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 § 47.5, 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 that commences upon the Federal Deposit Insurance Corporation being 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 § 252.153 of this title (Federal Reserve Board Regulation YY) (12 CFR 252.153); or a nonbank financial company supervised by the Federal Reserve Board under Title II 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. 2002 *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, with 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)(4)–(5)); 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. 80–b–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 sections 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 sections 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 section 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 paragraphs (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:

- (1) 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 paragraph (1) of this definition apply only with respect to the activities that require the entity to be so registered; or

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

Person includes an individual, bank, corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any other form of entity.

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 means a customer or counterparty that is:

- (1) An individual;
- (2) A business customer, but solely if and to the extent that:

(i) The national bank, Federal savings association, or Federal branch or agency manages its transactions with the business customer, including deposits, unsecured funding, and credit facility and liquidity facility transactions, in the same way it manages its transactions with individuals;

(ii) Transactions with the business customer have liquidity risk characteristics that are similar to comparable transactions with individuals; and

(iii) The total aggregate funding raised from the business customer is less than \$1.5 million; or

(3) A living or testamentary trust that:

(i) Is solely for the benefit of natural persons;

(ii) Does not have a corporate trustee; and

(iii) Terminates within 21 years and 10 months after the death of grantors or beneficiaries of the trust living on the effective date of the trust or within 25 years, if applicable under state law.

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 (12 U.S.C. 1813(a)), 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 (12 U.S.C. 1813(b)), 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 (12 U.S.C. 2002 *et seq.*); or an insured Federal credit union or State-chartered credit union under the Federal Credit Union Act (12 U.S.C. 1751 *et seq.*); 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 bank means any operating subsidiary of a national bank, Federal savings association, or Federal branch or agency as defined in § 5.34 of this chapter (national banks), or § 5.38 of this chapter (Federal savings associations), or any other entity owned or controlled by the covered bank that would be a subsidiary under 12 U.S.C. 1841 (Bank Holding Company Act).

U.S. agency has the same meaning as the term “agency” in 12 U.S.C. 3101(1).

U.S. branch has the same meaning as the term “branch” in 12 U.S.C. 3101(3).

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.

§ 47.3 Applicability.

(a) *General requirement.* A covered bank must ensure that each covered QFC conforms to the requirements of §§ 47.4 and 47.5.

(b) *Covered bank*—(1) *Generally.* For purposes of this part, a covered bank is:

(i) A national bank or Federal savings association that has more than \$700 billion in total assets as reported on the national bank’s or Federal savings association’s most recent Consolidated Reports of Condition and Income (Call Report);

(ii) A national bank or Federal savings association that is a subsidiary of a global systemically important bank holding company that has been designated pursuant to § 252.82 of this title (Federal Reserve Board Regulation YY) (12 CFR 252.82);

(iii) A national bank or Federal savings association that is a subsidiary of a global systemically important foreign banking organization that has been designated pursuant to § 252.87 of this title (Federal Reserve Board Regulation YY) (12 CFR 252.87); or

(iv) A Federal branch or agency, as defined in subpart B of this chapter (governing Federal branches and agencies), of a global systemically important foreign banking organization that has been designated pursuant to § 252.87 of this title (Federal Reserve Board Regulation YY) (12 CFR 252.87).

(2) *Subsidiary of a covered bank.* This part applies to a subsidiary of a covered bank as provided under paragraph (b)(1) of this section. Specifically, the covered bank is required to ensure that a covered QFC to which the subsidiary of a covered bank is a party (as a direct counterparty or a support provider) satisfies the requirements of §§ 47.4 and 47.5 in the same manner and to the same extent applicable to the covered bank.

(3) *Subsidiaries not included as covered banks.* Notwithstanding paragraphs (b)(1) and (2) of this section, a covered bank does not include:

(i) A subsidiary that is owned by a covered bank in satisfaction of debt previously contracted in good faith pursuant to section 5137 of the Revised

Statutes (12 U.S.C. 29) (national bank) or section 5(c) of the Home Owners’ Loan Act (12 U.S.C. 1464) (Federal savings association);

(ii) 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) (national banks), or under section 5(c) of the Home Owners’ Loan Act (12 U.S.C. 1464(c)) (Federal savings associations);

(iii) A subsidiary that is owned pursuant to paragraph (7) of section 5136 of the Revised Statutes (12 U.S.C. 24(Seventh)), or paragraph (11) of section 5136 of the Revised Statutes (12 U.S.C. 24(Eleventh)) (national banks), or § 5.59 of this chapter (12 CFR 5.59) (Federal savings associations) designed primarily to promote the public welfare, including the welfare of low- and 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 bank that is a covered bank on January 1, 2018, an in-scope QFC that the covered bank:

(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 1, 2019, if the covered bank, 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 bank that becomes a covered bank after January 1, 2018, an in-scope QFC that the covered bank:

(i) Enters, executes or otherwise becomes a party to on or after the later of the date the covered bank first becomes a covered bank 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 section with respect to the covered bank, if the covered bank 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) of this section with respect to the covered bank.

