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BUY-SIDE BEWARE: NEW LIMITS ON INSOLVENCY-RELATED REMEDIES IN CERTAIN QFCs

Federal banking regulators recently adopted final rules that will restrict insolvency-related contractual remedies of certain buy-side entities transacting in covered QFCs with U.S. and foreign GSIBs, and their affiliates. The authors discuss the ins and outs of these complex rules and report the regulators' responses to the numerous comments received on the proposed rules.

By Philip T. Hinkle, Robert H. Ledig, and Shayna Gilmore *

In mid- to late 2017, each of the Board of Governors of the Federal Reserve System (Board), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) (together these entities are referred to as the Regulators) adopted parallel, complementary and substantively identical final rules (Rules) that will impact the insolvency-related transfer and "default rights" of certain buy-side parties transacting in covered "qualified financial contracts" (Covered QFCs). These Covered QFCs include swaps, other derivatives contracts, repurchase agreements (repos) and reverse repos, and securities lending and borrowing transactions with certain systemically important banking entities.[1]

The Rules directly apply to banking entities that are: (i) deemed to be a global systemically important U.S. banking organization (U.S. GSIBs) or that meet an asset size threshold; (ii) certain subsidiaries of a U.S. GSIB; or (iii) certain U.S. operations of systemically important foreign banking organizations (Foreign GSIBs). (These entities are generally referred to as Covered Entities in this article and each category of Covered Entity, which includes a Covered Bank and a Covered FSI (each as defined below), is described in more detail.)

The Rules will require Covered Entities to eliminate certain contractual rights with respect to Covered QFCs when:

- the Covered Entity counterparty becomes subject to a receivership either (i) as a non-bank financial company pursuant to the Orderly Liquidation Authority (OLA) provisions of Title II of the Dodd-Frank Act (generally under the FDIC) or (ii) as an insured depository institution pursuant to the Federal Deposit Insurance Act (FDIA) under the FDIC (together U.S. Special Resolution Regimes) or

[1] 82 Fed. Reg. 42882 (Sept. 12, 2017) (Board Rules); 82 Fed. Reg. 56630 (Nov. 29, 2017) (OCC Rules); and 82 Fed. Reg. 50228 (Oct. 30, 2017) (FDIC Rules).

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- an affiliate of the Covered Entity counterparty is placed in a receivership, insolvency, liquidation, resolution, or similar proceeding (together referred to as Insolvency Proceedings), including under the U.S. Bankruptcy Code.

In this regard, buy-side parties to Covered QFCs with Covered Entities – including registered investment companies, hedge funds, and other private funds and asset managers that transact in Covered QFCs on behalf of their clients – will be required by their Covered Entity counterparties to amend the documentation for certain existing and new QFCs to reflect the requirements of the Rules in anticipation of the relevant compliance date, which for most buy-side parties will be July 1, 2019. However, there are numerous exceptions to certain of the requirements under the Rules, including, of particular note for certain U.S.-based buy-side parties, an exception from the requirement to reflect the required terms relating to the U.S. Special Resolution Regimes for QFCs that meet certain U.S. nexus criteria.

The contractual rights impacted under the Rules are standard contractual provisions that permit a party facing an insolvent Covered Entity counterparty, or benefitting from credit support provided by an insolvent affiliate of the Covered Entity counterparty, to *immediately*: (i) terminate the transaction; (ii) set off any net payment obligations owed between the parties; and (iii) liquidate the counterparty's collateral. As a result, impacted buy-side parties will need to consider how they will be impacted from a credit risk and regulatory compliance perspective by the Rules in order to be ready to assess and respond to requests from their Covered Entity counterparties to amend their Covered QFCs.

This article (i) provides an overview of the purposes, scope, and compliance schedule for the Rules, (ii) reviews the U.S. bankruptcy and U.S. Special Resolution Regimes that are referred to in the Rules, (iii) discusses the contractual provisions required for in-scope Covered QFCs, and (iv) appraises the potential impact of the Rules on buy-side parties that such parties to QFCs may wish to consider.

