FEDERAL RESERVE SYSTEM

12 CFR Parts 217, 249, and 252

[Regulations Q, WW, and YY; Docket No. R–1538]

RIN 7100–AE52

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

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

ACTION: Final rule.

SUMMARY: The Board is adopting a final rule to promote U.S. financial stability by improving the resolvability and resilience of systemically important U.S. banking organizations and systemically important foreign banking organizations pursuant to section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Under the final rule, any U.S. top-tier bank holding company identified by the Board as a global systemically important banking organization (GSIB), the subsidiaries of any U.S. GSIB (other than national banks, federal savings associations, state nonmember banks, and state savings associations), and the U.S. operations of any foreign GSIB (other than national banks, federal savings associations, state nonmember banks, and state savings associations) would be subjected to restrictions regarding the terms of their non-cleared qualified financial contracts (QFCs). First, a covered entity generally is required to ensure that QFCs to which it is party provide that any default rights and restrictions on the transfer of the QFCs are limited to the same extent as they would be under the Dodd-Frank Act and the Federal Deposit Insurance Act. Second, a covered entity generally is prohibited from being party to QFCs that would allow a QFC counterparty to exercise default rights against the covered entity, directly or indirectly, based on the entry into a resolution proceeding under the Dodd-Frank Act or Federal Deposit Insurance Act, or any other resolution proceeding, of an affiliate of the covered entity. The final rule also amends certain definitions in the Board's capital and liquidity rules; these amendments are intended to ensure that the regulatory capital and liquidity treatment of QFCs to which a covered entity is party is not affected by the final rule's restrictions on such QFCs. The Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) are expected to issue final rules that would subject GSIB subsidiaries for which the OCC and FDIC are the appropriate Federal banking agency to requirements substantively identical to those in this final rule.

DATES: The final rule is effective on November 13, 2017.

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SUPPLEMENTARY INFORMATION:

Table of Contents

I. Introduction

A. Background

In May 2016, the Board invited comment on a notice of proposed rulemaking ("proposal" or "proposed rule") to impose restrictions on the qualified financial contracts (QFCs)—such as derivatives contracts and repurchase agreements—of U.S. global systemically important banking organizations (GSIBs) and the U.S. operations of global systemically important foreign banking organizations or "foreign GSIBs" (collectively, "covered entities").[1] The proposal would have required the QFCs of covered entities to contain contractual provisions that opt into the temporary stay-and-transfer treatment of the Federal Deposit Insurance Act (FDI Act) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), thereby reducing the risk that the stay-and-transfer treatment would be challenged by a QFC counterparty or a court in a foreign jurisdiction. The FDI Act and Title II of the Dodd-Frank Act create special resolution frameworks for failed financial firms that provide that the rights of a failed firm's counterparties to terminate their QFCs are temporarily stayed when the firm enters a resolution proceeding to allow for the transfer of the relevant obligations under the QFC to a solvent party. The proposal also would have prohibited the exercise of default rights in QFCs related, directly or indirectly, to the entry into resolution of an affiliate of a covered entity (cross-default rights), subject to certain creditor protection exceptions that would not be expected to interfere with an orderly resolution.

This final rule, which is part of a set of actions by the Board to address the "too-big-to-fail" problem, addresses one of the ways in which the severe distress or failure of a major financial firm can destabilize the U.S. financial system. Protecting the financial stability of the United States by helping to address this too-big-to-fail problem is a core objective of the Dodd-Frank Act,[2] which Congress passed in response to the 2007–2009 financial crisis and the ensuing recession. As illustrated by the failure of Lehman Brothers in September of 2008, the failure of a large, interconnected financial company could cause severe damage to the U.S. financial system and, ultimately, to the economy as a whole. The Dodd-Frank Act and the actions that U.S. financial regulators have taken to implement it and to otherwise protect U.S. financial stability help to address the too-big-to-

[1] 81 FR 29169 (May 11, 2016).

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

fail problem in two ways: By reducing the probability that a systemically important financial company will fail, and by reducing the damage that such a company's failure would do if it were to occur. The second of these strategies, which is supported by this final rule, centers on measures designed to help ensure that a failed company's passage through a resolution proceeding—such as bankruptcy or the special resolution process created by the Dodd-Frank Act—would be more orderly, thereby helping to mitigate destabilizing effects on the rest of the financial system.[3]

This final rule represents a further step to increase the resolvability and resilience of U.S. GSIBs and foreign GSIBs that operate in the United States. The final rule complements the Board's final rulemaking on total loss-absorbing capacity, long-term debt, and clean holding company requirements for GSIBs (TLAC final rule)[4] and the ongoing work of the Board and the Federal Deposit Insurance Corporation (FDIC) on resolution planning requirements for GSIBs. The final rule focuses on improving the orderly resolution of a GSIB by limiting disruptions to a failed GSIB through its financial contracts with other companies. In particular, the requirements of the final rule seek to facilitate the orderly resolution of a failed GSIB by limiting the ability of the firm's QFC counterparties to terminate such contracts immediately upon entry of the GSIB or one of its affiliates into resolution. Given the large volume of QFCs to which covered entities are a party, the exercise of default rights en masse as a result of the failure or significant distress of a covered entity could lead to failure and a disorderly resolution if the failed firm were forced to sell off assets, which could spread contagion by increasing volatility and lowering the value of similar assets held by other firms, or to withdraw liquidity that it had provided to other firms.

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

For example, the triggering of default rights by counterparties of Lehman Brothers (Lehman) in 2008 was a key driver of the destabilization that resulted from its failure.[5] At the time of its failure, Lehman was party to very large volumes of financial contracts, including over-the-counter derivatives contracts.[6] When its holding company declared bankruptcy, Lehman's counterparties exercised their default rights.[7] Lehman's default "caused disruptions in the swaps and derivatives markets and a rapid, market-wide unwinding of trading positions."[8] Meanwhile, "out-of-the-money counterparties, which owed Lehman money, typically chose not to terminate their contracts" and instead suspended payment, reducing the liquidity available to the bankruptcy estate.[9] The complexity and disruption associated with Lehman's portfolios of financial contracts led to a disorderly resolution of Lehman.[10] This final rule is meant to help avoid a repeat of the systemic disruptions caused by the Lehman failure by preventing the exercise of default rights in financial contracts from leading to such disorderly and destabilizing severe distress or failures in the future.

This final rule responds to the threat to financial stability posed by such default rights in two ways. First, the final rule reduces the risk that courts in foreign jurisdictions would disregard statutory provisions that would stay the rights of a failed firm's counterparties to terminate their contracts when the firm enters a resolution proceeding under one of the special resolution frameworks for failed financial firms created by Congress under the FDI Act and the Dodd-Frank Act. Second, the final rule facilitates the resolution of a large financial entity under the U.S. Bankruptcy Code and other resolution frameworks by ensuring that the counterparties of solvent affiliates of the failed entity cannot unravel their contracts with the solvent affiliate based solely on the failed entity's resolution.

The Board is issuing this final rule under section 165 of the Dodd-Frank Act, as well as its safety and soundness and other relevant authorities.[11] Section 165 instructs the Board to impose enhanced prudential standards on bank holding companies with total consolidated assets of $50 billion or more "[i]n order to prevent or mitigate risks to the financial stability of the

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

[4] 82 FR 8266 (Jan. 24, 2017).

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

[6] *See* Michael J. Fleming and Asani Sarkar, "The Failure Resolution of Lehman Brothers," FRBNY Economic Policy Review 185 (Dec. 2014), *https://www.newyorkfed.org/medialibrary/media/research/epr/2014/1412flem.pdf*.

[7] *See id.*

[8] "The Orderly Liquidation of Lehman Brothers Holdings Inc. under the Dodd-Frank Act" 3, FDIC Quarterly (2011), *https://www.fdic.gov/bank/analytical/quarterly/2011_vol5_2/lehman.pdf*.

[9] Michael J. Fleming and Asani Sarkar, "The Failure Resolution of Lehman Brothers," FRBNY Economic Policy Review 185 (Dec. 2014), *https://www.newyorkfed.org/medialibrary/media/research/epr/2014/1412flem.pdf*.

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

[11] 12 U.S.C. 321–338a, 481–486, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1844(c), 3101 *et seq.*, 3101 note, 3904, 3906–3909, 4808, 5361, 5362, 5365, 5366, 5367, 5368, 5371.

United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions.'' [12] These enhanced prudential standards must increase in stringency based on the systemic footprint and risk characteristics of covered firms.[13] Section 165 requires the Board to impose enhanced prudential standards of several specified types and also authorizes the Board to establish ''such other prudential standards as the Board of Governors, on its own or pursuant to a recommendation made by the Council, determines are appropriate.'' [14]

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

The final rule should also improve the resilience of the U.S. operations of foreign GSIBs, and thereby increase the likelihood that a failed foreign GSIB with U.S. operations would be successfully resolved by its home jurisdiction authorities without the severe distress or failure of the foreign GSIB's U.S. operating entities and with limited effect on the financial stability of the United States.[15]

The Board has tailored this final rule to apply only to those banking organizations whose disorderly failure or severe distress would be likely to pose the greatest risk to U.S. financial stability: The U.S. GSIBs and the U.S. operations of foreign GSIBs. The Board believes that limiting the application of this final rule in this way sensibly balances the costs and benefits of the rule by effectively managing systemic risk while at the same time limiting the burden of compliance by not requiring non-GSIB firms with total assets in excess of $50 billion to comply with any part of this final rule.

Qualified financial contracts, default rights, and financial stability. The final rule pertains to several important classes of financial transactions that are collectively known as ''qualified financial contracts.'' [16] QFCs include derivatives, repurchase agreements (also known as ''repos''), reverse repos, and securities lending and borrowing agreements.[17] GSIBs enter into QFCs for a variety of purposes, including to borrow money to finance their investments, to lend money, to manage risk, and to enable their clients and counterparties to hedge risks, make markets in securities and derivatives, and take positions in financial investments.

QFCs play a role in economically valuable financial intermediation when markets are functioning normally. But they are also a major source of financial interconnectedness, which can pose a threat to financial stability in times of market stress. The final rule focuses on a context in which that threat is especially great: The severe distress or 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 a resolution proceeding.

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

This may occur through several channels. First, the exits may drain liquidity from a troubled GSIB, forcing the GSIB to rapidly sell off assets at depressed prices, both because the sales must be done within a short timeframe and because the elevated supply may push prices down. These asset fire sales may cause or deepen balance-sheet insolvency at the GSIB, causing a GSIB to fail more suddenly and reducing the amount that its other creditors can recover, thereby imposing losses on those creditors and threatening their solvency. The GSIB may also respond to a QFC run by withdrawing liquidity that it had offered to other firms, forcing them to engage in 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 as the GSIB marks those assets down to the new fire sale induced price level.[18] The counterparty's rights to set-off amounts owed, terminate the contract, or suspend payments may allow it to further drain the GSIB's capital and liquidity by withholding payments that it would otherwise owe to the GSIB. The GSIB may also have rehypothecated collateral that it received from QFC counterparties, for instance in repo or securities lending transactions that fund other client arrangements, in which case demands from those counterparties for the early

[12] 12 U.S.C. 5365(a)(1).

[13] 12 U.S.C. 5365(a)(1)(B), (b)(3)(A)–(D).

[14] 12 U.S.C. 5365(b)(1)(B)(iv).

[15] As discussed in detail in this **SUPPLEMENTARY INFORMATION** section, this rule is intended to help prevent systemic disruptions that may arise as a result of the exercise of certain contractual rights contained in QFCs entered into by GSIBs or their subsidiaries. This rule includes certain limitations on the exercise of these rights with a view to preventing such systemic disruptions. Separate from these limitations, both Title II of the Dodd-Frank Act and the FDI Act include various restrictions on the exercise of rights by parties to QFCs and provide the FDIC, as receiver of a company subject to resolution under Title II or the FDI Act, with special authorities. None of the provisions of this rule should be construed as being intended to modify or limit, in any manner, the rights and powers of the FDIC as receiver under Title II or the FDI Act, including, without limitation, the rights of the FDIC as receiver to enforce provisions of Title II or the FDI Act that limit the enforceability of certain contractual provisions.

[16] The final rule adopts the definition of ''qualified financial contract'' set out in section 210(c)(8)(D) of the Dodd-Frank Act, 12 U.S.C. 5390(c)(8)(D). *See* final rule § 252.81.

[17] The definition of ''qualified financial contract'' is broader than this list of examples, and the default rights discussed are not common to all types of QFC. *See* final rule § 252.81.

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

return of their rehypothecated collateral could be especially disruptive.[19]

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

Where there are significant simultaneous terminations and these effects occur contemporaneously, such as upon the failure or severe distress 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 because it helps to ensure that the GSIB entities remain viable and to avoid instability caused by asset fire sales.

Consequently, the Board and the FDIC have identified the exercise of certain default rights in financial contracts as a potential obstacle to orderly resolution in the context of resolution plans filed pursuant to section 165(d) of the Dodd-Frank Act [20] and have instructed the most systemically important firms to demonstrate that they are ''amending, on an industry-wide and firm-specific basis, financial contracts to provide for a stay of certain early termination rights of external counterparties triggered by insolvency proceedings.'' [21]

Direct defaults and cross-defaults. This final rule focuses on two distinct scenarios in which a non-defaulting party to a QFC is commonly able to exercise the rights described above. These two scenarios involve a default that occurs when either the GSIB legal entity that is a direct party [22] to the QFC or an affiliate of that legal entity enters a resolution proceeding.[23] The first scenario occurs when a GSIB entity that is itself a direct party to the QFC enters a resolution proceeding; this preamble refers to such a scenario as a ''direct default'' and refers to the default rights that arise from a direct default as ''direct default rights.'' The second scenario occurs when an affiliate of the GSIB entity that is a direct party to the QFC (such as the direct party's parent holding company) enters a resolution proceeding; this preamble refers to such a scenario as a ''cross-default'' and refers to default rights that arise from a cross-default as ''cross-default rights.'' For example, a GSIB parent entity might guarantee the derivatives transactions of its subsidiaries, and those derivatives contracts could contain cross-default rights against a subsidiary of the GSIB that would be triggered by the bankruptcy filing of the GSIB parent entity even though the subsidiary continues to meet all of its financial obligations.[24]

Importantly, this final rule does not affect all types of default rights. Moreover, the final rule is concerned only with default rights that run *against* a GSIB—that is, direct default rights and cross-default rights that arise from the entry into resolution of a GSIB entity. The final rule does not affect default rights that a GSIB entity (or any other entity) may have against a counterparty that is not a GSIB entity. This limited scope is appropriate because, as described above, the risk posed to financial stability by the exercise of QFC default rights is greatest when the defaulting counterparty is a GSIB entity.

Single-point-of-entry resolution. Cross-default rights are especially significant in the context of a GSIB failure because GSIBs typically enter into large volumes of QFCs through different entities controlled by the GSIB. For example, a U.S. GSIB is made up of a U.S. bank holding company and numerous operating subsidiaries that are owned, directly or indirectly, by the bank holding company. From the standpoint of financial stability, the most important of these operating subsidiaries are generally a U.S. insured depository institution, a U.S. broker-dealer, and similar entities organized in other countries.

Many complex GSIBs have developed resolution strategies that rely on a single-point-of-entry (SPOE) resolution strategy. In an SPOE resolution of a GSIB, only a single legal entity—the GSIB's top-tier bank holding company—would enter a resolution proceeding. The losses that led to the GSIB's failure would be passed up from the operating subsidiaries that incurred the losses to the holding company and would then be imposed on the equity holders and unsecured creditors of the holding company through the resolution process.[25] This strategy is designed to help ensure that the GSIB subsidiaries remain adequately capitalized and that operating subsidiaries of the GSIB are able to continue to meet their financial obligations without defaulting or entering resolution themselves. The expectation that the holding company's equity holders and unsecured creditors would absorb the GSIB's losses in the event of failure would help to maintain the confidence of the operating subsidiaries' creditors and counterparties (including their QFC

[19] *See generally* Adam Kirk, James McAndrews, Parinitha Sastry, and Phillip Weed, ''Matching Collateral Supply and Financing Demands in Dealer Banks,'' FRBNY Economic Policy Review 127 (Dec. 2014), *http://www.newyorkfed.org/medialibrary/media/research/epr/2014/1412kirk.pdf*.

[20] 12 U.S.C. 5365(d).

[21] Board and FDIC, ''Agencies Provide Feedback on Second Round Resolution Plans of 'First-Wave' Filers'' (Aug. 5, 2014), *http://www.federalreserve.gov/newsevents/press/bcreg/20140805a.htm*. *See also* Board and FDIC, ''Guidance for 2018 § 165(d) Annual Resolution Plan Submissions By Foreign-based Covered Companies that Submitted Resolution Plans in July 2015,'' (Mar. 24, 2017), *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170324a21.pdf*; Board and FDIC, ''Guidance for 2017 § 165(d) Annual Resolution Plan Submissions By Domestic Covered Companies that Submitted Resolution Plans in July 2015,'' (Apr. 13, 2016), *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20160413a1.pdf*; Board and FDIC, ''Agencies Provide Feedback on Resolution Plans of Three Foreign Banking Organizations,'' (Mar. 23, 2015), *http://www.federalreserve.gov/newsevents/press/bcreg/20150323a.htm*; Board and FDIC, ''Guidance for 2013 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012'' (Apr. 15, 2013), *http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20130415c2.pdf*.

[22] In general, a ''direct party'' refers to a party to a financial contract other than a credit enhancement (such as a guarantee). The definition of ''direct party'' and related definitions are discussed in more detail below.

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

[24] *See* Michael J. Fleming and Asani Sarkar, ''The Failure Resolution of Lehman Brothers,'' FRBNY Economic Policy Review 185 (Dec. 2014), *https://www.newyorkfed.org/medialibrary/media/research/epr/2014/1412flem.pdf*.

[25] The Board's final rule regarding total loss-absorbing capacity, long term debt and clean holding company requirements (TLAC rule) addresses the need for adequate external loss-absorbing capacity at the holding company level by requiring the top-tier holding companies of the U.S. GSIBs and the U.S. intermediate holding companies of foreign GSIBs to maintain outstanding required levels of unsecured long-term debt and TLAC, which is defined to include both tier 1 capital and eligible long-term debt. *See* 82 FR 8266, 8287 (Jan. 24, 2017).

counterparties), reducing their incentive to engage in potentially destabilizing funding runs or margin calls and thus lowering the risk of asset fire sales. A successful SPOE resolution would also avoid the need for separate resolution proceedings for separate legal entities run by separate authorities across multiple jurisdictions, which would be more complex and could therefore destabilize the resolution of a GSIB.

The Board's TLAC rule is intended to help, though not exclusively, to lay the foundation necessary for the SPOE resolution of a GSIB by requiring the top-tier holding companies of U.S. GSIBs and the U.S. intermediate holding companies of foreign GSIBs to maintain sufficient amounts of loss-absorbing capacity that could be used for resolution and to adopt a ''clean holding company'' structure, under which certain financial activities that could pose obstacles to orderly resolution would be impermissible for the holding company and could only be conducted by its operating subsidiaries.[26]

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

U.S. Bankruptcy Code. When an entity goes into resolution under the U.S. Bankruptcy Code, attempts by the debtor entity's creditors to enforce their debts through any means other than participation in the bankruptcy proceeding (for instance, by suing in another court, seeking enforcement of a preexisting judgment, or seizing and liquidating collateral) are generally blocked by the imposition of an automatic stay.[27] A key purpose of the automatic stay, and of bankruptcy law in general, is to maximize the value of the bankruptcy estate and the creditors' ultimate recoveries by facilitating an orderly liquidation or restructuring of the debtor. The automatic stay thus solves a collective action problem in which the creditors' individual incentives to become the first to recover as much from the debtor as possible, before other creditors can do so, collectively cause a value-destroying disorderly liquidation of the debtor.[28]

However, the U.S. Bankruptcy Code largely exempts QFC[29] counterparties of the debtor from the automatic stay through special ''safe harbor'' provisions.[30] Under these provisions, any rights that a QFC counterparty has to terminate the contract, set-off obligations, or liquidate collateral in response to a direct default are not subject to the stay and may be exercised against the debtor immediately upon default. (The U.S. Bankruptcy Code does not itself confer default rights upon QFC counterparties; it merely permits QFC counterparties to exercise certain rights created by other sources, such as contractual rights created by the terms of the QFC.)

The U.S. Bankruptcy Code's automatic stay also does not prevent the exercise of cross-default rights against an affiliate of the party entering resolution. The stay generally applies only to actions taken against the party entering resolution or the bankruptcy estate,[31] whereas a QFC counterparty exercising a cross-default right is instead acting against a distinct legal entity that is not itself in resolution—the debtor's affiliate.