(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 bank; or

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

(e) *Rules of construction.* For purposes of this part:

(1) A covered bank 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 bank that is a covered bank 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 bank) 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 bank) is not described in paragraphs (f)(1)(i) or (f)(1)(ii) of this section, or if, notwithstanding paragraph (f)(1)(ii) of this section, a party to the covered QFC (other than the covered bank) is a small financial institution.

(2) With respect to each of its covered QFCs, a covered bank that is not a covered bank 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 one year after the date the covered bank first becomes a covered bank 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 bank first becomes a covered bank if each party to the covered QFC (other than the covered bank) 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 two years from the date the covered bank first becomes a covered bank if a party to the covered QFC (other than the covered bank) is not described in paragraphs (f)(2)(i) or (f)(2)(ii) of this section, or if, notwithstanding paragraph (f)(2)(ii) of this section, a party to the covered QFC (other than the covered bank) is a small financial institution.

§ 47.4 U.S. special resolution regimes.

(a) *Covered QFCs not required to be conformed.* (1) Notwithstanding § 47.3, a covered bank is not required to conform a covered QFC to the requirements of this section if:

(i) The covered QFC designates, in the manner described in paragraph (a)(2) of this section, 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 bank, 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 bank 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 bank 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 bank or an affiliate of the covered bank 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 bank 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 § 47.5.

§ 47.5 Insolvency proceedings.

(a) *Covered QFCs not required to be conformed.* Notwithstanding § 47.3, a covered bank is not required to conform a covered QFC to the requirements of this section 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 under the covered affiliate credit enhancement.

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

(1) After the FDI Act stay period, if the covered affiliate credit enhancement is not transferred pursuant to section 11(e)(9)–(e)(10) of Federal Deposit Insurance Act (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.

§ 47.6 Approval of enhanced creditor protection conditions.

(a) *Protocol compliance*. (1) Unless the OCC 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 section 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 (2) of this section:

(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 section.

(A) The provisions of Section 1 of the attachment to the universal protocol may be limited in their application to a covered entity, covered bank, or covered FSI 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 a covered entity, covered bank, or covered FSI;

(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 provision of Section 4(b) of the attachment to the universal protocol may only be effective to the extent that the covered QFC 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 section;

(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 bank may request that the OCC approve as compliant with the requirements of §§ 47.4 and 47.5 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 § 47.5(b) that are different than that of paragraphs (d), (f), and (h) of § 47.5.

(3) A covered bank 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 OCC requests.

(c) *OCC approval.* The OCC may approve, subject to any conditions or commitments the OCC may set, a proposal by a covered bank 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 § 47.5 or that is amended as provided under paragraph (a) of this section, would promote the safety and soundness of federally chartered or licensed institutions by mitigating the potential destabilizing effects of the resolution of a global significantly important banking entity that is an affiliate of the covered bank, at least to the same extent.

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

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

affiliate of a covered bank, to be resolved in a rapid and orderly manner in the event of the financial distress or failure of the covered bank, or an affiliate of a covered bank, 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 banks or an affiliates of covered banks;

(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 banks or an affiliates of covered banks;

(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.

§ 47.7 Foreign bank multi-branch master agreements.

(a) *Treatment of foreign bank multi-branch master agreements.* With respect to a Federal branch or agency of a global systemically important foreign banking organization, a foreign bank multi-branch master agreement that is a covered QFC solely because the master agreement permits agreements or

transactions that are QFCs to be entered into at one or more Federal branches or agencies of the global systemically important foreign banking organization will be considered a covered QFC for purposes of this part only with respect to such agreements or transactions booked at such Federal branches or agencies.

(b) *Definition of foreign bank multi-branch master agreements.* A foreign bank multi-branch master agreement means a master agreement that permits a Federal branch or agency and another place of business of a foreign bank that is outside the United States to enter transactions under the agreement.

§ 47.8 Exclusion of certain QFCs.

(a) *Exclusion of QFCs with FMUs.* Notwithstanding § 47.3, a covered bank 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 bank) is an FMU.

(b) *Exclusion of certain covered entity and covered FSI QFCs.* If a covered QFC is also a covered QFC under part 382 or 252, subpart I, of this title that an affiliate of the covered bank is also required to conform pursuant to part 382 or 252, subpart I, of this title and the covered bank is:

(1) The affiliate credit enhancement provider with respect to the covered QFC, then the covered bank 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 excluded bank is the affiliate credit enhancement provider, then the covered bank 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 § 47.3, a covered bank 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 bank 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 bank or an affiliate of the covered bank; and

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

(d) *Exemption by order.* The OCC may exempt by order one or more covered banks 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 bank, or affiliates of the covered bank, 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 OCC deems relevant.

PART 50—LIQUIDITY RISK MEASUREMENT STANDARDS

■ 4. The authority citation for part 50 continues to read as follows:

Authority: 12 U.S.C. 1 *et seq.*, 93a, 481, 1818, and 1462 *et seq.*

■ 5. Section 50.3 is amended by revising the definition of “qualifying master netting agreement” to read as follows:

§ 50.3 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 national bank or Federal savings association 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 similar 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 47, subpart I of part 225, or part 382 of this title, as applicable;

* * * * *

Dated: November 20, 2017.

Keith A. Noreika,

Acting Comptroller of the Currency.

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