PURPOSES AND SCOPE OF THE RULES AND COMPLIANCE SCHEDULE

Under the Rules, each Covered Entity must ensure that each Covered QFC to which it is a party conforms to the requirements of the respective U.S. Special Resolution Regimes and Insolvency Proceedings provisions as described below.[2] This section describes the purposes of the Rules, the entities that are Covered Entities under the Rules, the in-scope, Covered QFCs that must conform to the requirements of the Rules, and the phased-in compliance schedule for the Rules.

Purposes of the Rules.

The Regulators explained that the Rules are directed at protecting against threats to financial stability. They noted that Rules' requirements are intended to improve the resolvability and resilience of U.S. GSIBs, and reduce the potential that the resolution of the firm will be disorderly and lead to disruptive asset sales and liquidations. The Regulators noted that the largest financial firms are interconnected with other financial firms through large volumes of financial transactions, including derivatives. They expressed concern that 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. The Regulators suggested that such terminations, especially if counterparties lose confidence in the GSIB quickly and to a large extent, can destabilize the financial system and potentially spark a financial crisis. This may destabilize the failed entity's otherwise solvent affiliates, causing them to fail and thereby destabilize the entire organization, as well as potentially causing their counterparties to fail in a chain reaction that can ripple through the system. This may also result in fire sales of large volumes of financial assets, including collateral securing the contracts, which, in turn, can weaken and cause stress for other firms by lowering the value of similar assets that they hold.[3]

The Regulators further commented that the Rule should improve the resilience of U.S. foreign banking organization operations, and thereby increase the likelihood that a failed foreign GSIB with U.S. operations would be successfully resolved by its home

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[2] 12 C.F.R. §§ 252.82(a); 47.3(a); 382.2(a).

[3] Board Rules, 82 Fed. Reg. at 42833; OCC Rules 82 Fed. Reg. at 56631; FDIC Rules, 82 Fed. Reg. at 50229.

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.[4]

The Regulators stated that the Rules reduce the risk that courts in foreign jurisdictions would disregard U.S. statutory provisions that would stay the rights of a failed Covered Entity's counterparties to terminate their contracts when the Covered Entity becomes subject to a resolution proceeding under a U.S. Special Resolution Regime (as described below). The Regulators further stated that the Rules facilitate the resolution of a large financial entity under the 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.[5] The Rules reflect the Regulators' consideration of numerous comments regarding its proposed rule[6] and includes a series of provisions intended to avoid having the Rules impose burdens on market participants that the Regulators did not believe were necessary to achieve their financial stability enhancement objectives.

Covered Entities.

The following describes the Covered Entities under each of the Board Rules, OCC Rules, and FDIC Rules.

- **Board Rules – "Covered Entity":** a bank holding company (BHC) that is a U.S. GSIB;[7] a subsidiary of a U.S. GSIB;[8] and a U.S. subsidiary, U.S. branch, or U.S. agency of a global systemically important foreign banking organization (Foreign GSIB).[9]

The Board Rules provide exceptions for (i) certain subsidiaries of U.S. GSIBs regulated by one of the other Regulators and (ii) certain other categories of entities[10] and parallel exceptions for subsidiaries of Foreign GSIBs.[11]

- **OCC Rules – "Covered Bank":** a national bank or Federal savings association (FSA) that has more than $700 billion in total assets;[12] a national bank or FSA that is a subsidiary of a U.S. GSIB;[13] and a national bank or FSA that is a subsidiary of a Foreign GSIB, and a Federal branch or agency of a Foreign GSIB.[14]

A Covered Bank described above must ensure that a Covered QFC to which its subsidiary is a party satisfies

[4] Board Rules, 82 Fed. Reg. at 42903; OCC Rules, 82 Fed. Reg. at 56647; FDIC Rules, 82 Fed. Reg. at 50246.