Title II of the Dodd-Frank Act and the Orderly Liquidation Authority. Title II of the Dodd-Frank Act imposes stay requirements on QFCs of financial companies that enter resolution under that Title. In general, no financial firm (regardless of size) is too-big-to-fail and a U.S. bank holding company (such as the top-tier holding company of a U.S. GSIB) that fails would be resolved under the U.S. Bankruptcy Code. Congress recognized, however, that a financial company might fail under extraordinary circumstances in which an attempt to resolve it through the bankruptcy process would have serious adverse effects on financial stability in the United States. Title II of the Dodd-Frank Act establishes the Orderly Liquidation Authority (OLA), an alternative resolution framework intended to be used in rare circumstances to manage the failure of a firm that poses a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard.[32] Title II authorizes the Secretary of the Treasury, upon the recommendation of other government agencies and a determination that several preconditions are met, to place a financial company into a receivership conducted by the FDIC as an alternative to bankruptcy.[33]

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.[34] 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.[35] Once the QFCs are transferred in accordance with the statute, Title II permanently stays the exercise of default rights for those reasons.[36]

Title II addresses cross-default rights through a similar procedure. It empowers the FDIC to enforce contracts of subsidiaries or affiliates of the failed covered financial company that are ''guaranteed or otherwise supported by or linked to the covered financial company, notwithstanding any contractual right to cause the termination, liquidation, or acceleration of such contracts based solely on the insolvency, financial condition, or receivership of'' the failed company, so long as, if such contracts are guaranteed or otherwise supported by the covered financial company, the FDIC takes certain steps to protect the QFC counterparties' interests by the end of the business day following the company's entry into OLA resolution.[37]

These stay-and-transfer provisions of the Dodd-Frank Act are intended to mitigate the threat posed by QFC default rights. At the same time, the provisions allow appropriate protections for QFC counterparties of the failed financial

[26] *See* 82 FR 8266 (Jan. 24, 2017).

[27] *See* 11 U.S.C. 362.

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

[29] 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.

[30] 11 U.S.C. 362(b)(6), (7), (17), (27), 362(o), 555, 556, 559, 560, 561. The U.S. Bankruptcy Code specifies the types of parties to which the safe harbor provisions apply, such as financial institutions and financial participants. *Id.*

[31] *See* 11 U.S.C. 362(a).

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

[33] *See* section 203 of the Dodd-Frank Act, codified at 12 U.S.C. 5383.

[34] *See* 12 U.S.C. 5390(c)(9).

[35] 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.

[36] 12 U.S.C. 5390(c)(10)(B)(i)(II).

[37] 12 U.S.C. 5390(c)(16).

company. The provisions stay only the exercise of default rights based on the failed company's entry into resolution, the fact of its insolvency, or its financial condition. 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) or, if applicable, provides adequate protection that the QFCs will be performed.

The Federal Deposit Insurance Act. Under the FDI Act, a failing insured depository institution would generally enter a receivership administered by the FDIC.[38] The FDI Act addresses direct default rights in the failed bank's QFCs with stay-and-transfer provisions that are substantially similar to the provisions of Title II of the Dodd-Frank Act discussed above.[39] However, the FDI Act does not address cross-default rights, leaving the QFC counterparties of the failed depository institution's affiliates free to exercise any contractual rights they may have to terminate, net, or liquidate collateral based on the depository institution's entry into resolution. Moreover, as with Title II of the Dodd-Frank Act, there is a possibility that a court of a foreign jurisdiction might decline to enforce the FDI Act's stay-and-transfer provisions under certain circumstances.

B. Notice of Proposed Rulemaking and General Summary of Comments

The proposal was intended to increase GSIB resolvability and resiliency by addressing two QFC-related issues. First, the proposal sought to address the risk that a court in a foreign jurisdiction may decline to enforce the QFC stay-and-transfer provisions of Title II and the FDI Act discussed above. Second, the proposal sought to address the potential disruption that may occur if a counterparty to a QFC with an affiliate of a GSIB entity that goes into resolution under the U.S. Bankruptcy Code or the FDI Act exercises cross-default rights.

Scope of application. The proposal's requirements would have applied to all ''covered entities.'' Under the proposal, ''covered entity'' included: Any U.S. top-tier bank holding company identified as a GSIB under the Board's rule establishing risk-based capital surcharges for GSIBs (GSIB surcharge rule);[40] any subsidiary of such a bank holding company; and any U.S. subsidiary, U.S. branch, or U.S. agency of a foreign GSIB.[41] ''Covered entity'' did not include national banks and Federal savings associations that are supervised by the Office of the Comptroller of the Currency (OCC), because the OCC was expected to issue, and ultimately did issue, a proposed rule that would subject those institutions to requirements substantively identical to those proposed by the Board's rule for covered entities.

In the proposal, ''qualified financial contract'' or ''QFC'' was defined to have the same meaning as in section 210(c)(8)(D) of the Dodd-Frank Act,[42] and included, among other things, derivatives, repos, and securities borrowing and lending agreements. Subject to the exceptions discussed below, the proposal's requirements would have applied to any QFC to which a covered entity is party (covered QFC). Under the proposal, a covered entity would have been required to conform pre-existing QFCs if a covered entity enters into a new QFC with a counterparty or its affiliate.

Required contractual provisions related to the U.S. Special Resolution Regimes. Under the proposal, covered entities would have been required to ensure that covered QFCs include contractual terms explicitly providing that any default rights or restrictions on the transfer of the QFC are limited to at least the same extent as they would be pursuant to the OLA and the FDI Act (U.S. Special Resolution Regimes).[43] The proposed requirements were not intended to imply that the statutory stay-and-transfer provisions would not in fact apply to a given QFC, but rather to help ensure that all covered QFCs would be treated the same way in the context of an FDIC receivership under the Dodd-Frank Act or the FDI Act. This provision was intended to address the first issue listed above and to decrease the QFC-related threat to financial stability posed by the failure and resolution of an internationally active GSIB. This section of the proposal was also consistent with analogous legal requirements that have been imposed in other national jurisdictions[44] and with the Financial Stability Board's ''Principles for Cross-border Effectiveness of Resolution Actions.''[45]

Prohibited cross-default rights. Under the proposal, a covered entity would have been prohibited from entering into covered QFCs that would allow the exercise of cross-default rights—that is, default rights related, directly or indirectly, to the entry into resolution of an affiliate of the direct party—against it.[46] Covered entities would have been similarly prohibited from entering into covered QFCs that included a restriction on the transfer of a credit enhancement supporting the QFC from the covered entity's affiliate to a transferee upon the entry into resolution of the affiliate.

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

Industry-developed protocol. As an alternative to bringing their covered QFCs into compliance with the requirements set out in the proposed rule, covered entities would have been permitted to comply with the requirements of the proposed rule by adhering to the International Swaps and Derivatives Association (ISDA) 2015 Universal Resolution Stay Protocol, including the Securities Financing Transaction Annex and the Other Agreements Annex (together, the ''Universal Protocol'').[47] The preamble to the proposal explained that the Board viewed the Universal Protocol as achieving an outcome consistent with the outcome intended by the requirements of the proposed rule by

[38] 12 U.S.C. 1821(c).

[39] *See* 12 U.S.C. 1821(e)(8)–(10).

[40] 12 CFR 217.402; 80 FR 49106 (Aug. 14, 2015).

[41] *See* proposed rule § 252.81.

[42] 12 U.S.C. 5390(c)(8)(D). *See* proposed rule § 252.81.

[43] *See* proposed rule § 252.83.

[44] *See, e.g.,* Bank of England Prudential Regulation Authority, Policy Statement, ''Contractual stays in financial contracts governed by third-country law'' (Nov. 2015), *http://www.bankofengland.co.uk/pra/Documents/publications/ps/2015/ps2515.pdf.*

[45] Financial Stability Board, ''Principles for Cross-border Effectiveness of Resolution Actions'' (Nov. 3, 2015), *http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf.*

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

[46] *See* proposed rule § 252.83(b).

[47] ISDA, ''Attachment to the ISDA 2015 Universal Resolution Stay Protocol,'' (Nov. 4, 2015), *http://assets.isda.org/media/ac6b533f-3/5a7c32f8-pdf/. See* proposed rule § 252.85(a).

similarly limiting direct default rights and cross-default rights.

Process for approval of enhanced creditor protection conditions. The proposal also would have allowed the Board, at the request of a covered entity, to approve as compliant with the proposal covered QFCs with creditor protections other than those that would otherwise be permitted under section 252.84 of the proposal.[48] The Board would have been permitted to approve such a request if, in light of several enumerated considerations,[49] the alternative creditor protections would mitigate risks to the financial stability of the United States presented by a GSIB's failure to at least the same extent as the proposed requirements.

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

Comments on the Proposal. The Board received approximately 30 comments on the proposed rule from banking organizations, trade associations, public interest advocacy groups, and private individuals. Board staff also met with some commenters at their request to discuss their comments on the proposal, and summaries of these meetings may be found on the Board's public Web site.

A number of commenters, including GSIBs that would be subject to the requirements of the proposal, expressed strong support for the proposed rule as a well-considered effort to reduce systemic risk with minimal burden and as one of the last important steps to ensure a more efficient and orderly resolution process for all covered entities and thereby to protect the stability of the U.S. financial system. Other commenters, however, expressed concern with the proposed rule. These commenters generally argued that the proposal should not restrict contractual rights of GSIB counterparties and contended that the proposal shifts the costs of resolving the covered entities to non-defaulting counterparties. Some commenters argued that the proposal would not assuredly mitigate systemic risk, as the requirements could result in increased market and credit risk for QFC counterparties of a GSIB. Commenters also argued that it would be more appropriate for Congress to impose the proposal's restrictions on contractual rights through the legislative process rather than for the Board to do so through a regulation.

As described above, the proposal applied to ''covered entities,'' which was defined to mean all U.S. GSIBs and their subsidiaries, as well as the U.S. operations (subsidiaries, branches, and agencies) of GSIBs that are foreign banking organizations. The proposal generally defined ''subsidiary'' as an entity controlled by a GSIB under the Bank Holding Company Act (BHC Act). Commenters urged the Board to move to a financial consolidation standard to define the subsidiaries of covered entities, arguing that the concept of control under the BHC Act includes entities (1) that are not under the operational control of the GSIB and over whom the GSIB does not have the practical ability to require remediation and (2) which are unlikely to raise the types of concerns for the orderly resolution of GSIBs targeted by the proposal. For similar reasons, these commenters argued that, for purposes of the requirement that a covered entity conform existing QFCs if a covered entity enters into a new QFC with a counterparty or its affiliate, a counterparty's ''affiliate'' should also be defined by reference to financial consolidation rather than BHC Act control.

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

Commenters also requested that certain types of contracts that may include transfer or default rights subject to the proposal's requirements (*e.g.,* warrants; certain commodity contracts, including commodity swaps; certain utility and gas supply contracts; certain retail customer and investment advisory agreements; securities underwriting agreements; securities lending authorization agreements) be excluded from all requirements of the final rule because these types of contracts do not raise the risks to the resolution of a covered entity or financial stability that are the target of this final rule and because certain existing contracts of these types would be difficult, if not impossible, to amend. Commenters also requested that securities contracts that typically settle in the short term or that typically include only transfer restrictions and not default rights similarly be excluded from all requirements of the final rule because they do not impose ongoing or continuing obligations on either party after settlement. In all of the above cases, commenters argued that remediation of such outstanding contracts would be burdensome with no meaningful resolution benefits. Certain commenters also urged the Board to apply the final rule only to contracts entered into after the final rule's effective date and not to contracts existing as of the final rule's effective date.

As noted above, the proposal would have deemed compliant covered QFCs amended by the existing Universal Protocol (which allows for creditor protections in addition to those otherwise permitted by the proposed rule). Commenters generally supported this aspect of the proposal, although they requested express clarification that adherence to the existing Universal Protocol would satisfy all of the requirements of the final rule. Commenters urged that the final rule should also provide a safe harbor for a future ISDA protocol that would be substantially similar to the existing Universal Protocol except that it would seek to address the specific needs of buy-side market participants, such as

[48] *See* proposed rule § 252.85.

[49] *See* proposed rule § 252.85(c).

asset managers, insurance companies, and pension funds who are counterparties to QFCs with GSIBs, to allow, for example, entity-by-entity adherence and the exclusion of certain foreign special resolution regimes.

Commenters expressed support for the exemption in the proposal for cleared QFCs but requested that this exemption be broadened to extend to the client leg of a cleared back-to-back transaction and also to exclude any contract cleared, processed, or settled on a financial market utility (FMU) as well as any QFC conducted according to the rules of an FMU. Commenters also requested an exemption for QFCs with sovereign entities and central banks. Commenters further requested a longer period of time for covered entities to conform covered QFCs with certain types of counterparties to comply with the requirements of the final rule. Commenters also requested that the Board coordinate with other regulatory agencies, consider comments submitted to the OCC regarding its proposal and from entities not regulated by the Board, and finalize a rule with conformance periods consistent with the OCC's final rule. In addition, commenters requested confirmation that modifications to contracts to comply with this rule would not trigger other regulatory requirements (*e.g.,* margin requirements for non-cleared swaps) or impact the enforceability of QFCs. The Board has considered the comments received on this proposal, including those of entities not regulated by the Board, as well as the comments submitted to the OCC and FDIC regarding their respective proposals, and these comments and changes in the final rule are described in more detail throughout the remainder of this **SUPPLEMENTARY INFORMATION**.

C. Overview of Final Rule

The Board is adopting this final rule to improve the resolvability and resilience of GSIBs and thereby reduce threats to financial stability. The Board has made a number of changes to the proposal in response to concerns raised by commenters, as further described below.

The final rule is intended to facilitate the orderly resolution of the most systemically important banking firms—the GSIBs—by limiting the ability of the firms' counterparties to terminate QFCs upon the entry of the GSIB or one or more of its affiliates into resolution. The rule requires the inclusion of contractual restrictions on the exercise of certain default rights in those QFCs. In particular, the final rule requires the QFCs of covered entities to contain contractual provisions that opt into the stay-and-transfer treatment of the FDI Act and the Dodd-Frank Act to reduce the risk that the stay-and-transfer treatment would be challenged by a QFC counterparty or a court in a foreign jurisdiction. The final rule also prohibits covered entities from entering into QFCs that contain cross-default rights, subject to certain creditor protection exceptions that would not be expected to interfere with an orderly resolution.

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

The final rule requires covered entities to conform certain covered QFCs to the requirements of the final rule on the first day of the first calendar quarter that begins a year after issuance of the final rule (first compliance date) and phases in conformance requirements with respect to all covered QFCs over a two-year period depending on the type of counterparty. As explained below, a covered entity generally is required to conform pre-existing QFCs only if the covered entity or an affiliate of the covered entity enters into a new QFC with the same counterparty or a consolidated affiliate of the counterparty on or after the first compliance date.

1. Covered Entities

The final rule continues to apply to ''covered entities,'' which generally are U.S. GSIBs and their subsidiaries and the U.S. operations of foreign GSIBs. ''Subsidiary'' continues to be defined in the final rule by reference to BHC Act control. Because the FDIC and OCC are expected to finalize substantively identical final rules to that of the Board, the definition of ''covered entity'' in the final rule excludes state savings associations and state nonmember banks (FSIs), which are supervised by the FDIC, and GSIB subsidiaries (*e.g.,* national banks), U.S. branches, and U.S. agencies that are supervised by the OCC. The final rule refers to FSIs and entities supervised by the OCC (*e.g.,* national banks) that would be covered entities but for this exclusion as ''excluded banks.'' [50] As discussed below, certain other types of GSIB subsidiaries, such as merchant banking portfolio companies, are also excluded from the final rule.

2. Covered Qualified Financial Contracts

The final rule, like the proposal, defines ''qualified financial contract'' or ''QFC'' to have the same meaning as in section 210(c)(8)(D) of the Dodd-Frank Act [51] and would include, among other things, derivatives, repos, and securities lending agreements.[52] Subject to the exceptions discussed below, the final rule's requirements apply to any QFC to which a covered entity is party (covered QFC). The final rule makes clear that covered entities do not need to conform QFCs that have no transfer restrictions, direct default rights, or cross-default rights, as these QFCs have no provisions that the rule is intended to address.[53] The final rule also excludes retail investment advisory agreements and certain existing warrants.[54] It also provides the Board with authority to exempt one or more covered entities from conforming certain contracts or types of contracts to the requirements of the final rule after considering, in addition to any other factor the Board deems relevant, the burden the exemption would relieve and the potential impact of the exemption on the resolvability of the covered entity or its affiliates.[55]

The final rule also makes clear that a covered entity must conform existing

[50] *See* final rule § 252.81 for definitions of ''excluded bank'' and ''FSI.'' *See also* 12 U.S.C. 1813.

[51] 12 U.S.C. 5390(c)(8)(D).

[52] *See* final rule § 252.81; proposed rule § 252.81.

[53] *See* final rule § 252.84(a).

[54] *See* final rule § 252.88(c).

[55] *See* final rule § 252.88(d).

QFCs with a counterparty if the GSIB group (*i.e.,* the covered entity or its affiliates that are covered entities or excluded banks) enters into a new QFC with that counterparty or its affiliate, defined by reference to financial consolidation principles. In particular, the final rule provides that a covered QFC includes a QFC that the covered entity entered, executed, or otherwise became a party to before the first compliance date of this final rule if the covered entity or any affiliate that is a covered entity or excluded bank also enters, executes, or otherwise becomes a party to a QFC with the same person or a consolidated affiliate of that person on or after the first compliance date.[56] ''Consolidated affiliate'' is a defined term in the final rule that is defined by reference to financial consolidation principles.[57]

3. Required Contractual Provisions Related to the U.S. Special Resolution Regimes

Under the final rule, covered entities are required to ensure that covered QFCs include contractual terms explicitly providing that any default rights or restrictions on the transfer of the QFC are limited to the same extent as they would be pursuant to the U.S. Special Resolution Regimes.[58] However, any covered QFC that is governed under U.S. law and involves only parties (other than the covered entity) that are domiciled in, incorporated in, organized under, or whose principal place of business is located in the United States, including any state, or that is a U.S. branch or agency (U.S. counterparties) is also excluded from the requirements of the final rule relating to Title II of the Dodd-Frank Act and the FDI Act because it is sufficiently clear that the stay-and-transfer provisions of those acts would be enforceable.[59]

4. Prohibited Cross-Default Rights

Under the final rule, a covered entity is prohibited from entering into covered QFCs that would allow the exercise of cross-default rights—that is, default rights related, directly or indirectly, to the entry into resolution of an affiliate of the direct party—against it.[60] Covered entities are similarly prohibited from entering into covered QFCs that would restrict the transfer of a credit enhancement supporting the QFC from the covered entity's affiliate to a transferee upon the entry into resolution of the affiliate.[61]

The final rule does not prohibit covered entities from entering into QFCs that provide their counterparties with direct default rights against the covered entity. Under the final rule, a covered entity may be party to a QFC that, to the extent not inconsistent with Title II or the FDI Act, provides the counterparty with the right to terminate the QFC if the covered entity fails to perform its obligations under the QFC.

5. Industry-Developed Protocol

As an alternative to bringing their covered QFCs into compliance with the requirements of the final rule, the final rule allows covered entities to comply with the rule by adhering to the Universal Protocol.[62] The final rule also permits compliance with the final rule through adherence to a new protocol (the U.S. Protocol) that is the same as the existing Universal Protocol but for minor changes intended to encourage a broader range of QFC counterparties to adhere only with respect to covered entities and excluded banks. The Universal Protocol and the U.S. Protocol differ from the requirements of this final rule in certain respects. Nevertheless, as described in greater detail below, the final rule allows compliance through adherence to these protocols in light of the fact that the protocols contain certain desirable features that the final rule lacks and produce outcomes substantially similar to this final rule.

6. Process for Approval of Enhanced Creditor Protection Conditions

The final rule also allows the Board, at the request of a covered entity, to approve as compliant with the final rule covered QFCs with creditor protections other than those that would otherwise be permitted under section 252.84 of the final rule.[63] The Board could approve such a request if, in light of several enumerated considerations, the alternative approach would prevent or mitigate risks to the financial stability of the United States presented by a GSIB's failure and would protect the safety and soundness of bank holding companies and state member banks to at least the same extent as the final rule's requirements.[64]

7. Amendments to Certain Definitions in the Board's Capital and Liquidity Rules

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

D. Consultation With U.S. Financial Regulators, the Council, and Foreign Authorities

In developing this final rule, the Board consulted with the FDIC, the OCC, and the Financial Stability Oversight Council (Council).[65] The final rule reflects input received by the Board during this consultation process. Furthermore, the Board has consulted with, and expects to continue to consult with, foreign financial regulatory authorities regarding this final rule and the establishment of other standards that would maximize the prospects for the cooperative and orderly cross-border resolution of a failed GSIB on an international basis.[66]

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

[56] *See* final rule § 252.82(c).

[57] *See* final rule § 252.81.

[58] *See* final rule § 252.83.

[59] *See* final rule § 252.83(a).

[60] *See* final rule § 252.84(b).

[61] *See id.*

[62] *See* final rule § 252.85(a).

[63] *See* final rule § 252.85(c).

[64] *See* final rule § 252.85(c)–(d).

[65] One commenter also requested that the Board consult with other agencies with entities under their jurisdiction affected by the final rule. Several commenters requested that the Board consult with the OCC in developing its final rule and coordinate its final rule with that of the OCC. Board staff has consulted with the Council as well as the FDIC and OCC in developing this final rule.

[66] Certain commenters also requested that the Board consult with foreign regulatory authorities in developing its final rule.

II. Restrictions on QFCs of GSIBs

A. Covered Entities (Section 252.82(b) of the Final Rule)

The proposed rule applied to ''covered entities,'' which included (a) any U.S. GSIB top-tier bank holding company, (b) any subsidiary of such a bank holding company that is not a ''covered bank,'' and (c) the U.S. operations of any foreign GSIB, with the exception of any ''covered bank.'' In the proposal, the term ''covered bank'' was defined to include certain entities, such as certain national banks, that are supervised by the OCC. Covered banks would have been exempt from the requirements of the proposal because the OCC was expected to issue a proposed rule that would impose substantively identical requirements on covered banks.[67] Commenters supported this exemption for QFCs of covered banks on the basis that these banks should not have to comply with two sets of rules.[68]

Under the proposal, covered entities included the entities identified as U.S. GSIB top-tier holding companies under the Board's GSIB surcharge rule[69] as well as all subsidiaries of U.S. GSIBs (other than covered banks, as defined in the proposal).[70] The definition of ''subsidiary'' under the proposal included any company that is owned or controlled directly or indirectly by another company, where the term ''control'' was defined by reference to the BHC Act.[71] The BHC Act definition of control includes ownership, control or the power to vote 25 percent of any class of voting securities; control in any manner of the election of a majority of the directors or trustees; or exercise of a controlling influence over the management or policies.[72]

A few commenters urged the Board not to expand the scope of covered entity to include non-GSIBs, arguing that such an expansion would exceed the Board's statutory authority under the Dodd-Frank Act. The Board is not including non-GSIBs as covered entities in its final rule.

A number of commenters urged the Board to move to a financial consolidation standard to define a ''subsidiary'' of a covered entity instead of BHC Act control.[73] These commenters argued that, under Generally Accepted Accounting Principles, a company generally would consolidate an entity in which it holds a majority voting interest or over which it has the power to direct the most significant economic activities, to the extent it also holds a variable interest in the entity. In addition, commenters 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 argued that BHC Act control may include an entity that is not under the day-to-day operational control of the GSIB and over whom the GSIB does not have the practical ability to require remediation of that entity's QFCs to comply with the proposed rule. Moreover, commenters contended that entities that are not consolidated with a GSIB for financial reporting purposes are unlikely to raise the types of concerns for the orderly resolution of GSIBs targeted by the proposal. Commenters also noted that the ISDA master agreements and the 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 Board to define the term ''subsidiary'' of a covered entity based on financial consolidation under the final rule.

Commenters urged that, regardless of whether a financial consolidation standard is adopted for the purpose of defining ''subsidiary,'' the final rule should exclude from the definition of ''covered entity'' entities over which the covered entity does not exercise operational control, such as merchant banking portfolio companies, section 2(h)(2) companies, joint ventures, sponsored funds as distinct from their sponsors or investment advisors, securitization vehicles, entities in which the 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).[74] With respect to merchant banking authority, which allows a financial holding company to make a majority or minority investment in a portfolio company that is engaged in activity that is not financial in nature, certain commenters noted that section 4(k) of the BHC Act prohibits the financial holding company from routinely managing or operating the portfolio company except as may be necessary or required to obtain a reasonable return on investment upon resale or other disposition of the portfolio company.[75] Regarding sponsored funds, commenters argued that each sponsored or advised fund is a separate legal entity that is distinct from its sponsor or investment advisor regardless of whether the fund is consolidated and that the sponsor or advisor has no claim on the fund's assets and may not use the fund's assets for its benefit.

In terms of foreign GSIBs, certain commenters argued that foreign banking organization (FBO) subsidiaries for which the FBO has been given special relief by Board order not to hold the subsidiary under an intermediate holding company should not be included in the definition of covered entity, even if such entities would be consolidated under financial consolidation principles.[76] These commenters argued that, since neither the covered entity 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 entity or any other affiliate. These commenters further noted that the few such requests that have been granted by the Board 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.

[67] Section 252.88 of the Board's proposal also clarified that covered entities would not be required to conform covered QFCs with respect to a part of a covered QFC that a covered bank also would be required to conform under the proposed rule that the OCC subsequently issued.

[68] Commenters requested further clarification on the interaction between the final rules of the Board and the OCC to avoid legal uncertainty. As noted above, the OCC and FDIC are expected to finalize rules that are substantively identical to this final rule, and the banking agencies are expected to coordinate in the interpretation of the rules. Section 252.88(b) of the final rule, which addresses potential overlap between the agencies' final rules, has been clarified in response to commenters' requests. Section 252.88(b) is discussed in more detail below.

[69] 12 CFR 217.402. *See also* 80 FR 49082 (Aug. 14, 2015).

[70] *See* proposed rule § 252.82(a)(1).

[71] *See* 12 CFR 252.2.

[72] *See* 12 U.S.C. 1841(a).

[73] Commenters generally expressed a similar view with respect to the definition of ''affiliate'' of a covered entity as the term is used in sections 252.83 and 84 of the proposed rule. That term which was similarly defined by reference to BHC Act control under the proposal.

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

[75] 12 U.S.C. 1843(k)(4)(H)(iv); 12 CFR 225.171(a).

[76] Board orders granting requests from FBOs for such treatment can be found at Regulation YY Foreign Banking Organization Requests, *https://www.federalreserve.gov/supervisionreg/regulation-yy-foreign-banking-organization-requests.htm.*

branches and agencies of FBOs be excluded from the definition of ''covered entity'' and ''U.S. operations'' of foreign GSIBs where the foreign GSIB's home country legal framework meets the objectives of the final rule. These commenters argued that the requirements of the final rule would be duplicative of requirements on a foreign GSIB's U.S. branches and agencies if those entities' 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.[77]

Under the final rule, a ''covered entity'' is generally (a) any U.S. GSIB top-tier bank holding company; (b) any subsidiary of such a company that is not a national bank, Federal savings association, Federal branch, Federal agency, or FSI; and (c) the U.S. operations of any foreign GSIB that is not a national bank, Federal savings association, Federal branch, Federal agency, or FSI, with certain specified exceptions.[78] ''FSI'' is defined to include state nonmember banks and state savings associations, which are supervised by the FDIC.[79] National banks, Federal savings associations, Federal branches, Federal agencies, and FSIs that are exempt from the final rule are ''excluded banks'' under the final rule.[80] Excluded banks are exempt from the requirements of this final rule because the OCC and FDIC are expected to issue final rules that would impose substantively identical requirements on excluded banks in the near future.[81]

U.S. GSIB bank holding companies. As in the proposal, covered entities include the entities identified as U.S. GSIB top-tier holding companies under the Board's GSIB surcharge rule.[82] Under the GSIB surcharge rule, a U.S. top-tier bank holding company subject to the advanced approaches rule[83] must determine whether it is a GSIB by applying a multifactor methodology established by the Board.[84] The methodology evaluates a banking organization's systemic importance on the basis of its attributes in five broad categories: Size, interconnectedness, cross-jurisdictional activity, substitutability, and complexity.[85]

Accordingly, the methodology provides a tool for identifying those banking organizations whose failure or material distress would pose especially large risks to the financial stability of the United States. Improving the orderly resolution and resolvability of such firms, including by reducing risks associated with their QFCs, would be an important step toward achieving the goals of the Dodd-Frank Act. The final rule's focus on GSIBs is also in keeping with the Dodd-Frank Act's mandate that more stringent prudential standards be applied to the most systemically important bank holding companies.[86] Moreover, several of the attributes that feed into the determination of whether a given firm is a GSIB incorporate aspects of the firm's QFC activity. These attributes include the firm's total exposures, its intra-financial system assets and liabilities, its notional amount of over-the-counter derivatives, and its cross-jurisdictional claims and liabilities.

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

U.S. GSIB subsidiaries. Covered entities also include all subsidiaries of the U.S. GSIBs (other than excluded banks and the exceptions described below).[87] U.S. GSIBs generally enter into QFCs through subsidiary legal entities rather than through the top-tier holding company.[88] 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 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 covered entities should help ensure that such cross-default rights do not affect the ability of performing and solvent entities of a GSIB—regardless of jurisdiction—to remain outside of resolution proceedings.

''Subsidiary'' in the final rule continues to be defined by reference to BHC Act control, as does the definition of ''affiliate.''[89] The final rule does not define covered entities to include only those subsidiaries of GSIBs that are financially consolidated, as requested by certain commenters. Defining ''subsidiary'' and ''affiliate'' by reference to BHC Act control is consistent with the definitions of those terms in the FDI Act and Title II of the Dodd-Frank Act. Specifically, Title II permits the FDIC, as receiver of a covered financial company or as receiver for its subsidiary, to enforce QFCs and other contracts of subsidiaries and affiliates, defined by reference to the BHC Act, notwithstanding cross-default rights based solely on the insolvency, financial condition, or receivership of the covered financial company.[90] Therefore, maintaining consistent definitions of subsidiary and affiliate with Title II should better ensure that QFC stays may be effected in resolution under a U.S. Special Resolution Regime. As covered entities are subject to the activity

[77] In the alternative, these commenters requested that the requirements only apply to U.S. branches 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.

[78] *See* final rule § 252.82(b).

[79] The terms ''state non-member bank'' and ''state savings association'' are defined in the final rule by reference to section 3 of the Federal Deposit Insurance Act, 12 U.S.C. 1813. *See* final rule § 252.81.

[80] *See* final rule § 252.81. However, excluded banks do not include subsidiaries of a GSIB that are DPC subsidiaries or portfolio companies owned under the Small Business Investment Act of 1956, or public welfare investments.

[81] Section 252.88(b) of the final rule, like the proposal, clarifies that covered entities are not required to conform covered QFCs with respect to a part of a covered QFC that an excluded bank also would be required to conform under the final rules that the OCC and FDIC are expected to issue. Such overlap could occur, for example, where a bank holding company that is a covered entity provides, as part of a master agreement governing swaps, a guaranty for a swap between a subsidiary that is an excluded bank and the excluded bank's counterparty. *See also* 12 U.S.C 5390(c)(8)(D)(vi)(V), (viii). As requested by commenters, this provision in the final rule has been revised to further clarify its application.

[82] *See* final rule § 252.82(b)(1); 12 CFR 217.402.

[83] 12 CFR part 217, subpart E.

[84] 12 CFR 217.402, 217.404.

[85] 12 CFR 217.404.

[86] 12 U.S.C. 5365(a)(1)(B).

[87] *See* final rule § 252.82(b)(2).

[88] Under the clean holding company component of the Board's recent 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 (Jan. 24, 2017).

[89] *See* 12 CFR 252.2.

[90] 12 U.S.C. 5390(c)(16).

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.[91] 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 entity DPC subsidiaries and merchant banking portfolio companies, as requested by certain commenters. The final rule also excludes portfolio companies held under section 4(k)(4)(I) of the BHC Act, which is an investment authority for insurance companies that is similar to merchant banking authority; portfolio companies held under the Small Business Investment Act of 1956; and certain companies engaged in the business of making public welfare investments.[92] In general, subsidiaries held under these authorities are temporary, and 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 resolution of a GSIB would cause the disorderly unwind of the QFCs of these subsidiaries in a manner that would impair the orderly resolution of the GSIB. Therefore, the impact of these exclusions should be relatively small while responding to commenter concerns and reducing burden.

U.S. operations of foreign GSIBs. Finally, covered entities include almost all U.S. operations of foreign GSIBs—their U.S. subsidiaries, U.S. branches, and U.S. agencies that are not national banks, Federal savings associations, Federal branches, Federal agencies, or FSIs. The term ''global systemically important foreign banking organization'' (which this preamble shortens to ''foreign GSIB'') is defined to include any FBO that it or the Board determines has the characteristics of a GSIB under the methodology for identifying GSIBs adopted by the Basel Committee on Banking Supervision (global methodology).[93] Foreign GSIB also is defined to include a foreign banking organization or U.S. intermediate holding company required to be formed by the Board's Regulation YY (IHC) that the Board determines would be designated as a GSIB under the Board's GSIB surcharge rule if the entity were subject to the rule.[94]

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

The proposal would have required a top-tier foreign banking organization that is, or controls, a covered company under the Board's resolution plan rule (Regulation QQ) to submit by January 1 of each calendar year a notice of whether its home country supervisor (or other appropriate home country authority) has adopted standards consistent with the global methodology; whether the foreign banking organization prepares or reports the indicators used by the global methodology to identify GSIBs; and, if it does, whether the foreign banking organization has determined that it has the characteristics of a GSIB.[95] In order to reduce burden, the notice requirement of the final rule only applies to foreign banking organizations that determine that they have the characteristics of a GSIB.[96] The first notice required under this provision of the final rule is due January 1, 2018.[97]

As with U.S. GSIBs, the final rule's focus on those foreign banking organizations that qualify as GSIBs is in keeping with the Dodd-Frank Act's mandate that more stringent prudential standards be applied to the most systemically important banking organizations.[98] The final rule, like the proposal, covers only the U.S. operations of foreign GSIBs. Like the proposal, the final rule excludes section 2(h)(2) companies [99] and DPC branch

[91] For example, a covered entity may own more than 5 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 bank holding company 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 bank holding company and the bank holding company 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 Board permits).

[92] *See* final rule § 252.82(b).

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

In November 2016, the FSB and the BCBS published an updated list of banking organizations that are GSIBs under the assessment methodology. The list includes the eight U.S. GSIBs and the following 22 foreign banking organizations: Agricultural Bank of China, Bank of China, Barclays, BNP Paribas, China Construction Bank, Credit Suisse, Deutsche Bank, Groupe BPCE, Groupe Crédit Agricole, Industrial and Commercial Bank of China Limited, HSBC, ING Bank, Mitsubishi UFJ FG, Mizuho FG, Nordea, Royal Bank of Scotland, Santander, Société Générale, Standard Chartered, Sumitomo Mitsui FG, UBS, and Unicredit Group. *See* FSB, ''2016 update of list of global systemically important banks'' (November 21, 2016), *http://www.fsb.org/wp-content/uploads/2016-list-of-global-systemically-important-banks-G-SIBs.pdf.*

[94] *See* final rule § 252.87(a).

[95] *See* proposed rule § 252.87(b).

[96] *See* final rule § 252.87(b). Like the proposal, the final rule requires top-tier foreign banking organizations that are or control covered companies under Regulation QQ and that prepare or report the indicator amounts necessary to determine whether the organization is a GSIB to use the data to determine whether the organization has the characteristics of a GSIB. *See id.* at § 252.87(c).

[97] The final rule makes clear that foreign banking organizations that are subject to similar notice and determination requirements under the Board's TLAC rule (12 CFR 252.153(b)(5)–(b)(6)) may comply with the final rule by complying with the similar requirements in the Board's TLAC rule. *See id.* at § 252.87(d).

[98] 12 U.S.C. 5365(a)(1)(B).

[99] Section 2(h)(2) of the BHC Act provides that the activity and ownership restrictions of section 4 of the BHC Act do not apply to shares of any company organized under the laws of a foreign country (or to shares held by such company in any company engaged in the same general line of business as the investor company or in a business related to the

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subsidiaries, which are also types of entities excluded by regulation from being held under an IHC.[100] To provide the same treatment for foreign GSIBs and U.S. GSIBs, the final rule also excludes DPC subsidiaries, merchant banking portfolio companies, portfolio companies held under section 4(k)(4)(I) of the BHC Act, portfolio companies held under the Small Business Investment Act of 1956, and public welfare investments of foreign GSIBs.[101]

The final rule does not exempt U.S. branches and agencies of foreign GSIBs or U.S. subsidiaries of foreign GSIBs that are not held under an IHC pursuant to a Board order, as requested by certain commenters. The exemptions by Board order were provided in the context of another rule, and the same considerations do not apply in the context of this final rule as these subsidiaries could impact the resolvability of the U.S. operations of a foreign GSIB.[102] 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, U.S. branch, or U.S. 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.[103]

B. Covered QFCs (Section 252.82(c) of the Final Rule)

General definition. The proposal applied to any ''covered QFC,'' generally defined as any QFC that a covered entity enters into, executes, or otherwise becomes party to with the person or an affiliate of the same person.[104] Under the proposal, ''qualified financial contract'' or ''QFC'' was defined as in section 210(c)(8)(D) of Title II of the Dodd-Frank Act and included swaps, repo and reverse repo transactions, securities lending and borrowing transactions, commodity contracts, and forward agreements.[105]

The application of the rule's requirements to a ''covered QFC'' was one of the most commented upon aspects of the proposal. Certain commenters argued that the definition of QFC in Title II of the Dodd-Frank Act was overly broad and imprecise and could include agreements that market participants may not expect to be subject to the stay-and-transfer provisions of the U.S. Special Resolution Regimes. More generally, commenters argued that the proposed definition of QFC was too broad and would capture contracts that do not present any obstacles to an orderly resolution. Commenters urged the Board to exclude a variety of types of QFCs from the requirements of the final rule. In particular, a number of commenters urged the Board 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 FX transactions (including securities conversion transactions), retail brokerage agreements, retirement/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 transaction, 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 Board 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;[106] 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.[107] 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 Board 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 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

business of the investor company) that is principally engaged in business outside the United States if such shares are held or acquired by a bank holding company organized under the laws of a foreign country that is principally engaged in the banking business outside the United States. 12 U.S.C. 1841(h)(2). As with the similar exclusion to the Board's U.S. IHC requirement (12 CFR 252.153(b)(1)), the Board has taken into account the nonfinancial activities and affiliations of a foreign banking organization in permitting the exclusion for section 2(h)(2) companies from the final rule. *Cf.* 79 FR 17240 (Mar. 27, 2014).

[100] 12 CFR 252.2(j) and (x).

[101] *See* final rule § 252.82(b)(3).

[102] *See* 12 CFR 252.153(c)(1)–(2).

[103] 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.

[104] *See* proposed rule § 252.83(a). For convenience, this preamble generally refers to ''a covered entity's QFCs'' or ''QFCs to which a covered entity is party'' as shorthand to encompass the definition of ''covered QFC.''

[105] *See* proposed rule § 252.81. *See also* 12 U.S.C. 5390(c)(8)(D).

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

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

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.[108] 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.[109] 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.[110]

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.[111] As under the proposal, ''qualified financial contract'' or ''QFC'' is defined in the final rule as in section 210(c)(8)(D) of Title II of the Dodd-Frank Act and includes swaps, repo and reverse repo transactions, securities lending and borrowing transactions, commodity contracts, and forward agreements.[112] 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 entity or explicitly provide default rights that may be exercised against a covered entity (in-scope QFCs).[113] This change addresses a major concern raised by commenters regarding the overbreadth of the definition of ''covered QFC'' in the proposal. The change also mitigates the burden of complying with the proposed rule without undermining its purpose by not requiring covered entities to conform contracts that do not contain the types of default rights and transfer restrictions that the final rule is intended to address. The Board 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 entity is not required to conform certain investment advisory contracts described by commenters (*i.e.,* investment advisory contracts with retail advisory customers[114] of the covered entity that 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

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

[109] One commenter also argued that utility and gas supply contracts are covered sufficiently in section 366 of the U.S. Bankruptcy Code. This section of the U.S. Bankruptcy Code places restrictions on the ability of a utility to ''alter, refuse, or discontinue service to, or discriminate against, the trustee or the debtor solely on the basis of the commencement of a case under [the U.S. Bankruptcy Code] or that a debt owed by the debtor to such utility for service rendered before the order for relief was not paid when due.'' 11 U.S.C. 366. The purpose and effect of section 252.84 of the final rule and section 366 of the U.S. Bankruptcy Code are different and therefore do not serve as substitutes. Section 366 of the U.S. Bankruptcy Code does not address cross-defaults or provide additional clarity regarding the application of the U.S. Special Resolution Regimes. Similarly, section 252.84 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.

[110] One commenter also requested exclusion of overnight transactions, particularly overnight repurchase agreements, arguing that such transactions present little risk of creating negative liquidity effects and that an express exclusion for such transactions may increase the likelihood that such contracts would remain viable funding sources in times of liquidity stress. Although the final rule does not exempt overnight repo transactions, the final rule may have limited if any effect on such transactions. As described below, the final rule provides a number of exemptions that may apply to overnight repo and similar transactions. Moreover, the restrictions on default rights in section 252.84 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 § 252.81 (defining ''default right''). Therefore, section 252.84 does not restrict the ability of QFCs, including overnight repos, to terminate at the end of the term of the contract.

[111] *See* final rule § 252.82(c).

[112] *See* final rule § 252.81. *See also* 12 U.S.C. 5390(c)(8)(D).

[113] *See* final rule § 252.82(d).

[114] *See* final rule § 252.88(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/reportforms/forms/FR_2052a20161231_f.pdf*. Covered entities should be familiar with this definition and its application.

otherwise acquire a security of a covered entity or its affiliate.[115] The Board has determined to exclude 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.[116]

The final rule also provides the Board with authority to exempt one or more covered entities from conforming certain contracts or types of contracts to the final rule after considering, in addition to any other factor the Board deems relevant, the burden the exemption would relieve and the potential impact of the exemption on the resolvability of the covered entity or its affiliates.[117] Covered entities that request that the Board exempt additional contracts from the final rule should be prepared to provide information in support of their requests. The Board expects to consult as appropriate with the FDIC and OCC during its consideration of any such request.

Definition of counterparty. As noted above, the proposal 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.[118] ''Affiliate'' in the proposal was defined in the same manner as under the BHC Act to mean any company that controls, is controlled by, or is under common control with another company.[119] 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.[120]

Commenters argued that requiring remediation of existing QFCs of a person if the GSIB entered into a new QFC with an affiliate of the person would make compliance with the proposed rule overly burdensome.[121] These arguments were similar to commenters' arguments regarding the definition of ''subsidiary'' of a covered entity, which were discussed above. Commenters pointed out that this requirement would demand that the GSIB track each counterparty's organizational structure by relying on information provided by counterparties, which would subject counterparties to enhanced tracking and reporting burdens. Commenters requested that the phrase ''or affiliate of the same person'' be deleted from the definition of covered QFC and argued that such a modification would not undermine the ultimate goals of the rule since existing QFCs with the counterparty's affiliate would still have be remediated if the covered entity or its affiliate enters into a new QFC with that counterparty affiliate. In the alternative, commenters argued that an affiliate of a counterparty be established by reference to financial consolidation principles rather than BHC Act control, since counterparties may not be familiar with BHC Act control. Commenters argued that many counterparties are not regulated bank holding companies and would be unfamiliar with BHC Act control. Certain commenters also argued that a new QFC with one fund in a fund family should not result in other funds in the fund family being required to conform their pre-existing QFCs with the covered entity or an affiliate.

The final rule's definition of ''covered QFC'' has been modified to address the concerns raised by commenters. In particular, the final rule provides that a covered QFC includes a QFC that the covered entity entered, executed, or otherwise became a party to before January 1, 2019, if the covered entity or any affiliate that is a covered entity or excluded bank also enters, executes, or otherwise becomes a party to a QFC with the same person or a consolidated affiliate of the same person on or after January 1, 2019.[122] The final rule defines ''consolidated affiliate'' by reference to financial consolidation principles.[123] As commenters pointed out, counterparties will already track and monitor financially consolidated affiliates. Moreover, exposures to a non-consolidated affiliate may be captured as a separate counterparty (*e.g.,* when the non-consolidated affiliate enters a new QFC with the covered entity). 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.

The definition of ''covered QFC'' is intended to limit the restrictions of the final rule to those financial transactions whose disorderly unwind has substantial potential to frustrate the orderly resolution of a GSIB, as discussed above. By adopting the Dodd-Frank Act's definition of QFC, with the modifications described above, the final rule generally extends stay-and-transfer protections to the same types of transactions as Title II of the Dodd-Frank Act. In this way, the final rule enhances the prospects for an orderly resolution in bankruptcy and under the U.S. Special Resolution Regimes.

Exclusion of cleared QFCs. The proposal excluded from the definition of ''covered QFC'' all QFCs that are cleared through a central counterparty (CCP).[124] Commenters generally expressed support for this exclusion, but some commenters requested that the Board broaden this exclusion in the final rule. In particular, a number of commenters urged the Board to exclude the ''client-facing leg'' of a cleared swap where a clearing member faces a CCP on one leg of the transaction and faces the client on an otherwise identical offsetting transaction.[125] One commenter

[115] *See* final rule § 252.88(c)(2). Warrants issued after the effective date of the final rule are not excluded from the requirements of the final rule.

[116] These exemptions are not interpretations of the definition of QFC.

[117] *See* final rule § 252.88(d).

[118] *See* proposed rule §§ 252.83(a), 225.84(a).

[119] *See* 12 CFR 252.2 (defining ''affiliate'').

[120] *See* 12 U.S.C. 1841(k).

[121] 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.

[122] *See* final rule § 252.82(c).

[123] *See* final rule § 252.81.

[124] *See* proposed rule § 252.88(a).

[125] 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 entity, 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 Board to adopt the same approach taken under Section 2 of the Universal Protocol, which allows the client-facing leg of the cleared swap with the clearing member that is a covered entity to be closed out substantially contemporaneously with the CCP-facing leg in the event the CCP were to take action to close out the CCP-facing leg.

Some commenters requested clarification that transactions between a covered entity client and its clearing member (as opposed to transactions where the 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 entity is a clearing member or a client. A covered QFC—generally a QFC to which a covered entity is a party—is exempted from the requirements of the final rule if a CCP is also a party.

requested the Board confirm its understanding that ''FCM agreements,'' which the commenter defined as futures and cleared swaps agreements with a futures commission merchant, are excluded because FCM agreements ''are only QFCs to the extent that they relate to futures and swaps and, since futures and cleared swaps are excluded, the FCM Agreements are also excluded.'' [126] The commenter requested, in the alternative, that the final rule expressly exclude such agreements.

A few commenters requested that the Board modify the definition of ''central counterparty,'' which was defined to mean ''a counterparty (for example, a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating trades'' in the proposal.[127] These commenters 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.'' [128] As an alternative definition of CCP, these commenters suggested the final rule should define central counterparty to mean: ''an entity (for example, a clearinghouse or similar facility, system, or organization) that, with respect to an agreement, contract, or transaction: (i) Enables each party to the agreement contract, or transaction to substitute, through novation or otherwise, the credit of the CCP for the credit of the parties; and (ii) arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such agreements, contracts, or transactions executed by participants in the CCP.'' [129]

Commenters also urged the Board 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,[130] or that are entered into subject to the rules of an FMU.[131] 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 entity that is a member of the CSD in connection with the settlement of securities transactions, should be excluded from the requirements of the final rule. Commenters contended that, similar to CCPs, the relationship between a covered 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 exemption to cover FMUs would serve to mitigate the systemic risk of a GSIB in distress, an underlying objective of the rule's requirements. Commenters contended that such an exclusion would be consistent with the treatment of FMUs under U.K. regulations and German law. Some commenters also requested that related or underlying agreements to CCP-cleared QFCs and QFCs entered into with other FMUs also be excluded, since such agreements ''form an integrated whole with [those] QFCs'' and such an exemption would facilitate the continued expansion of the clearing and settlement framework and the benefits of such a framework.[132] One commenter urged that the final rule should not in any manner restrict an FMU's ability to close out a defaulting clearing member's portfolio, including potential liquidation of cleared contracts.

The issues that the final rule is intended to address with respect to non-cleared QFCs may also exist in the context of centrally cleared QFCs. However, clearing through a CCP provides unique benefits to the financial system while presenting unique issues related to the cancellation of cleared contracts. Accordingly, the Board 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 Board 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 trades, which is a broad definition that should be familiar to market participants as it is used in the regulatory capital rules.[133]

The final rule also makes clear that, if one or more FMUs are the only counterparties to a covered QFC, the covered entity is not required to conform the covered QFC to the final rule.[134] 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 entities 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 entity but the requirements of the final rule *would* apply to the bilateral QFC between the two covered entities. 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 entities that are related to the direct QFC with the FMU

[126] Letter to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, from James M. Cain, Sutherland Asbill & Brennan LLP, writing on behalf of the eleven Federal Home Loan Banks, at 2 (Aug. 5, 2016).

[127] 12 CFR 217.2.

[128] Letter to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, from Walt L. Lukken, President and CEO, Futures Industry Association, at 8–9 (Aug. 5, 2016) (citing Principles of Financial Market Infrastructures (Apr. 2012), published by the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions, at 9).

[129] *Id.* at 9.

[130] 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.*

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

[132] 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 (Aug. 5, 2016).

[133] *See* final rule § 252.81. *See also* 12 CFR 217.2.

[134] *See* final rule § 252.88(a)(2). In response to commenters, the final rule uses the definition of FMU in Title VIII of the Dodd-Frank Act and may apply, for purposes of the final rule, to entities regardless of jurisdiction. The definition of FMU in the final rule includes a broader set of entities, in addition to CCPs. However, the definition in the final rule does not include depository institutions that are engaged in carrying out banking-related activities, including providing custodial services for tri-party repurchase agreements. The definition also explicitly excludes certain types of entities (*e.g.,* registered futures associations, swap data repositories) and other types of entities that perform certain functions for or related to FMUs (*e.g.,* futures commission merchants).

remain subject to the final rule's requirements.

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

Exclusion of certain QFCs under multi-branch master agreements of foreign banking organizations. To avoid imposing unnecessary restrictions on QFCs that are not closely connected to the United States, the proposal 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.[135] The proposed definition of ''QFC'' included master agreements that apply to QFCs.[136] 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 the proposal would adopt, treats master agreements for QFCs together with all supplements to the master agreement (including underlying transactions) as a single QFC.[137]

Foreign GSIBs have master agreements that permit transactions to be entered into both at a U.S. branch or U.S. agency of the foreign GSIB and at a non-U.S. location of the foreign GSIB (such as a foreign branch). Notwithstanding the proposal's general treatment of a master agreement and all QFCs thereunder as a single QFC, the proposal would have excluded QFCs under such a ''multi-branch master agreement'' that are not booked at a covered entity and for which no payment or delivery may be made at a covered entity.[138] Under the proposal, a multi-branch master agreement was a covered QFC with respect to QFC transactions that are booked at a covered entity or for which payment or delivery may be made at a covered entity.

Commenters expressed support for this exclusion, but requested that the requirement exclude from the definition of covered QFC those transactions under master agreements where payment and deliveries may be made by or to the U.S. branch or agency so long as the transactions or assets are not booked in the U.S. branch or agency. These commenters argued that the ability to make payments or delivery alone does not make a QFC sufficiently closely connected to the United States to raise the concerns about resolution that the rule is 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 entities 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 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 U.S. branch or agency after the compliance date or if a new QFC is entered into with an affiliate of the U.S. branch or agency that is also subject to the requirements.

The final rule has been modified from the proposal to address the concerns raised by commenters. In particular, the final rule provides that, with respect to a U.S. branch or U.S. agency of a foreign GSIB, a foreign GSIB multi-branch master agreement that is a covered QFC solely because the master agreement permits agreements or transactions that are QFCs to be entered into at one or more U.S. branches or U.S. agencies of the foreign GSIB will be considered a covered QFC for purposes of this subpart only with respect to such agreements or transactions booked at such U.S. branches and U.S. agencies.[139] 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 U.S. 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 U.S. branch or U.S. 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 proposal 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.

[135] *See* proposed rule § 252.86.

[136] *See* proposed rule § 252.81.

[137] 12 U.S.C. 5390(c)(8)(D)(viii); *see also* 12 U.S.C. 1821(e)(8)(D)(vii); 109 H. Rpt. 31, Prt. 1 (April 8, 2005) (explaining that a ''master agreement for one or more securities contracts, commodity contracts, forward contracts, repurchase agreements or swap agreements will be treated as a single QFC under the FDIA or the [Federal Credit Union Act] (but only with respect to the underlying agreements are themselves QFCs)'').

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

[139] *See* final rule § 252.86.

QFCs with Central Banks and Sovereign Entities. The proposal included covered QFCs with sovereign entities and central banks, consistent with Title II of the Dodd-Frank Act and the FDI Act. Commenters urged the Board 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.[140] Commenters further noted that these entities did not participate in the development of the Universal Protocol and that the Universal Protocol does not provide a viable mechanism for compliance with the final rule by these entities.

The Board continues to believe that covering QFCs with sovereigns and central banks under the final rule is an important requirement and has not modified the final rule to address the requests made by commenters. Excluding QFCs with sovereigns and central banks would be inconsistent with Title II of the Dodd-Frank Act and the FDI Act. Moreover, the mass termination of such QFCs has the potential to undermine the resolution of a GSIB and the financial stability of the United States. The final rule provides covered entities two years to conform covered QFCs with central banks and sovereigns (as well as certain other counterparties, as discussed below). This additional time should provide covered entities sufficient time to develop separate conformance mechanisms for sovereigns and central banks, if necessary.

C. Definition of ''Default Right'' (Section 252.81 of the Final Rule)

As discussed above, a party to a QFC generally has a number of rights that it can exercise if its counterparty defaults on the QFC by failing to meet certain contractual obligations. These rights are generally, but not always, contractual in nature. One common default right is a setoff right: The right to reduce the total amount that the non-defaulting party must pay by the amount that its defaulting counterparty owes. A second common default right is the right to liquidate pledged collateral and use the proceeds to pay the defaulting party's net obligation to the non-defaulting party. Other common rights include the ability to suspend or delay the non-defaulting party's performance under the contract or to accelerate the obligations of the defaulting party. Finally, the non-defaulting party typically has the right to terminate the QFC, meaning that the parties would not make payments that would have been required under the QFC in the future. The phrase ''default right'' in the proposed rule was broadly defined to include these common rights as well as ''any similar rights.'' [141] Additionally, the definition included all such rights regardless of source, including rights existing under contract, statute, or common law.

However, the proposed definition of default right excluded two rights that are typically associated with the business-as-usual functioning of a QFC. First, same-day netting that occurs during the life of the QFC in order to reduce the number and amount of payments each party owes the other was excluded from the definition of ''default right.'' [142] 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.[143] The reason for these exclusions was to leave such rights unaffected by the proposed rule. The proposal's preamble explained that such exclusions were appropriate because the proposal was intended to improve resolvability by addressing default rights that could disrupt an orderly resolution, not to interrupt the parties' business-as-usual interactions under a QFC.

However, certain QFCs are also commonly subject to rights that would increase the amount of collateral or margin that the defaulting party (or a guarantor) must provide upon an event of default. The financial impact of such default rights on a covered entity could be similar to the impact of the liquidation and acceleration rights discussed above. Therefore, the proposed definition of ''default right'' 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).[144]

Finally, contractual rights to terminate without the need to show cause, including rights to terminate on demand and rights to terminate at contractually specified intervals, were excluded from the definition of ''default right'' under the proposal for purposes of the proposed rule's restrictions on cross-default rights.[145] This exclusion was consistent with the proposal's objective of restricting only default rights that are related, directly or indirectly, to the entry into resolution of an affiliate of the covered entity, while leaving other default rights unrestricted.

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 Board'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

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

[141] *See* proposed rule § 252.81.

[142] *See id.*

[143] *See id.*

[144] *See id.*

[145] *See* proposed rule §§ 252.81, 252.84.

expressed concern that the definition of default right in the proposal would permit a defaulting covered entity to demand collateral from its QFC counterparty as margin due to a market price change, but would not allow the non-covered entity to demand collateral from the covered entity.

The final rule retains the same definition of ''default right'' as that of the proposal.[146] The Board 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.[147]

''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 entity or its affiliate enter resolution and that would not be affected by the stay-and-transfer provisions of the U.S. Special Resolution Regimes also would not be affected.

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

[146] *See* final rule § 252.81.

[147] *See* final rule § 252.84(b).

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

The proposed rule generally would have required a covered QFC to explicitly provide both (a) that the transfer of the QFC (and any interest or obligation in or under it and any property securing it) from the covered entity to a transferee would be effective to the same extent as it would be under the U.S. Special Resolution Regimes if the covered QFC were governed by the laws of the United States or of a state of the United States and (b) that default rights with respect to the covered QFC that could be exercised against a covered entity could be exercised to no greater extent than they could be exercised under the U.S. Special Resolution Regimes if the covered QFC were governed by the laws of the United States or of a state of the United States.[148] The final rule contains these same provisions.[149]

A number of commenters noted that the wording of these requirements in proposed section 252.83(b) was confusing and could be read to be inconsistent with the intent of the section. In response to comments, the final rule makes clearer that the substantive restrictions apply only in the event the covered entity (or, in the case of the requirement regarding default rights, its affiliate) becomes subject to a proceeding under a U.S. Special Resolution Regime.[150]

A number of commenters argued that QFCs should be exempt from the requirements of proposed section 252.83 if the QFC is governed by U.S. law. An example of such a QFC provided by commenters includes the standard form repurchase and securities lending agreement published by the Securities Industry and Financial Markets Association. These commenters argued that counterparties to such agreements are already required to observe the stay-and-transfer provisions of the FDI Act and Title II of the Dodd-Frank Act, as mandatory provisions of U.S. federal law, and that requiring an amendment of these types of QFCs to include the express provisions required under section 252.83 would be redundant and would not provide any material resolution benefit, but would significantly increase the remediation burden on covered entities.

Other commenters proposed a three-prong test of ''nexus with the United States'' for purposes of recognizing an exclusion from the express acknowledgment of the requirements of proposed section 252.83. In particular, these commenters argued that the presence of two factors, in addition to the contract being governed by U.S law, would provide greater certainty that courts would apply the stay-and-transfer provisions of the FDI Act and Title II of the Dodd-Frank Act: (1) If a contract is entered into between entities organized in the United States; and (2) to the extent the GSIB's obligations under the QFC are collateralized, if the collateral is held with a U.S. custodian or depository pursuant to an account agreement governed by U.S. law.[151] Other commenters contended that only whether the contract is under U.S. law, and not the location of the counterparty or the collateral, is relevant to the analysis of whether the FDI Act and the Dodd-Frank Act would govern the contract. Commenters also requested that if the first additional factor (*i.e.,* that the QFC be entered into between entities organized in the United States) were to be included within the exception, it should be broadened to include counterparties that have principal places of business or that are otherwise domiciled in the United States.

The requirements of the final rule seek to provide certainty that all covered QFCs would be treated the same way in the context of a resolution of a covered entity 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.[152] Further, the knowledge that a court in a foreign

[148] *See* proposed rule § 252.83(b).

[149] *See* final rule § 252.83(c).

[150] *See id.*

[151] 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.

[152] *See generally* Financial Stability Board, ''Principles for Cross-border Effectiveness of Resolution Actions'' (Nov. 3, 2015), *http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf.*

jurisdiction would reject the purported exercise of default rights in violation of the required contractual provisions would deter covered entities' counterparties from attempting to exercise such rights.

In response to comments, the final rule exempts from the requirements of section 252.83 a covered QFC that meets two requirements.[153] First, the covered QFC must state that it is governed by the laws of the United States or a state of the United States.[154] 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.[155] 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 entity must be organized under the laws of the United States or a State,[156] have its principal place of business [157] located in the United States, or be a U.S. branch or agency.[158] Similarly, a counterparty that is an individual must be domiciled in the United States.[159] 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.[160] 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.[161] 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.[162] Additionally, the Swiss Federal Council requires that banks ''ensure at both the individual institution and group level that new agreements or amendments to existing agreements which are subject to foreign law or envisage a foreign jurisdiction are agreed only if the counterparty recognises a postponement of the termination of agreements in accordance with'' the Swiss special resolution regime.[163] 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.[164]

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 Board to do so through this final rule. The Board believes it is appropriate to adopt this final rule in order to promote U.S. financial stability by improving the resolvability and resilience of U.S. GSIBs and foreign GSIBs pursuant to section 165 of the Dodd-Frank Act. 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, section 252.83 of the final rule requires similar contractual recognition to help ensure that courts in foreign jurisdictions will recognize these provisions.

This requirement would advance the goal of the final rule of removing QFC-related obstacles to the orderly resolution of a GSIB. As discussed above, restrictions on the exercise of QFC default rights are an important prerequisite for an orderly GSIB resolution. Congress recognized the importance of such restrictions when it enacted the stay-and-transfer provisions of the U.S. Special Resolution Regimes. As demonstrated by the 2007–2009 financial crisis, the modern financial system is global in scope, and covered entities are party to large volumes of QFCs with connections to foreign

[153] *See* final rule § 252.83(a).

[154] 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).

[155] 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., Hauenstain* 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.'').

[156] For purposes of this requirement of the exemption, ''State'' means any state, commonwealth, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, or the United States Virgin Islands. 12 CFR 252.2(y).

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

[158] *See* final rule § 252.83(a)(1)(ii).

[159] *See id.*

[160] *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).

[161] *See* PRA Rulebook: CRR Firms and Non-Authorised Persons: Stay in Resolution Instrument 2015, (Nov. 12, 2015), *http://www.bankofengland.co.uk/pra/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/pra/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 UK financial holding companies and UK mixed financial holding companies.

[162] *See* Gesetz zur Sanierung und Abwicklung von Instituten und Finanzgruppen, Sanierungs-und Abwicklungsgesetz [SAG] [German Act on the Reorganisation and Liquidation of Credit Institutions], Dec. 10, 2014, § 60a, *https://www.gesetze-im-internet.de/bundesrecht/sag/gesamt.pdf,* as amended by Gesetz zur Anpassung des nationalen Bankenabwicklungsrechts an den Einheitlichen Abwicklungsmechanismus und die europäischen Vorgaben zur Bankenabgabe, Nov. 2, 2015, Artikel 1(17).

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

[164] *See* section III–11 of Comprehensive Guidelines for Supervision of Major Banks, etc., *http://www.fsa.go.jp/common/law/guide/city.pdf.*

jurisdictions. The stay-and-transfer provisions of the U.S. Special Resolution Regimes would not achieve their purpose of facilitating orderly resolution in the context of the failure of a GSIB with large volumes of QFCs if such QFCs could escape the effect of those provisions. To remove doubt about the scope of coverage of these provisions, the requirements of section 252.83 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 firms subject to the requirements.

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

Definitions. Section 252.84 of the final rule, like the proposal, pertains to cross-default rights in QFCs between covered entities and their counterparties, many of which are subject to credit enhancements (such as a guarantee) provided by an affiliate of the covered entity. Because credit enhancements on QFCs are themselves ''qualified financial contracts'' under the Dodd-Frank Act's definition of that term (which this final rule adopts), the final rule includes the following additional definitions in order to facilitate a precise description of the relationships to which it would apply. These definitions are the same as under the proposal since no comments were received on these definitions.

First, the final rule distinguishes between a credit enhancement and a ''direct QFC,'' defined as any QFC that is not a credit enhancement.[165] The final rule also defines ''direct party'' to mean a covered entity that is itself a party to the direct QFC, as distinct from an entity that provides a credit enhancement.[166] In addition, the final rule defines ''affiliate credit enhancement'' to mean ''a credit enhancement that is provided by an affiliate of a party to the direct QFC that the credit enhancement supports,'' as distinct from a credit enhancement provided by either the direct party itself or by an unaffiliated party.[167] Moreover, the final rule defines ''covered affiliate credit enhancement'' to mean an affiliate credit enhancement provided by a covered entity or excluded bank and defines ''covered affiliate support provider'' to mean the affiliate of the covered entity that provides the covered affiliate credit enhancement.[168] 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).[169]

General prohibitions. The final rule, like the proposal, prohibits a covered entity from being party to a covered QFC that allows for the exercise of any default right that is related, directly or indirectly, to the entry into resolution of an affiliate of the covered entity, subject to the exceptions discussed below.[170] The final rule also generally prohibits a covered entity from being party to a covered QFC that would prohibit the transfer of any credit enhancement applicable to the QFC (such as another entity's guarantee of the covered entity's obligations under the QFC), along with associated obligations or collateral, upon the entry into resolution of an affiliate of the covered entity.[171]

One commenter expressed strong support for these provisions.[172] Another commenter expressed support for this provision as currently limited in scope under the proposal to prohibited cross-default rights and requested that the scope not be expanded. The Board's final rule retains the same scope as the proposal.

A number of commenters representing counterparties to covered entities objected to section 252.84 of the proposal 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 regulatory authority with particular expertise in the resolution of the type of entity subject to the proceedings. Certain commenters argued that eliminating cross-default termination rights undermines the ability of QFC counterparties to effectively manage and mitigate their exposure to market and credit risk to a GSIB and interferes with market forces. One commenter similarly argued that, unless the Board takes appropriate measures to strengthen the financial condition and creditworthiness of a failing GSIB during and after the temporary stay, the stay will only expose QFC counterparties to an additional 48 hours of credit risk exposure without achieving the orderly resolution goals of the rule. Another commenter argued that non-defaulting counterparties should not be prevented from filing proofs of claim or other pleadings in a bankruptcy case during the stay period, since bankruptcy deadlines might pass and leave the counterparty unable to collect the unsecured creditor dividend. Commenters contended that restrictions on cross-default rights may lead to pro-cyclical behavior with asset managers moving funds away from covered entities 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).[173]

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[165] *See* final rule § 252.84(c)(2).

[166] *See* final rule § 252.84(c)(1).

[167] *See* final rule § 252.84(c)(3).

[168] *See* final rule § 252.84(e)(2)–(3).

[169] *See* final rule § 252.84(e)(4).

[170] *See* final rule § 252.84(b)(1). A few commenters requested that the Board clarify that covered QFCs that do not contain the cross-default rights or transfer restrictions on credit enhancement that are prohibited by section 252.84 would not be required to be remediated. This reading of section 252.84 of the proposed and final rule is correct. In addition, section 252.84(a) of the final rule provides the requested clarity.

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

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

The final rule retains the exception as proposed. The requested exception would add uncertainty as to whether transfers may be made during the stay period and potentially subsume the transfer prohibition.

[172] This commenter also expressed support for Congressional amendment of the U.S. Bankruptcy Code.

[173] 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

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 entity counterparties may challenge the legality of contractual stays on the exercise of default rights if a GSIB becomes distressed. Certain commenters also questioned the Board's ability to rely on section 165 of the Dodd-Frank Act in imposing these requirements and argued that making SPOE resolution possible under the U.S. Bankruptcy Code was not an appropriate justification for this 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 these requirements, these commenters expressed the view that, if the Board moves forward with these provisions, the final rule should include at least those minimum creditor protections established by the Universal Protocol. Certain commenters also argued that this provision was overly broad in that it covered not only U.S. federal resolution and insolvency proceedings but also state and foreign resolution and insolvency proceedings.[174] Certain commenters also urged the Board to provide a limited exception to these restrictions, if retained in the final rule, to help ensure the continued functioning of physical commodities markets.[175]

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

A primary purpose of these restrictions is to facilitate the resolution of a GSIB outside of Title II of the Dodd-Frank Act, including under the U.S. Bankruptcy Code. As discussed above, the potential for mass exercises of QFC default rights is one reason why a GSIB's failure could cause severe damage to financial stability. In the context of an SPOE resolution, if the GSIB parent's entry into resolution led to the mass exercise of cross-default rights by the subsidiaries' QFC counterparties, then the subsidiaries could themselves fail or experience financial distress. Moreover, the mass exercise of QFC default rights could entail asset fire sales, which likely would affect other financial companies and undermine financial stability. Similar disruptive results can occur with an MPOE resolution of a GSIB affiliate if an otherwise performing GSIB entity is subject to having its QFCs terminated or accelerated as a result of the default of its affiliate.

In an SPOE resolution, this damage can be avoided if actions of the following two types are prevented: The exercise of direct default rights against the top-tier holding company that has entered resolution, and the exercise of cross-default rights against the operating subsidiaries based on their parent's entry into resolution. (Direct default rights against the subsidiaries would not be exercisable, because the subsidiaries would not enter resolution.) In an MPOE resolution, this damage occurs from exercise of default rights against a performing entity based on the failure of an affiliate.

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 above, 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 by extending the stay-and-transfer provisions to any type of resolution of a covered entity. 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 entities from having QFCs that would allow the QFC counterparty to prevent such a transfer or to use it as a ground for exercising default rights.[176]

The final rule also is intended to facilitate other approaches to GSIB resolution. For example, it would facilitate a similar resolution strategy in which a U.S. depository institution subsidiary of a GSIB enters resolution under the FDI Act while its subsidiaries continue to meet their financial obligations outside of resolution.[177] Similarly, the final rule would facilitate the orderly resolution of a foreign GSIB under its home jurisdiction resolution regime by preventing the exercise of cross-default rights against the foreign GSIB's U.S. operations. The final rule would also facilitate the resolution of an IHC of a foreign GSIB, and the recapitalization of its U.S. operating subsidiaries, as part of a broader MPOE resolution strategy under which the foreign GSIB's operations in other

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.

[174] 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 proposal. In addition, the additional creditor protections for supported parties under the final rule permit contractual requirements that any transferee not be in bankruptcy proceedings and that the credit support provider not be in bankruptcy proceedings other than a Chapter 11 proceeding. *See* final rule § 252.84(f).

[175] In particular, these commenters requested that, when a covered entity defaults on any physical delivery obligation to any counterparty following the insolvency of an affiliate of a covered entity, 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 entity. The final rule, like the proposal, allows covered QFCs to permit a counterparty to exercise its default rights under a covered QFC if the covered entity has failed to pay or perform its obligations under the covered QFC. *See* final rule § 252.84(d). The final rule, like the proposal, also allows covered QFCs to permit a counterparty to exercise its default rights under a covered QFC if the covered entity 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 entity.

[176] *See* final rule § 252.84(b).

[177] As discussed above, the FDI Act would limit the exercise of direct default rights against the depository institution, but does not address the threat posed to orderly resolution by cross-default rights in the QFCs of the depository institution's subsidiaries. This final rule would facilitate orderly resolution under the FDI Act by filling that gap. *See* final rule § 252.84(h).

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

The final rule is intended to enhance the potential for orderly resolution of a GSIB under the U.S. Bankruptcy Code, the FDI Act, or a similar resolution regime. The risks to an orderly resolution under the U.S. Bankruptcy Code include separate resolution or insolvency proceedings, including proceedings in non-U.S. jurisdictions. Therefore, by staying default rights arising from affiliates entering such proceedings, the final rule would advance the Dodd-Frank Act's goal of making orderly GSIB resolution workable under the U.S. Bankruptcy Code.[178]

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 regulation does not prohibit a covered QFC from permitting the exercise of default rights against a covered entity that has entered bankruptcy proceedings.[179] 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 should also benefit the counterparties of a subsidiary of a failed GSIB by preventing the severe distress or disorderly failure of the subsidiary and allowing it to continue to meet its obligations. While it may be in the individual interest of any given counterparty to exercise any available rights to run on a subsidiary of a failed GSIB, the mass exercise of such rights could harm the counterparties' collective interest by causing an otherwise-solvent subsidiary to fail. Therefore, like the automatic stay in bankruptcy, which serves to maximize creditors' ultimate recoveries by preventing a disorderly liquidation of the debtor, the final rule seeks to mitigate this collective action problem to the benefit of the failed firm's creditors and counterparties by preventing a disorderly resolution. And because many creditors and counterparties of GSIBs are themselves systemically important financial firms, improving outcomes for those creditors and counterparties should further protect the financial stability of the United States.

General creditor protections. While the restrictions of the final rule are intended to facilitate orderly resolution, they may also diminish the ability of covered entities' QFC counterparties to include certain protections for themselves in covered QFCs, as noted by certain commenters. In order to reduce this effect, the final rule, like the proposal, includes several substantial exceptions to the restrictions.[180] These permitted creditor protections are intended to allow creditors to exercise cross-default rights outside of an orderly resolution of a GSIB (as described above) and therefore would not be expected to undermine such a resolution.

First, in order to ensure that the proposed prohibitions would apply only to cross-default rights (and not direct default rights), the final rule provides that a covered QFC may permit the exercise of default rights based on the direct party's entry into a resolution proceeding.[181] 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, a covered entity's direct QFC counterparties would not risk the delay and expense associated with becoming involved in a bankruptcy proceeding and would be able to take advantage of default rights that would fall within the 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 the direct party, a covered affiliate support provider, or a transferee that assumes a credit enhancement to satisfy its payment or delivery obligations under the direct QFC or credit enhancement.[182] Moreover, the final rule allows covered QFCs to permit the exercise of a default right in one QFC that is triggered by the direct party's failure to satisfy its payment or delivery obligations under another contract between the same parties.[183] This exception takes appropriate account of the interdependence that exists among the contracts in effect between the same counterparties.

As explained in the proposal, the exceptions in the final rule for the creditor protections described above are intended to help ensure that the final rule permits a covered entity's QFC

[178] *See* 12 U.S.C. 5365(d).

[179] *See* final rule § 252.84(d)(1).

[180] *See* final rule § 252.84(d).

[181] *See* final rule § 252.84(d)(1). The proposal exempted from this creditor protection provision proceedings under a U.S. or foreign special resolution regime. As explained in the proposal, special resolution regimes typically stay direct default rights, but may not stay cross-default rights. For example, as discussed above, the FDI Act stays direct default rights, *see* 12 U.S.C. 1821(e)(10)(B), but does not stay cross-default rights, whereas the Dodd-Frank Act's OLA stays direct default rights and cross-defaults arising from a parent's receivership, *see* 12 U.S.C. 5390(c)(10)(B) and 5390(c)(16). The proposed exemption of special resolution regimes from the creditor protection provisions was intended to help ensure that special resolution regimes that do not stay cross-defaults, such as the FDI Act, would not disrupt the orderly resolution of a GSIB under the U.S. Bankruptcy Code or other ordinary insolvency proceedings.

One commenter requested the Board revise this provision to clarify that default rights based on a covered entity 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 Board clarify that such default rights are permitted so long as they are subject to the provisions of the FDI Act or Title II of the Dodd-Frank Act as required under section 225.83. 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.

[182] *See* final rule § 252.84(d)(2)–(3). These provisions should respond to comments requesting that the final rule confirm the ability of a covered entity's counterparty to exercise default rights arising from the failure of a direct party to satisfy a payment or delivery obligation during the stay period. *But see* final rule § 252.83(c).

[183] *See* final rule § 252.84(d)(2).

counterparties to protect themselves from imminent financial loss and does not create a risk of delivery gridlocks or daisy-chain effects, in which a covered entity's failure to make a payment or delivery when due leaves its counterparty unable to meet its own payment and delivery obligations (the daisy-chain effect would be prevented because the covered entity's counterparty would be permitted to exercise its default rights, such as by liquidating collateral). These exceptions are generally consistent with the treatment of payment and delivery obligations under the U.S. Special Resolution Regimes.[184]

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

Additional creditor protections for supported QFCs. The final rule, like the proposal, allows the inclusion of additional creditor protections for a non-defaulting counterparty that is the beneficiary of a credit enhancement from an affiliate of the covered entity that is also a covered entity or excluded bank.[185] The final rule allows these creditor protections in recognition of the supported party's interest in receiving the benefit of its credit enhancement. These creditor protections would not undermine an SPOE resolution of a GSIB.

Where a covered QFC is supported by a covered affiliate credit enhancement,[186] the covered QFC and the credit enhancement would be permitted to allow the exercise of default rights under the circumstances discussed below after the expiration of a stay period. Under the 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.[187] This portion of the final rule is similar to the stay treatment provided in a resolution under the OLA or the FDI Act.[188]

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.[189] 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.[190]

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.[191] Such creditor protections are permitted in order to prevent the support provider or the transferee from ''cherry picking'' by assuming only those QFCs of a given counterparty that are favorable to the support provider or transferee. Title II of the Dodd-Frank Act and the FDI Act contain similar provisions to prevent cherry picking.

Finally, if the covered affiliate credit enhancement is transferred to a transferee, the QFC may permit the non-defaulting counterparty to exercise default rights at the end of the stay period unless either (a) all of the covered affiliate support provider's ownership interests in the direct party are also transferred to the transferee or (b) reasonable assurance is provided that substantially all of the covered affiliate support provider's assets (or the net proceeds from the sale of those assets) will be transferred or sold to the transferee in a timely manner.[192] These conditions help to assure the supported party that the transferee would be at least roughly as financially capable of providing the credit enhancement as the covered affiliate support provider. Title II of the Dodd-Frank Act similarly requires that certain conditions be met with respect to affiliate credit enhancements.[193]

Commenters generally expressed strong support for these exclusions but also requested that these exclusions be broadened in a number of ways. Certain commenters urged the Board to broaden the exclusions to permit, after 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). Certain commenters contended that, at a minimum, the final rule should provide for creditor protections that meet the minimum standards set forth by the Universal Protocol. One commenter specifically identified three creditor protections found in the Universal Protocol that it argued the Board should include in section 252.84: (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

[184] *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).

[185] *See* final rule § 252.84(f).

[186] Note that the exception in section 252.84(f) of the final rule would not apply with respect to credit enhancements that are not covered affiliate credit enhancements. In particular, it would not apply with respect to a credit enhancement provided by a non-U.S. entity of a foreign GSIB, which would not be a covered entity or excluded bank under the final rule. *See* final rule § 252.84(e)(2) (defining ''covered affiliate credit enhancement'').

[187] *See* final rule § 252.84(g)(1).

[188] *See* 12 U.S.C. 1821(e)(10)(B)(I), 5390(c)(10)(B)(i), 5390(c)(16)(A). While the final rule's stay period is similar to the stay periods that would be imposed by the U.S. Special Resolution Regimes, it could run longer than those stay periods under some circumstances.

[189] *See* final rule § 252.84(f)(1). Chapter 11 (11 U.S.C. 1101–1174) is the portion of the U.S. Bankruptcy Code that provides for the reorganization of the failed company, as opposed to its liquidation, and is generally well-understood by market participants.

[190] *See* final rule § 252.84(f)(2).

[191] *See* final rule § 252.84(f)(3).

[192] *See* final rule § 252.84(f)(4).

[193] *See* 12 U.S.C. 5390(c)(16)(A).

out of both the original QFC with the direct counterparty as well as QFCs with the transferee if the transferee defaults under the transferred QFC or under any other QFC with the non-defaulting counterparty, subject to the contractual terms and consistent with applicable law. Another commenter argued for creditor protections not found in the Universal Protocol, including that the transferee be required to be a U.S. person and be registered with and licensed by the primary regulator of either the direct counterparty or transferor entity.

The final rule does not include the additional creditor protections of the Universal Protocol or other creditor protections requested by commenters. As explained in the proposal and below, the additional creditor protections of the Universal Protocol do not appear to materially diminish the prospects for an orderly resolution of a GSIB because the Universal Protocol includes a number of desirable features that the final rule otherwise lacks.[194] Providing additional circumstances under which default rights may be exercised during and immediately after the stay period, in the absence of any counterbalancing benefits to resolution, would increase the risk of a disorderly resolution of a GSIB in contravention of the purposes of the rule.

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 252.84 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 section 252.84(h) of the final rule. The Board is not adopting the proposed additional creditor protection because it would defeat in large part the purpose of section 252.84 and potentially create confusion regarding the requirements and purposes of sections 252.83 and 252.84 of the final rule.[195]

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) and noted that foreign GSIBs often will have their QFCs supported by a non-U.S. affiliate that is not a covered entity. Such non-U.S. affiliate credit supporter providers would not be able to rely on the additional creditor protections for supported QFCs. As the proposal explained, ''Such credit enhancements [are] excluded in order to help ensure that the resolution of a non-U.S. entity would not negatively affect the financial stability of the United States by allowing for the exercise of default rights against a covered entity.''[196]

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 entities may be entities organized or operating in the United States or, with respect to U.S. GSIBs, abroad. The final rule, like the proposal, is limited to QFCs to which a covered entity is a party. Section 252.84 of the final rule generally prohibits QFCs to which a covered entity 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 section 252.84(g)(3) (section 252.84(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 section 252.84, if triggered, permit contractual provisions allowing the exercise of existing default rights against the direct party to the covered QFC, as well as any existing rights against the credit enhancement provider.

Another commenter suggested revising section 252.84(g) (section 252.84(f) of the final rule) to clarify that, for a covered direct QFC supported by a covered affiliate credit enhancement, the covered direct QFC and the covered affiliate credit enhancement may permit the exercise of a default right after the stay period that is related, directly or indirectly, to the covered affiliate support provider entering into resolution proceedings. This reading is incorrect and revising the rule as requested would largely defeat the purpose of section 252.84 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 entity defaults on any physical delivery obligation to any counterparty. As noted above, QFCs may permit a counterparty to exercise its default rights immediately, even during the stay period, if the covered entity fails to pay or perform on the covered QFC with the counterparty (or another contract between the same parties that gives rise to a default under the covered QFC).

Creditor protections related to FDI Act proceedings. In the case of a covered QFC that is supported by a covered affiliate credit enhancement, both the covered QFC and the credit enhancement would be permitted to allow the exercise of default rights related to the credit support provider's entry into resolution proceedings under the FDI Act[197] only under the following circumstances: (a) After the FDI Act stay period,[198] if the credit enhancement is not transferred under the relevant provisions of the FDI Act[199] and associated regulations, and (b) during the FDI Act stay period, to the extent

[194] *See* 81 FR 29169, 29182 (May 11, 2016).

[195] To the extent the commenter's reference to ''bridge financial company'' was not only to a bridge financial company under Title II of the Dodd-Frank Act, the requested amendment would not appear to provide a meaningful reduction in credit risk to counterparties compared to the creditor protections permitted under section 252.84 of the final rule and those available under the Universal Protocol and U.S. Protocol, discussed below.

[196] 81 FR 29169, 29180 n.92 (May 11, 2016) (''Note that the exception in § 252.84(g) of the proposed rule would not apply with respect to credit enhancements that are not covered affiliate credit enhancements. In particular, it would not apply with respect to a credit enhancement provided by a non-U.S. entity of a foreign GSIB, which would not be a covered entity under the proposal. Such credit enhancements would be excluded in order to help ensure that the resolution of a non-U.S. entity would not negatively affect the financial stability of the United States by allowing for the exercise of default rights against a covered entity.''). *See also* final rule § 252.84(f).

[197] As discussed above, the FDI Act stays direct default rights against the failed depository institution but does not stay the exercise of cross-default rights against its affiliates.

[198] Under the FDI Act, the relevant stay period runs until 5:00 p.m. (eastern time) on the business day following the appointment of the FDIC as receiver. 12 U.S.C. 1821(e)(10)(B)(I). *See also* final rule § 252.81.

[199] 12 U.S.C. 1821(e)(9)–(10).

that the default right permits the supported party to suspend performance under the covered QFC to the same extent as that party would be entitled to do if the covered QFC were with the credit support provider itself and were treated in the same manner as the credit enhancement.[200] This provision is intended to ensure that a QFC counterparty of a subsidiary of a bank that goes into FDI Act receivership can receive the same level of protection that the FDI Act provides to QFC counterparties of the bank itself. No comments were received on this aspect of the proposal and the final rule contains no changes from the proposal.

Prohibited terminations. In case of a legal dispute as to a party's right to exercise a default right under a covered QFC, the final rule, like the proposal, requires that a covered QFC must provide that, after an affiliate of the direct party has entered a resolution proceeding, (a) the party seeking to exercise the default right bears the burden of proof that the exercise of that right is indeed permitted by the covered QFC, and (b) the party seeking to exercise the default right must meet a ''clear and convincing evidence'' standard, a similar standard,[201] or a more demanding standard.[202] The purpose of this requirement is to deter the QFC counterparty of a covered entity from thwarting the purpose of the final rule by exercising a default right because of an affiliate's entry into resolution under the guise of other default rights that are unrelated to the affiliate's entry into resolution.

A few commenters requested guidance on how to satisfy the burden of proof of clear and convincing evidence so that they may avoid seeking such clarity through litigation. Other commenters urged that this standard was not appropriate and should be eliminated. In particular, a number of commenters expressed concern that the burden of proof requirements, which are more stringent than the burden of proof requirements for typical contractual disputes adjudicated in a court, unduly hamper the creditor protections of counterparties and impose a burden directly on non-covered 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 Board in a rulemaking to alter the burden of proof for contractual disputes. One commenter suggested that, in a scenario involving a master agreement with some transactions out of the money and others in the money, the defaulting GSIB will have a lower burden of proof for demonstrating that it is owed money than for demonstrating that it owes money, should the non-GSIB counterparty exercise its termination rights. Certain commenters suggested instead that the final rule shift the burden and instead adopt a rebuttable presumption that the non-defaulting counterparty's exercise of default rights is permitted under the QFC unless the defaulting covered entity demonstrates otherwise. One commenter requested that the burden of proof not apply to the exercise of direct default rights.

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.

Agency transactions. In addition to entering into QFCs as principals, GSIBs may engage in QFCs as agent for other principals. For example, a GSIB subsidiary may enter into a master securities lending arrangement with a foreign bank as agent for a U.S.-based pension fund. The GSIB would document its role as agent for the pension fund, often through an annex to the master agreement, and would generally provide to its customer (the principal party) a securities replacement guarantee or indemnification for any shortfall in collateral in the event of the default of the foreign bank.[203] A covered entity may also enter into a QFC as principal where there is an agent acting on its behalf or on behalf of its counterparty.

This proposal would have applied to a covered QFC regardless of whether the covered entity or the covered entity's direct counterparty is acting as a principal or as an agent. Sections 252.83 and 252.84 of the proposal did not distinguish between agents and principals with respect to default rights or transfer restrictions applicable to covered QFCs. Under the proposal, section 252.83 would have limited default rights and transfer restrictions that the principal and its agent may have against a covered entity consistent with the U.S. Special Resolution Regimes.[204] Section 252.84 of 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 entity based on the resolution of an affiliate of the covered entity.[205]

Commenters argued that the provisions of sections 252.83 and 252.84 that relate to transactions entered into by the covered entity as agent should exclude QFCs where the covered entity 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 entity acts as agent for a counterparty whose transactions are excluded from the requirements of the rule.[206] Commenters provided as an example where an agent simply executes an agreement on behalf of the principal but bears no liability thereunder, such as where an investment manager signs an agreement on behalf of a client. Commenters noted that such agreements could contain events of default relating to the

[200] *See* final rule § 252.84(h).

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

[202] *See* final rule § 252.84(i).

[203] The definition of QFC under Title II of the Dodd-Frank Act, which is adopted in the final rule, includes security agreements and other credit enhancements as well as master agreements (including supplements). 12 U.S.C. 5390(c)(8)(D); *see also* final rule § 252.81.

[204] *See* proposed rule § 252.83(a)(3).

[205] *See* proposed rule §§ 252.84(a)(3), 252.84(d).

[206] 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.

insolvency of the agent or an affiliate of the agent but that such default rights would be difficult to track and that close-out of such QFCs would not result in any loss or liquidity impact to the agent. Rather, early termination under the agreements would subject the cash and securities of the principals—not the agent—to realization and liquidation. Therefore, the agent would not be exposed to the liquidity and asset fire sale risks the proposal was intended to address.

Commenters contended that the requirement to conform QFCs with all affiliates of a counterparty when an agent is acting on behalf of the counterparty would be particularly burdensome, as the agent may not have information about the counterparty's affiliates or their 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 entity under the proposal, since default rights related to the non-U.S. operations of foreign GSIBs are not the focus of the rule and do not bear a sufficient connection to U.S. financial stability to warrant the burden and cost of compliance.

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

To respond to concerns raised by commenters, the agency provisions of the proposed rule have been modified in the final rule. The final rule provides that a covered entity does not become a party to a QFC solely by acting as agent to a QFC.[207] Therefore, an in-scope QFC would not be a covered QFC solely because a covered entity was acting as the agent of a principal with respect to the QFC.[208] For example, the final rule would not require a covered entity 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 entity 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 entity 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 entity is acting solely as agent with respect to the master securities lending agreement but is acting as agent and guarantor with respect to the SLAA. However, SLAAs would be exempted under the final rule to the extent that they are not ''in-scope QFCs'' or otherwise meet the exemptions for covered QFCs of the final rule.

Enforceability. Commenters also requested that the final rule should clarify that obligations under a QFC would still be enforceable even if its terms do not comply with the requirements of the final rule, similar to assurances provided in respect of the UK rule and German legislation. The enforceability of a contract is beyond the scope of this rule.

Interaction with Other Regulatory Requirements. Certain commenters requested clarification that amending covered QFCs as required by this final rule should not trigger other regulatory requirements for covered entities, such as the swap margin requirements issued by the Board, other prudential regulators (the OCC, 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 rule as they relate to the requirements of another rule issued by the Board 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. However, as the proposal noted, the Board 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.[209] The Board does not expect that compliance with this final rule would trigger the swap margin requirements for non-cleared swaps.

Compliance with the Universal and U.S. Protocols. The final rule, like the proposal, allows covered entities to conform covered QFCs to the requirements of the proposed rule through adherence to the Universal Protocol.[210] The two primary operative provisions of the Universal Protocol are Section 1 and Section 2. Under Section 1, adhering parties essentially ''opt in'' to the U.S. Special Resolution Regimes and certain other special resolution regimes. Therefore, Section 1 is generally responsive to the concerns addressed in section 252.83 of the final rule. Under Section 2, adhering parties essentially forego, subject to the creditor protections of Section 2, cross-default rights and transfer restrictions on affiliate credit enhancements. Therefore, Section 2 is generally responsive to the concerns addressed in section 252.84 of the final rule.

The proposal noted that, while the scope of the stay-and-transfer provisions of the Universal Protocol are narrower than the stay-and-transfer provisions that would have been required under the proposal and the Universal Protocol provides a number of creditor protection provisions that would not otherwise have been available under the proposal, the Universal Protocol includes a

[207] *See* final rule § 252.82(e)(1).

[208] 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 Board notes that covered entities do not include non-U.S. subsidiaries of a foreign GSIB.

[209] *See* 81 FR 29169, 29186 (May 11, 2016).

[210] *See* final rule § 252.85(a).

number of desirable features that the proposal lacked. The proposal explained that ''when an entity (whether or not it is a covered entity) adheres to the [Universal] Protocol, it necessarily adheres to the [Universal] Protocol with respect to all covered entities that have also adhered to the Protocol rather than one or a subset of covered entities (as the proposal may otherwise permit). . . . This feature appears to allow the [Universal] Protocol to address impediments to resolution on an industry-wide basis and increase market certainty, transparency, and equitable treatment with respect to default rights of non-defaulting parties.'' [211] This feature is referred to as ''universal adherence.'' The proposal explained that other favorable features of the Universal Protocol included that it amends all existing transactions of adhering parties, does not provide the counterparty with default rights in addition to those provided under the underlying QFC, applies to all QFCs, and includes 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 section 252.84 of the proposal.

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

A few commenters requested that the final rule clarify two technical aspects of adherence to the Universal Protocol. These commenters requested confirmation that adherence to the Universal Protocol would also satisfy the requirements of section 252.83. 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.[212] By clarifying section 252.85(a), the final rule confirms that adherence to the Universal Protocol is deemed to satisfy the requirements of section 252.83 of the final rule (as well as section 252.84) and that conformance of a covered QFC through the Universal Protocol includes incorporation of the terms of the Universal Protocol by reference by protocol adherents. This clarification also applies to the U.S. Protocol, discussed below.

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

Many commenters argued that the final rule should also allow compliance with the rule through a yet-to-be-created ''U.S. Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol'' (an ''approved U.S. JMP'') that is generally the same but narrower in scope than the Universal Protocol.[213] 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 proposal did not include any Country Annex for any Protocol-eligible Regime.[214]

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

[211] 81 FR 29169, 29182–83 (May 11, 2016).

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

[213] Commenters argued that approval of the approved U.S. JMP should not require satisfaction of the administrative requirements of section 252.85(b)(3), since the Board has already conducted that analysis in deciding to provide a safe harbor for the Universal Protocol.

[214] The proposal defined the Universal Protocol as the ''ISDA 2015 Universal Resolution Stay Protocol, including the Securities Financing Transaction Annex and Other Agreements Annex, published by the International Swaps and Derivatives Association, Inc., as of May 3, 2016, and minor or technical amendments thereto.'' *See* proposed rule § 252.85(a). As of May 3, 2016, ISDA had not published any Country Annex for a Protocol-eligible Regime and such publication would not be a minor or technical amendment to the Universal Protocol. Consistent with the proposal, the final rule does not define the Universal Protocol to include any Country Annex. However, the final rule does not penalize adherence to any Country Annex. A covered QFC that is amended by the Universal Protocol—but not a Country Annex—will be deemed to conform to the requirements of the final rule. In addition, a covered QFC that is amended by the Universal Protocol—including one or more Country Annexes—is also deemed to conform to the requirements of the final rule. *See* final rule § 252.85(a)(2).

force counterparties to give up default rights in jurisdictions where that is not yet legally required.[215] 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.[216]

With respect to the universal adherence feature of the Universal Protocol, commenters argued that universal adherence imposed significant monitoring burden since new adherents may join the Universal Protocol at any time. To address this concern, some commenters requested that an approved U.S. JMP allow a counterparty to adhere on a firm-by-firm or entity-by-entity basis. Other commenters suggested, or supported approval of, an approved U.S. JMP in which a counterparty would adhere to all current covered 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, 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 entity or excluded bank was not a party. Certain commenters argued that adhering with respect to any counterparty would also be inconsistent with their fiduciary duties.

In response to comments and to further facilitate compliance with the rule, the final rule provides that covered QFCs amended through adherence to the Universal Protocol or a new (and separate) protocol (the ''U.S. Protocol'') would be deemed to conform the covered QFCs to the requirements of the final rule.[217] The U.S. Protocol may differ from the Universal Protocol in certain respects, as discussed below, but otherwise must be substantively identical to the Universal Protocol.[218] Therefore, the reasons for deeming covered QFCs amended by the Universal Protocol to conform to the final rule, discussed above and in the proposal, apply to the U.S. Protocol.

Consistent with the proposal[219] 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 entities and excluded banks.[220] 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 expected to be issued by the OCC and FDIC and not also QFCs outside the scope of the agencies' final rules (*i.e.,* QFCs between parties that are not covered entities or excluded banks).

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.[221] As noted above, the Universal Protocol, as defined in the proposal, did not include any Country Annex for a Protocol-eligible Regime; the only special resolution regimes specifically identified in the Universal Protocol, as defined in the proposal, were the U.S. Special Resolution Regimes and the other Identified Regimes. As explained in the proposal, inclusion of the Identified Regimes should help facilitate the resolution of a GSIB across a broader range of circumstances.[222] 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.[223] Inclusion of only the Identified Regimes in the U.S. Protocol, considered in light of the other benefits to the resolution of GSIBs provided by the Universal Protocol and U.S. Protocol as well as commenters' concerns with potential adherence to Protocol-eligible Regimes, should sufficiently advance the objective of the final rule to increase the likelihood that a resolution of a GSIB could be carried out in an orderly manner under a range of scenarios.

The U.S. Protocol does not permit parties to adhere on a firm-by-firm or entity-by-entity basis because such adherence mechanisms requested by commenters would obviate one of the 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.[224] Although the static list would initially provide for universal adherence, the static list would not provide for universal adherence with respect to entities that became covered 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.[225] The Universal Protocol refers to these

[215] 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.

[216] One commenter requested clarification that a QFC of a covered entity with a non-U.S. credit support provider for the covered entity complies with the requirements of the final rule to the extent the covered entity 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 counties do not satisfy the requirements of the final rule.

[217] The final rule also provides that the Board may determine otherwise based on specific facts and circumstances. *See* final rule § 252.85(a).

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

[219] The proposal explained that a ''jurisdictional module for the United States that is substantively identical to the [Universal] Protocol in all respects aside from exempting QFCs between adherents that are not covered entities or covered banks would be consistent with the current proposal.'' 81 FR 29169, 29181 n.106 (May 11, 2016).

[220] 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 § 252.85(a)(3)(ii)(F).

[221] *See* final rule § 252.85(a)(3)(ii)(A). The U.S. Protocol is likewise not required to include definitions and adherence mechanisms related to Protocol-eligible Regimes. The final rule allows the U.S. Protocol to include minor and technical differences from the Universal Protocol and, similarly, differences necessary to conform the U.S. Protocol to the substantive differences allowed or required from the Universal Protocol. *See* final rule § 252.85(a)(3)(ii)(E).

[222] 81 FR 29169, 29183 (May 11, 2016).

[223] *See* final rule § 252.85(a)(3)(ii)(A).

[224] The final rule, however, does not prohibit the creation of a dynamic list identifying of all current ''Covered Parties,'' as would be defined in the U.S. Protocol, to facilitate due diligence and provide additional clarity to the market. *See* final rule § 252.85(a)(2)(ii)(E) (allowing minor and technical differences from the Universal Protocol).

[225] Section 4(b) of the Universal Protocol.

provisions as ''opt-outs.'' The proposal explained that adherence to the Universal Protocol was an alternative method of compliance with the proposed rule and that covered QFCs that were not amended by the Universal Protocol must otherwise conform to the proposed rule. In other words, the proposal would have required that a covered QFC be conformed regardless of the method the covered entity and counterparty chooses to conform the QFC.[226]

Consistent with the basic purposes of the proposed and final rules, the U.S. Protocol requires that opt-outs exercised by its adherents will only be effective to the extent that the 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 entities to ensure that their covered QFCs continue to conform to the requirements of the rule.

The final rule also provides that, under the U.S. Protocol, the opt-out in Section 4(b)(i)(A) of the attachment to the Universal Protocol (Sunset Opt-out)[227] 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 FDIC and OCC, 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 proposal, 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.[228]

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

As discussed above, the restrictions of the final rule leaves many creditor protections that are commonly included in QFCs unaffected. The final rule also allows any covered entity to submit to the Board a request to approve as compliant with the rule one or more QFCs that contain additional creditor protections—that is, creditor protections that would be impermissible under the restrictions set forth above.[229] A covered entity making such a request would be required to provide an analysis of the contractual terms for which approval is requested in light of a range of factors that are set forth in the final rule and intended to facilitate the Board's consideration of whether permitting the contractual terms would be consistent with the proposed restrictions.[230] The Board also expects to consult with the FDIC and OCC during its consideration of such a request.

The first two factors concern the potential impact of the requested creditor protections on GSIB resilience and resolvability. The next four concern the scope of the final rule: Adoption on an industry-wide basis, coverage of existing and future transactions, coverage of one or multiple QFCs, and coverage of some or all covered entities. Creditor protections that may be applied on an industry-wide basis may help to ensure that impediments to resolution are addressed on a uniform basis, which could increase market certainty, transparency, and equitable treatment. Creditor protections that apply broadly to a range of QFCs and covered entities would increase the chances that all of a GSIB's QFC counterparties would be treated the same way during a resolution of that GSIB and may improve the prospects for an orderly resolution of that GSIB. By contrast, proposals that would expand counterparties' rights beyond those afforded under existing QFCs would conflict with the proposal's goal of reducing the risk of mass unwinds of GSIB QFCs. The final rule also includes three factors that focus on the creditor protections specific to supported parties. The Board may weigh the appropriateness of additional protections for supported QFCs against the potential impact of such provisions on the orderly resolution of a GSIB.

In addition to analyzing the request under the enumerated factors, a covered entity requesting that the Board approve enhanced creditor protections would be required to submit a legal opinion stating that the requested terms would be valid and enforceable under the applicable law of the relevant jurisdictions, along with any additional relevant information requested by the Board.[231]

Under the final rule, the Board could approve a request for an alternative set of creditor protections if the terms of the QFC, as compared to a covered QFC containing only the limited creditor protections permitted by the final rule, would prevent or mitigate risks to the financial stability of the United States that could arise from the failure of a GSIB and would protect the safety and soundness of bank holding companies and state member banks to at least the same extent.[232] Once approved by the Board, enhanced creditor protections could be used by other covered entities (in addition to the covered entity that submitted the request for Board approval), as appropriate. The request-and-approval process would improve flexibility by allowing for an industry-proposed alternative to the set of creditor protections permitted by the final rule while ensuring that any approved alternative would serve the final rule's policy goals to at least the same extent as a covered QFC that complies fully with the final rule.

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 Board would approve or deny a request. Certain commenters urged that counterparties and trade groups, in addition to covered entities, should be permitted to make such requests. One commenter noted that the proposal's approval process would have created a free-rider problem, where parties that submit enhanced creditor protection conditions for Board 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

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

[227] *See* Section 4(b)(i)(A) of the Universal Protocol.

[228] Section 2 of the Universal Protocol provides an exemption for any client-facing leg of a cleared transaction. *See* Section 2(k) of the Universal Protocol and the definition of ''Cleared Client Transaction.'' The final rule does not amend the proposal's treatment of QFCs that are ''Cleared Client Transactions'' under the Universal Protocol, but requires that the provisions of that section must not apply with respect to the U.S. Protocol. *See* final rule § 252.85(a)(3)(ii)(D).

[229] *See* final rule § 252.85(b).

[230] Final rule § 252.85(d)(1)–(10).

[231] *See* final rule § 252.85(b)(3)(ii)–(iii).

[232] *See* final rule § 252.85(c).

provisions and amendments would be valid and enforceable under applicable law of the relevant jurisdictions'' should be eliminated as unnecessary.[233] Additionally, commenters also urged that the provision should be broadened to allow approvals of provisions not directly related to enhanced creditor protections.

The Board has clarified that the Board could approve an alternative proposal of additional creditor protections as compliant with sections 252.83 and 252.84 of the final rule, but has not otherwise modified these provisions of the proposal in response to changes requested by commenters. The provisions contain flexibility and guidance on the process for submitting and approving enhanced creditor protections. The final rule directly places requirements only on covered entities, and thus only covered entities are eligible to submit requests pursuant to these provisions. In response to commenters' concerns, the Board notes that the final rule does not prevent multiple covered entities from presenting one request and does not prevent covered entities 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.

III. Transition Periods

Under the proposal, the rule would have required compliance on the first day of the first calendar quarter beginning at least one year after the issuance of the final rule, which the proposal referred to as the effective date.[234] A number of commenters urged the Board 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 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 Board'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 Board confirm that entities acquired by a GSIB, and thereby become new covered entities, have until the first day of the first calendar quarter immediately following one year after becoming covered entities 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 entities to engage in corporate activities. These commenters also requested clarification that, during that conformance period, affiliates of covered entities would not be prohibited from entering into new transactions or QFCs with counterparties of the newly acquired entity if the existing covered entities otherwise comply with the rule's requirements. Some commenters urged the Board to exclude existing contracts from the final rule's requirements and only apply the rule on a prospective basis.

The effective date for the final rule is 60 days following publication in the **Federal Register**. However, in order to reduce the compliance burden of the final rule, the Board has adopted a phased-in compliance schedule, as requested by commenters. The final rule provides that a covered entity must conform a covered QFC to the requirements of this final rule by the first day of the calendar quarter immediately following one year from the effective date of this subpart with respect to covered QFCs with other covered entities and excluded banks (referred to in this discussion as the ''first compliance date'').[235] This provision allows the counterparties that should be most familiar with the requirements of the final rule over one year to conform with the rule's requirements. Moreover, this is a relatively small number of counterparties that would need to modify their QFCs in the first year following the effective date of the final rule, and many covered entities and excluded banks with covered QFCs have already adhered to the Universal Protocol.

The final rule provides additional time for compliance with the requirements for other types of counterparties. In particular, for other types of financial counterparties[236] (other than small financial institutions)[237], the final rule provides

[233] 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.

[234] *See* proposed rule § 252.82(b). Under section 302(b) of the Riegle Community Development and Regulatory Improvement Act of 1994, new Board regulations that impose requirements on insured depository institutions generally must ''take effect on the first day of a calendar quarter which begins on or after the date on which the regulations are published in final form.'' 12 U.S.C. 4802(b).

[235] *See* final rule § 252.82(f)(1)(i). The definition of covered QFC of the final rule has been revised to make clear that, consistent with the proposal, a covered QFC is a QFC that the covered entity becomes a party to on or after the first day of the calendar quarter immediately following one year from the effective date of this subpart. *See* final rule § 252.82(c). As discussed above, a covered entity's in-scope QFC that is entered into before this date may also be a covered QFC if the covered entity or any affiliate that is a covered entity or excluded bank also becomes a party to a QFC with the same counterparty or a consolidated affiliate of the same counterparty on or after the first compliance date. *See id.*

[236] *See* final rule § 252.81 (defining ''financial counterparty'').

[237] The final rule defines small financial institution as an insured bank, insured savings

approximately 18 months from the effective date of the final rule for compliance with its requirements, as requested by commenters.[238] For community banks and other non-financial counterparties, the final rule provides approximately two years from the effective date of the final rule for compliance with its requirements, as requested by commenters.[239] 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 Board is giving this additional time for compliance to respond to concerns raised by commenters. The Board encourages covered entities to start planning and outreach efforts early in order to come into compliance with the rule on the time frames provided. The Board believes that this additional time for compliance should also address concerns raised by commenters regarding the burden of conforming existing contracts by allowing firms additional time to conform all covered QFCs to the requirements of the final rule.

Although the phased-in compliance period does not contain special rules related to acting as an agent as requested by certain commenters, the rule has been modified as described above to clarify that a covered entity does not become a party to a QFC solely by acting as agent with respect to the QFC.[240]

Entities that are covered entities when the final rule is effective would be required to comply with the requirements of the final rule beginning on the first compliance date. Thus, a covered entity would be required to ensure that covered QFCs entered into on or after the first compliance date comply with the rule's requirements but would be given more time to conform such covered QFCs with entities that are not covered entities or excluded banks.[241] Moreover, a covered entity would be required to bring an in-scope QFC entered into prior to the first compliance date into compliance with the rule no later than the applicable date of the tiered compliance dates (discussed above) if the covered entity or an affiliate (that is also a covered entity or excluded bank) 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.[242] (Thus, a covered entity would not be required to conform a pre-existing QFC if that covered entity and its covered entity and excluded bank affiliates do not enter into any new QFCs with the same counterparty or its consolidated affiliates on or after the first compliance date.)

In addition, an entity that becomes a covered entity after the effective date of the final rule (a ''new covered entity'' for purposes of this preamble) generally has the same period of time to comply as an entity that is a covered entity on the effective date (*i.e.,* compliance will phase in over a two-year period based on the type of counterparty).[243] The final rule also clarifies that a covered QFC, with respect to a new covered entity, means an in-scope QFC that the new covered entity becomes a party to (1) on the date the covered entity first becomes a covered entity, and (2) before that date, if the covered entity or one of its affiliates that is a covered entity or exempt bank also enters, executes, or otherwise becomes a party to a QFC with the same counterparty or a consolidated affiliate of the counterparty after that date.[244] Under the final rule, a company that is a covered entity on the effective date of the final rule (an ''existing covered entity'' for purposes of this preamble) and becomes an affiliate of a new covered entity generally must conform any existing but non-conformed in-scope QFC that the existing covered entity continues to have with a counterparty after the applicable initial compliance date by the date the new covered entity 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.

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 United Kingdom and the statutory requirements adopted by Germany.

The Board 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 entity. 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.[245] Therefore, the final rule requires an existing QFC between a covered entity and a counterparty to be conformed to the requirements of the final rule if the covered entity (or an affiliate that is a covered entity or excluded bank) enters into another QFC with the counterparty or its consolidated affiliate on or after the first day of the calendar quarter immediately following one year from the effective date of the final rule.[246] By permitting a covered entity to remain a party to noncompliant QFCs entered before the effective date unless the covered entity or any affiliate (that is also a covered entity or excluded bank) 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 entities 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 entity ensure that all existing QFCs with a particular counterparty and its affiliates are compliant before it or any affiliate of the covered entity (that is also a covered entity or excluded bank) enters into a new QFC with the same counterparty or its affiliates after the effective date will provide covered entities with an incentive to seek the modifications necessary to ensure that their QFCs with their most important counterparties are compliant. Moreover, the volume of noncompliant covered

association, farm credit system institution, or credit union with assets of $10,000,000,000 or less. *See* final rule § 252.81.

[238] *See* final rule § 252.82(f)(1)(ii).

[239] *See* final rule § 252.82(f)(1)(iii).

[240] *See* final rule § 252.82(e)(1).

[241] *See* final rule §§ 252.82(c)(1), 252.82(f)(1).

[242] *See id.*

[243] *See* final rule § 252.82(f)(2).

[244] *See* final rule § 252.82(c)(2).

[245] The requirements of the final rule, particularly those of section 252.84, may have a different impact on netting, including close-out netting, than the U.K. and German requirements cited by commenters.

[246] Subject to any compliance date applicable to the covered entity, the Board expects a covered entity to conform existing QFCs that become covered QFCs within a reasonable period.

QFCs outstanding can be expected to decrease over time and eventually to reach zero. In light of these considerations, and to avoid creating potentially inappropriate compliance costs with respect to existing QFCs with counterparties that, together with their consolidated affiliates, do not enter into new covered QFCs with the GSIB on or after the first day of the calendar quarter that is one year from the effective date of the final rule, it would be appropriate to permit a limited number of noncompliant QFCs to remain outstanding, in keeping with the terms described above. Moreover, the final rule also excludes existing warrants and retail investment advisory agreements to address concerns raised by commenters and mitigate burden.[247] That said, the Board will monitor covered entities' levels of noncompliant QFCs and evaluate the risk, if any, that they pose to the safety and soundness of the GSIBs or to U.S. financial stability.

IV. Costs and Benefits

The Board invited comment on its evaluation of the costs and benefits of the proposal. In response to comments received, the Board has made a number of changes to the proposal that are expected to reduce costs and burdens of compliance with the final rule while at the same time ensuring that the final rule serves its intended purposes.

A number of commenters argued that particular aspects of the proposal were burdensome and costly as described throughout this **SUPPLEMENTARY INFORMATION**. One commenter stated that the proposal was overly complex and difficult for market participants to evaluate and for courts to interpret, which could lead to potentially different or conflicting interpretations.[248] Another commenter contended that the Board has not adequately considered the litigation costs that will result from the final rule's heightened burden of proof. Certain commenters expressed the view that the proposal made unquantified assumptions about the costs, provided no evidence that benefits would outweigh the costs, and did not discuss the impact of the requirements for particular market segments (*e.g.,* physical commodity markets). Certain commenters urged the Board to consider the costs of the contractual default rights lost under the rule and to consider the compliance costs and additional collateral costs the rule will impose on non-GSIB parties to QFCs (including parties not regulated by the Board), particularly in stress scenarios where the non-GSIB party cannot require the GSIB counterparty to post collateral. Some commenters contended that GSIB entities will have to compensate sophisticated non-covered entities for the additional risks they are forced to incur if forced to give up default rights and will bear the cost of the economic barriers to engaging in international finance that follow from this rule. A few commenters argued that, before the Board proceeds to finalize this rule, the Board should conduct a study and assessment of the costs and benefit as well as the market impact of the proposed rules, the TLAC rules, and the broader FSB initiatives, with a specific focus on application to existing default rights and the impact on all affected market participants.

Other commenters pointed out that since large banks already adhere to the Universal Protocol, more than 90 percent of outstanding notional swaps are already subject to stays. These commenters argued that further study and analysis was needed to determine whether it is necessary to restrict end-user default rights by subjecting them indirectly to the proposed rule to capture the remaining 10 percent of the swaps market, including why the benefits outweigh the costs. Commenters also urged further analysis of why other categories of QFCs present the same concerns as swaps such that it is necessary for the Board to alter default rights contained therein (*e.g.,* commodity and forward contracts) and the likely effect of the proposed rule on the markets for such QFCs.

One commenter argued that the benefits of the proposal likely substantially outweigh the costs. This commenter contended that the losses in the Lehman bankruptcy alone due to the ability of counterparties to close out QFCs and seize collateral destroyed millions if not billions of dollars and argued that the exemption of QFCs from the automatic stay of the U.S. Bankruptcy Code has effectively subsidized the cost of credit extended among QFC participants. In this commenter's view, any increase in the cost of QFCs relative to other financial instruments does not reflect true additional cost but rather reflects the loss of this implicit subsidy. The commenter estimated that the 2008 financial crisis following the Lehman bankruptcy had an estimated cost in lost or avoided gross domestic product of more than $20 trillion.

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

The costs of the final rule to covered entities and their QFC counterparties would generally be of three types. The first cost would be the cost to QFC counterparties arising from the relinquishment of certain rights, such as cross-default rights, that would have been permitted prior to the rule. However, the costs of restricting such rights are expected to be low as the nature of the rights that are restricted is narrow, the likelihood of exercising such rights is low, and other forms of protection are available that are not prohibited by the rule.

The second cost associated with the rule is the cost of lost revenue for covered entities that might result if non-covered entity counterparties refuse to engage in QFCs with covered entities as a result of the reduction in rights required by the rule. This cost, however, only accrues in the aggregate to the financial system to the extent that non-covered entity counterparties refuse to engage in QFCs with any counterparty. Third and finally, this rule imposes costs on covered entities and non-covered entities to the extent that they are required to bear legal and administrative costs associated with drafting and negotiating compliant contracts. These costs are expected to be small relative to the costs of doing business in the financial sector generally. Moreover, the final rule explicitly allows for the use of standardized industry protocols in lieu of complying with the terms of the rule, which should reduce the legal and administrative costs associated with complying with the rule.

The Board has taken into account the information regarding costs and benefits provided by commenters and modified the proposed rule to reduce costs. To reduce the overall burden, the final rule contains a number of changes to respond to commenter concerns. As described above, the final rule reduces compliance and negotiating costs by excluding contracts from the scope of ''covered QFCs'' subject to the requirements of the final rule to the extent the contract contains no default, cross-default, or transfer restrictions.

[247] *See* final rule § 252.88(c).

[248] Some commenters requested that the rule be rewritten to be more understandable to non-covered entity counterparties and that the Board release FAQs regarding this final rule that are understandable to non-financial counterparties. The Board has endeavored to clarify the final rule as much as possible and has discussed those clarifications throughout this **SUPPLEMENTARY INFORMATION**. The Board does not believe FAQs for this final rule are required at this time, but will consider the need for such FAQs in the future.

Commenters argued that remediating such contracts would be costly without an attendant benefit to resolution of a GSIB. The final rule also only requires remediation of existing contracts with a counterparty if the counterparty or a consolidated affiliate of the counterparty enters into a new QFC with the covered entity (or certain affiliates). This change to consolidated affiliate is in response to many commenters' argument that burden would be mitigated by defining counterparties by reference to financial consolidation. Additionally, in certain cases, where remediation of existing contracts would be difficult, the Board excludes such existing contracts from the scope of coverage of the requirements of the final rule. Finally, the final rule allows for the application of two standardized industry protocols as a means of complying with the requirements of the final rule. Adhering to an industry protocol will provide for a low cost and efficient means of compliance that does not result in excessive amounts of legal or administrative costs.

The final rule similarly excludes from section 252.83 contracts that are with U.S. counterparties and governed by U.S. law. Commenters argued that renegotiating these contracts would be burdensome with no benefit to resolution. The final rule has also been modified to address concerns raised by foreign GSIBs regarding QFCs under multi-branch master agreements by excluding from the rule QFCs where only payment or delivery may be made at a U.S. branch or agency. Foreign GSIB commenters urged that this change would eliminate the need under the proposal to modify thousands of contracts at great cost.

The final rule also provides a longer transition period requested by commenters for certain counterparties in order to help mitigate the compliance burden on covered entities and their counterparties.

The Board believes that the changes above address many of the significant concerns raised by commenters regarding the burdens of the proposed rule and should serve to mitigate the compliance costs of the final rule. The Board also notes that application of the final rule is limited to GSIBs and believes that this approach to limiting the application of this final rule sensibly balances the costs and benefits of the rule by effectively managing systemic risk while at the same time limiting the burden of compliance by not requiring non-GSIB firms to comply with any part of this final rule.

Additionally, the stay-and-transfer provisions of the Dodd-Frank Act and the FDI Act are already in force, and the Universal Protocol is already partially effective. This observation provides further support for the view that any marginal costs created by the final rule—which is intended to extend the effects of the stay-and-transfer provisions under those acts and the Universal Protocol—are unlikely to be material.

Thus, the costs of the final rule are likely to be small relative to its benefits. These relatively small costs appear to be significantly outweighed by the substantial benefits that the rule would produce for the U.S. economy. Financial crises impose enormous costs on the real economy, so even small reductions in the probability or severity of future financial crises create substantial economic benefits. The final rule would materially reduce the risk to the financial stability of the United States that could arise from the severe distress or failure of a GSIB by enhancing the prospects for the orderly resolution of such a firm and would thereby materially reduce the probability and severity of financial crises in the future. The final rule would therefore advance a key objective of the Dodd-Frank Act and help protect the American economy from the substantial costs associated with more frequent and severe financial crises.

In addition, the final rule would likely benefit subsidiaries of a failed GSIB, as well as their counterparties and creditors, by helping to prevent the disorderly failure of the subsidiaries and allowing them to continue to meet their obligations. Moreover, non-covered entity counterparties may choose to engage in QFCs with non-GSIB counterparties, in which case revenue that is lost by a GSIB may be recouped by a non-GSIB and aggregate QFC activity by the financial system would not decline.

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

The final rule also amends several definitions in the Board's capital and liquidity rules to help ensure that the final rule would not have unintended effects for the treatment of covered entities' netting sets under those rules. The amendments are similar to the proposed rule as well as revisions that the Board and the OCC made in a 2014 interim final rule to prevent similar effects from foreign jurisdictions' special resolution regimes and firms' adherence to the 2014 Universal Protocol.[249]

The Board's regulatory capital rules permit a banking organization to measure exposure from certain types of financial contracts on a net basis and recognize the risk-mitigating effect of financial collateral for other types of exposures, provided that the contracts are subject to a ''qualifying master netting agreement'' or agreement that provides for certain rights upon the default of a counterparty.[250] The Board has defined ''qualifying master netting agreement'' to mean a netting agreement that permits a banking organization to terminate, apply close-out netting, and promptly liquidate or set off collateral upon an event of default of the counterparty, thereby reducing its counterparty exposure and market risks.[251] On the whole, measuring the amount of exposure of these contracts on a net basis, rather than on a gross basis, results in a lower measure of exposure and thus a lower capital requirement.

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

Accordingly, the final rule amends the definition of ''qualifying master netting agreement'' so that a master netting agreement could qualify for such treatment where the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of default of the counterparty is consistent with the

[249] *See* 12 CFR part 217.

[250] *See id.*

[251] *See* 12 CFR 217.2.

requirements of the final rule. This revision maintains the existing treatment for these contracts under the Board's capital and liquidity rules by accounting for the restrictions that the final rule, or the substantively identical rules expected to be issued by the FDIC and OCC, would place on default rights related to covered entities' and excluded banks' QFCs. The Board does not believe that the disqualification of master netting agreements that would result in the absence of the amendment would accurately reflect the risk posed by the affected QFCs. As discussed above, the implementation of consistent restrictions on default rights in GSIB QFCs would increase the prospects for the orderly resolution of a failed GSIB and thereby protect the financial stability of the United States.

The final rule similarly revises certain other definitions in the regulatory capital rules to make analogous conforming changes designed to account for the final rule's restrictions and ensure that a banking organization may continue to recognize the risk-mitigating effects of financial collateral received in a secured lending transaction, repo-style transaction, or eligible margin loan for purposes of the Board's rules. Specifically, the final rule revises the definitions of ''collateral agreement,'' ''eligible margin loan,'' and ''repo-style transaction'' to provide that a counterparty's default rights may be limited as required by the final rule without unintended effects.[252]

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.'' [253] Thus, it may also be appropriate to amend the definition of ''eligible master netting agreement'' to account for the restrictions on covered entities' QFCs. Because the Board issued the swap margin rule jointly with other U.S. regulatory agencies, however, the Board is consulting with the other prudential regulators regarding amending that rule's definition of ''eligible master netting agreement.''

[252] As noted above, the FDIC and OCC are expected to issue substantively identical final rules in the near future. A Board-regulated instiution that amends a qualifying master netting agreement, collateral agreement, eligible margin loan, or repo-style transaction to the extent necessary for its counterparty to conform the agreement to any final rules issued by the FDIC or OCC would continue to meet such definition under the Board's capital and/or liquidity rules, regardless of whether the agreement is amended before the effective date of any final rule issued by the FDIC or OCC.

[253] 80 FR 74840, 74861–62 (Nov. 30, 2015).

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

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

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

VI. Regulatory Analysis

A. Paperwork Reduction Act

Certain provisions of the final rule contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501 through 3521). The Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget (OMB). The reporting requirements are found in sections 252.85(b) and 252.87(b) of the final rule. These information collection requirements would be implemented pursuant to section 165 of the Dodd-Frank Act, as well as its safety and soundness and other relevant authorities, as described in the Abstract below. In accordance with the requirements of the PRA, the Board may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid OMB control number.

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

The Board has a continuing interest in the public's opinions of collections of information. At any time, commenters may submit comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, to the **ADDRESSES** section. All comments will become a matter of public record. Additionally, commenters may send a copy of their comments to the OMB desk officer for the agency by mail to the Office of Information and Regulatory Affairs, U.S. Office of Management and Budget, New Executive Office Building, Room 10235, 725 17th Street NW., Washington, DC 20503; by fax to (202) 395–6974; or by email to *oira_submission@omb.eop.gov*.

Proposed Revision, With Extension, of the Following Information Collection

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

Agency Form Number: Reg YY.

OMB Control Number: 7100–0350.

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

Affected Public: Businesses or other for-profit.

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

Abstract: Section 165 of the Dodd-Frank Act requires the Board to implement enhanced prudential standards for bank holding companies with total consolidated assets of $50 billion or more, including global systemically important foreign banking organizations with $50 billion or more in total consolidated assets. Section 165 of the Dodd-Frank Act also permits the Board to establish such other prudential standards for such banking organizations as the Board determines are appropriate. This regulation is being implemented by the Board under section 165 of the Dodd-Frank Act, as well as its safety and soundness and other relevant authorities.[254]

Reporting Requirements

Section 252.85(b) of the final rule would require a covered entity to request the Board to approve as compliant with the requirements of sections 252.83 and 252.84 of this subpart 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. Enhanced creditor protection conditions means a set of limited exemptions to the requirements of section 252.84(b) of this subpart that are different than those of paragraphs (d), (f), and (h) of section 252.84 of this subpart. A covered entity making a request must provide (1) an analysis of the proposal under each consideration of paragraph 252.85(d) of this subpart; (2) a written legal opinion verifying that proposed provisions or amendments would be valid and enforceable under applicable law of the relevant jurisdictions, including, in the case of proposed amendments, the validity and enforceability of the proposal to amend the covered QFCs; and (3) any additional relevant information that the Board requests.

Section 252.87(b) of the final rule would require each top-tier foreign banking organization that determines that it has the characteristics of a global systemically important banking organization under the global methodology to notify the Board of the determination by January 1 of each calendar year.[255]

Estimated Paperwork Burden for Proposed Revisions

Estimated Number of Respondents: Section 252.85(b)—10 respondents. Section 252.87(b)—22 respondents.

Estimated Burden per Response: Section 252.85(b)—40 hours. Section 252.87(b)—1 hour.

Current estimated annual burden for Reporting, Recordkeeping, and Disclosure Requirements Associated with Enhanced Prudential Standards (Regulation YY): 118,842 hours.

Proposed revisions estimated annual burden: 422 hours.

Total estimated annual burden: 119,264 hours.

B. Regulatory Flexibility Act: Final Regulatory Flexibility Analysis

The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (RFA), generally requires that an agency prepare and make available an initial regulatory flexibility analysis in connection with a notice of proposed rulemaking.

The Board solicited public comment on this rule in a notice of proposed rulemaking[256] and has considered the potential impact of this rule on small entities in accordance with section 604 of the RFA. Based on the Board's analysis, and for the reasons stated below, the Board believes the final rule will not have a significant economic impact on a substantial number of small entities.

Under regulations issued by the Small Business Administration, a small entity includes a depository institution, bank holding company, or savings and loan holding company with assets of $550 million or less (small banking entities).[257] Based on data as of June 2017, there are approximately 3,758 bank holding companies, savings and loan holding companies, and state member banks that have total domestic assets of $550 million or less and thus are considered small entities for purposes of the RFA. Based on the Board's analysis, and for the reasons stated below, the Board believes the final rule will not have a significant economic impact on a substantial number of small entities.

1. *Statement of the need for, and objectives of, the final rule.*

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

2. *Significant issues raised by the public comments in response to the IRFA and comments filed by the Chief Counsel for Advocacy of the Small Business Administration in response to the proposed rule and summary of any changes made in the proposed rule as a result of such comments.*

Commenters did not raise any issues in response to the IRFA. The Chief Counsel for Advocacy of the Small Business Administration did not file any comments in response to the proposed rule.

3. *Description and estimate of the number of small entities to which the final rule will apply.*

The final rule's requirements to conform covered QFCs would only apply to GSIBs, which are the largest, most systemically important banking organizations, and certain of their subsidiaries. More specifically, the final rule would apply to (a) any U.S. GSIB top-tier bank holding company, (b) any subsidiary of such a bank holding company other than the exceptions described in the **SUPPLEMENTARY INFORMATION** above for institutions regulated by the FDIC and OCC and certain investments, and (c) the U.S. operations of any foreign GSIB other than the exceptions described in the **SUPPLEMENTARY INFORMATION** above for institutions regulated by the FDIC and OCC and certain investments. The Board estimates that these requirements would apply to approximately 30 banking organizations: Eight U.S. bank holding companies (*i.e.,* U.S. GSIBs) and approximately 22 foreign banking organizations (*i.e.,* foreign GSIBs with U.S. operations). None of these banking organizations would qualify as a small banking entity for the purposes of the RFA. However, as discussed above, the final rule also applies to each covered GSIB's subsidiary that meets the definition of a covered entity (regardless of the subsidiary's size) because an

[254] 12 U.S.C. 321–338a, 481–486, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1844(c), 3101 *et seq.,* 3101 note, 3904, 3906–3909, 4808, 5361, 5362, 5365, 5366, 5367, 5368, 5371.

[255] Global methodology means the assessment methodology and the higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision, as updated from time to time. 12 CFR 252.2(o).

[256] *See* 81 FR 29169 (May 11, 2016).

[257] *See* 13 CFR 121.201. Effective July 14, 2014, the Small Business Administration revised the size standards for banking organizations to $550 million in assets from $500 million in assets. 79 FR 33647 (June 12, 2014).

exemption for small entities would significantly impair the effectiveness of the proposed stay-and-transfer provisions and thereby undermine a key objective of the final rule: To reduce the execution risk of an orderly GSIB resolution. The Board anticipates that any small subsidiary of a GSIB that is covered by this final rule would rely on its parent GSIB or a large subsidiary of that GSIB for reporting, recordkeeping, or similar compliance requirements and would not bear additional costs.

Section 252.87(b) of the final rule would require each top-tier foreign banking organization that determines that it has the characteristics of a global systemically important banking organization under the global methodology to notify the Board of the determination by January 1 of each calendar year.[258] All of these organizations by definition have $50 billion or more in total consolidated assets. None of these banking organizations would qualify as a small banking entity for the purposes of the RFA.

4. *Significant alternatives to the final rule.*

In light of the foregoing, the Board does not believe that this final rule will have a significant negative economic impact on any small entities and therefore believes that there are no significant alternatives to the final rule that would reduce the impact on small entities.

5. *Steps taken to minimize the significant economic impact on small entities.*

As noted, the Board believes that an exemption for small entities would significantly impair the effectiveness of the proposed stay-and-transfer provisions and thereby undermine a key objective of the final rule: To reduce the execution risk of an orderly GSIB resolution. The Board did not receive any comments from small entities suggesting alternatives specific to those entities or quantifying their projected costs. The Board received, however, general comments that suggested alternatives that would reduce the burden on entities without regard to size. The Board has considered those comments and changes in the final rule in response to such comments in other sections of this **SUPPLEMENTARY INFORMATION** section. In addition, the Board anticipates that any small subsidiary of a GSIB that is covered by this final rule would rely on its parent GSIB or a large subsidiary of that GSIB for reporting, recordkeeping, or similar compliance requirements and would not bear additional costs.

C. Riegle Community Development and Regulatory Improvement Act of 1994

The Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA) requires that each Federal banking agency, in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, consider, consistent with principles of safety and soundness and the public interest, any administrative burdens that such regulations would place on depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. The Board has considered comment on these matters in other sections of this **SUPPLEMENTARY INFORMATION** section.

In addition, new regulations that impose additional reporting, disclosures, or other new requirements on insured depository institutions generally must take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form. Therefore, covered entities, which include certain insured depository institutions, are required to comply with the requirements of the final rule on the first day of calendar quarters after the effective date of the regulation.

D. Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the U.S. banking agencies to use plain language in all proposed and final rulemakings published after January 1, 2000.[259] The Board received no comment on these matters and believes that the final rule is written plainly and clearly.

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

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

Authority and Issuance

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

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

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

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

■ 2. Section 217.2 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'';
■ d. Republishing the introductory text of the definition of ''repo-style transaction''; and
■ e. Revising paragraph (3)(ii)(A) of the definition of ''repo-style transaction''.

The revisions and republication are set forth below:

§ 217.2 Definitions.

* * * * *

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

(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 similar[4] to the U.S. laws

[258] Global methodology means the assessment methodology and the higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision, as updated from time to time. 12 CFR 252.2(o).

[259] 12 U.S.C. 4809(a).

[4] The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation

referenced in this paragraph (1)(i) in order to facilitate the orderly resolution of the defaulting counterparty;

(ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (1)(i) of this definition; or

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

* * * * *

Eligible margin loan means:

(1) * * *

(iii) The extension of credit is conducted under an agreement that provides the Board-regulated institution the right to accelerate and terminate the extension of credit and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, conservatorship, or similar proceeding, of the counterparty, provided that, in any such case:

(A) Any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(*1*) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs,[5] or laws of foreign jurisdictions that are substantially similar[6] to the U.S. laws referenced in this paragraph (1)(iii)(A)(*1*) in order to facilitate the orderly resolution of the defaulting counterparty; or

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

(B) The agreement may limit the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty to the extent necessary for the counterparty to comply with the requirements of subpart I of the Board's Regulation YY (part 252 of this chapter), part 47 of this title, or part 382 of this title, as applicable.

* * * * *

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

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

(2) The agreement provides the Board-regulated institution the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case:

(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[7] 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 subpart I of the Board's Regulation YY (part 252 of this chapter), part 47 of this title, or part 382 of this title, as applicable;

* * * * *

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

(3) * * *

(ii) * * *

(A) The transaction is executed under an agreement that provides the Board-regulated institution the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case:

(*1*) Any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(*i*) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar[8] to the U.S. laws referenced in this paragraph (3)(ii)(A)(*1*)(*i*) in order to facilitate the orderly resolution of the defaulting counterparty;

(ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (3)(ii)(A)(*1*)(*i*) of this definition; and

(*2*) The agreement may limit the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty to the extent necessary for the counterparty to comply with the requirements of subpart I of the Board's Regulation YY (part 252 of this chapter), part 47 of this title, or part 382 of this title, as applicable; or

* * * * *

PART 249—LIQUIDITY RISK MEASUREMENT STANDARDS (REGULATION WW)

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

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

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

§ 249.3 Definitions.

* * * * *

whether foreign special resolution regimes meet the requirements of this paragraph.

[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 Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

[7] The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

[8] The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

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

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

(2) The agreement provides the Board-regulated institution the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case:

(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 [1] to the U.S. laws referenced in this paragraph (2)(i)(A) in order to facilitate the orderly resolution of the defaulting counterparty;

(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 subpart I of the Board's Regulation YY (part 252 of this chapter), part 47 of this title, or part 382 of this title, as applicable;

* * * * *

PART 252—ENHANCED PRUDENTIAL STANDARDS (REGULATION YY)

■ 5. The authority citation for part 252 continues to read as follows:

Authority: 12 U.S.C. 321–338a, 481–486, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1844(c), 3101 *et seq.,* 3101 note, 3904, 3906–3909, 4808, 5361, 5362, 5365, 5366, 5367, 5368, 5371.

[1] The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

■ 6. Add subpart I to read as follows:

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

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

§ 252.81 Definitions.

For purposes of this subpart:

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

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

Consolidated affiliate means an affiliate of another company that

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

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

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

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

Excluded bank:

(1) Means a national bank, a Federal savings association, a Federal branch, a Federal agency, or an FSI that is exempted from the scope of this subpart pursuant to paragraph (b)(2) or (b)(3) of § 252.82;

(2) Does not include any entity described in paragraph (1) of this definition that is owned pursuant to section 3(a)(A)(ii) of the Bank Holding Company Act (12 U.S.C. 1842(a)(A)(ii)); is owned by a depository institution in satisfaction of debt previously contracted in good faith; is 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); is owned pursuant to paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24); or is a DPC branch subsidiary.

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

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

Financial counterparty means a person that is:

(1)(i) A bank holding company or an affiliate thereof; a savings and loan holding company as defined in section 10(n) of the Home Owners' Loan Act (12 U.S.C. 1467a(n)); a U.S. intermediate holding company that is established or designated for purposes of compliance with this part; or a nonbank financial company supervised by the Board;

(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) & (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. 80b–2(a)); an entity that would be an investment company under section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3) but for section 3(c)(5)(C); or an entity that is deemed not to be an investment company under section 3 of the Investment Company Act of 1940 pursuant to Investment Company Act Rule 3a–7 (17 CFR 270.3a–7) of the U.S. Securities and Exchange Commission;

(ix) A commodity pool, a commodity pool operator, or a commodity trading advisor as defined, respectively, in 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 this clause 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.

FSI means a state savings association or state nonmember bank (as the terms are defined in section 3 of the Federal Deposit Insurance Act, 12 U.S.C. 1813).

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

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

Person has the same meaning as in 12 CFR 225.2.

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

Retail customer or counterparty has the same meaning as in § 249.3 of the Board's Regulation WW (12 CFR 249.3).

Small financial institution means a company that:

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

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

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

§ 252.82 Applicability.

(a) *General requirement.* A covered entity must ensure that each covered QFC conforms to the requirements of §§ 252.83 and 252.84.

(b) *Covered entities.* For purposes of this subpart, a covered entity is:

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

(2) A subsidiary of a company identified in paragraph (b)(1) of this section other than a subsidiary that is:

(i) A national bank, a Federal savings association, a Federal branch, a Federal agency, an FSI;

(ii) A company owned pursuant to section 3(a)(A)(ii), 4(c)(2), 4(k)(4)(H), or 4(k)(4)(I) of the Bank Holding Company Act (12 U.S.C. 1842(a)(A)(ii), 1843(c)(2), 1843(k)(4)(H), 1843(k)(4)(I));

(iii) A company owned by a depository institution in satisfaction of debt previously contracted in good faith;

(iv) A portfolio concern, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662); or

(v) A company the business of which is to make investments that are designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs)); or

(3) A U.S. subsidiary, U.S. branch, or U.S. agency of a global systemically important foreign banking organization other than a U.S. subsidiary, U.S. branch, or U.S. agency that is:

(i) A national bank, a Federal savings association, a Federal branch, a Federal agency, an FSI;

(ii) A company owned pursuant to section 3(a)(A)(ii), 4(c)(2), 4(k)(4)(H), or 4(k)(4)(I) of the Bank Holding Company Act (12 U.S.C. 1842(a)(A)(ii), 1843(c)(2), 1843(k)(4)(H), 1843(k)(4)(I));

(iii) A company owned by a depository institution in satisfaction of debt previously contracted in good faith;

(iv) 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);

(v) A company the business of which is to make investments that are designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs);

(vi) A section 2(h)(2) company; or

(vii) A DPC branch subsidiary.

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

(1) With respect to a covered entity that is a covered entity on November 13, 2017, an in-scope QFC that the covered entity:

(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 entity or any affiliate that is a covered entity or excluded bank also enters, executes, or otherwise becomes a party to a QFC with the same person or a consolidated affiliate of the same person on or after January 1, 2019.

(2) With respect to a covered entity that becomes a covered entity after November 13, 2017, an in-scope QFC that the covered entity:

(i) Enters, executes or otherwise becomes a party to on or after the later of the date the covered entity first becomes a covered entity 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 entity, if the covered entity or any affiliate that is a covered entity or excluded bank also enters, executes, or otherwise becomes a party to a QFC with the same person or consolidated affiliate of the same person on or after the date identified in paragraph (c)(2)(i) with respect to the covered entity.

(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 entity; or

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

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

(1) A covered entity 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 entity that is a covered entity on November 13, 2017 must conform the covered QFC to the requirements of this subpart by:

(i) January 1, 2019, if each party to the covered QFC is a covered entity or an excluded bank;

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

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

(2) With respect to each of its covered QFCs, a covered entity that is not a covered entity on November 13, 2017 must conform the covered QFC to the requirements of this subpart by:

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

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

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

§ 252.83 U.S. Special Resolution Regimes.

(a) *Covered QFCs not required to be conformed.* (1) Notwithstanding § 252.82, a covered entity 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 entity, 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 entity 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 entity 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 entity or an affiliate of the covered entity 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 entity 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 § 252.84.

§ 252.84 Insolvency proceedings.

(a) *Covered QFCs not required to be conformed.* Notwithstanding § 252.82, a covered entity 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 or excluded bank 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 or excluded bank is a party.

(2) *Covered affiliate credit enhancement.* Covered affiliate credit enhancement means an affiliate credit enhancement in which a covered entity or excluded bank is the obligor of the credit enhancement.

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

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

(f) *Additional creditor protections for supported QFCs.* Notwithstanding paragraph (b) of this 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 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.

§ 252.85 Approval of enhanced creditor protection conditions.

(a) *Protocol compliance.* (1) Unless the Board determines otherwise based on the specific facts and circumstances, a covered QFC is deemed to comply with this subpart 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 covered entities and excluded banks and may be limited with respect to resolutions under the Identified Regimes, as those regimes are identified by the universal protocol;

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

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

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

(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 entity may request that the Board approve as compliant with the requirements of §§ 252.83 and 252.84 proposed provisions of one or more forms of covered QFCs, or proposed amendments to one or more forms of covered QFCs, with enhanced creditor protection conditions.

(2) Enhanced creditor protection conditions means a set of limited exemptions to the requirements of § 252.84(b) that is different than that of paragraphs (d), (f), and (h) of § 252.84.

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

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

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

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

(c) *Board approval.* The Board may approve, subject to any conditions or commitments the Board may set, a proposal by a covered entity under paragraph (b) of this section if the proposal, as compared to a covered QFC that contains only the limited exemptions in paragraphs of (d), (f), and (h) of § 252.84 or that is amended as provided under paragraph (a) of this section, would prevent or mitigate risks to the financial stability of the United States that could arise from the failure of a global systemically important BHC, a global systemically important foreign banking organization, or the subsidiaries of either and would protect the safety and soundness of bank holding companies and state member banks to at least the same extent.

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

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

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

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

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

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

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

(7) With respect to a supported party, the degree of assurance the proposal provides to the supported party that the material payment and delivery obligations of the covered affiliate credit enhancement and the covered direct QFC it supports will continue to be performed after the covered affiliate support provider enters a receivership, insolvency, liquidation, resolution, or similar proceeding;

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

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

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

§ 252.86 Foreign bank multi-branch master agreements.

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

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

§ 252.87 Identification of global systemically important foreign banking organizations.

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

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

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

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

(ii) That the top-tier foreign banking organization, if it were subject to the Board's Regulation Q (part 217 of this chapter), would be identified as a global systemically important BHC under § 217.402 of the Board's Regulation Q; or

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

(b) Each top-tier foreign banking organization that determines pursuant to paragraph (c) of this section that it has the characteristics of a global systemically important banking organization under the global methodology must notify the Board of the determination by January 1 of each calendar year.

(c) A top-tier foreign banking organization that is or controls a covered company (as defined at 12 CFR 243.2(f)) and prepares or reports for any purpose the indicator amounts necessary to determine whether the top-tier foreign banking organization is a global systemically important banking organization under the global methodology must use the data to determine whether the top-tier foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology.

(d) Each top-tier foreign banking organization that controls a U.S. intermediate holding company and that meets the requirements of § 252.153(b)(5) and (6) also meets the requirements of paragraphs (b) and (c) of this section.

§ 252.88 Exclusion of certain QFCs.

(a) *Exclusion of QFCs with FMUs.* Notwithstanding § 252.82, a covered entity is not required to conform to the requirements of this subpart a covered QFC to which:

(1) A CCP is party; or

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

(b) *Exclusion of certain excluded bank QFCs.* If a covered QFC is also a covered QFC under parts 47 or 382 of this title that an affiliate of the covered entity is also required to conform pursuant to parts 47 or 382 of this title and the covered entity is:

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

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

(c) *Exclusion of certain contracts.* Notwithstanding § 252.82, a covered entity is not required to conform the following types of contracts or agreements to the requirements of this subpart:

(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 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 entity 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 entity or an affiliate of the covered entity; and

(ii) Was issued prior to November 13, 2017.

(d) *Exemption by order.* The Board may exempt by order one or more covered entities from conforming one or more contracts or types of contracts to one or more of the requirements of this subpart after considering:

(1) The potential impact of the exemption on the ability of the covered entity(ies), or affiliates of the covered entity(ies), 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 Board deems relevant.

By order of the Board of Governors of the Federal Reserve System, September 1, 2017.

Ann E. Misback,

Secretary of the Board.

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