[5] The Regulators stated that they issued the Rules under section 165 of the Dodd-Frank Act, which authorizes them to establish additional prudential standards under their safety and soundness, and under other relevant authorities.

[6] *See* Dechert OnPoint, Proposed U.S. Federal Reserve Board Rule's Impact on Buy-Side Remedies in QFCs with Global Systemically Important Banking Organizations and their Affiliates (June 2016), *available at* https://www.dechert.com/knowledge/onpoint/2016/6/proposed-u-s-federal-reserve-board-rules-impact-on-buy-side-rem.html.

[7] 12 C.F.R. § 252.82(b)(1). 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.

[8] 12 C.F.R. § 252.82(b)(2). A subsidiary is an entity that is deemed to be controlled by an entity for Bank Holding

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Company Act (BHCA) purposes, with control generally being present where (i) a company holds 25 percent or more of the voting shares of another company, (ii) the election of a majority of the directors is controlled in any manner by another company, and (iii) a company is determined by the Board to have the power to exercise a controlling influence over another company.

[9] The Board Rules set forth a series of tests that will be used by the Board to determine whether an entity will be treated as a Foreign GSIB. *Id.* at § 252.87. In this regard, the Board noted that in November 2016 the Financial Stability Board and the Basel Committee on Bank Supervision published their list of GSIBs. That list identifies the following 22 non-U.S. GSIBs: Agricultural Bank of China, Bank of China, Barclays, BNP Paribas, China Construction Bank, Credit Suisse, Deutsche Bank, Group BPCE, Group Credit Agricole, Industrial and Commercial Bank of China Limited, HSBC, ING Bank, Mitsubishi UFJ FG, Nordea, Royal Bank of Scotland, Santander, Societe General, Standard Chartered, Sumitomo Mitsui FG, UBS, and Unicredit Group.

[10] The Board Rules exclude certain kinds of entities from being treated as a subsidiary of a U.S. GSIB. 12 C.F.R. § 252.82(b)(2)(i)-(v).

[11] 12 C.F.R. § 252.82(b)(3)(i)-(v). In addition, the Board Rules exclude a section 2(h)(2) company and a DPC branch subsidiary of a foreign GSIB. *Id.* at § 252.82(b)(3)(vi)-(vii).

[12] 12 C.F.R. § 47.3(b)(1)(i). The asset-level test refers to the assets as reported by the entity on its most recent Consolidated Reports of Condition and Income (Call Report).

[13] 12 C.F.R. § 47.3(b)(1)(ii).

[14] 12 C.F.R. § 47.3(b)(1)(iii)-(iv).

the requirements of the OCC Rules. The OCC Rules provide exceptions to this requirement for certain subsidiary entities.[15]

- **FDIC Rules – "Covered FSI" (FDIC-Supervised Institution):** any state savings association or state non-member bank (as defined in the FDIA) that is a direct or indirect subsidiary of a U.S. or Foreign GSIB;[16] and any subsidiary of a Covered FSI listed in the above with certain exceptions.[17]

QFC Definition.

The Rules relate to financial transactions known as "qualified financial contracts" or QFCs. For purposes of the Rules, QFC includes transactions that are securities contracts, commodity contracts, forward contracts, repurchase agreements, and swap agreements, as well as related master agreements, security agreements, guarantees, credit enhancements, and reimbursement obligations.[18] This means that any swaps, other derivatives contracts, repos and reverse repos, and securities lending and borrowing agreements with a Covered Entity may potentially be in-scope.

In-Scope QFCs.

The Rules provide that an "in-scope QFC" is a QFC that explicitly: (i) 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 (ii) provides one or more default rights with respect to a QFC that may be exercised against a Covered Entity.[19]

The Regulators noted that a party to a QFC generally has a number of rights it can exercise if a counterparty defaults on the QFC, including the ability to: (i) terminate the QFC, so that the parties would not make payments that would have been required under the QFC in the future; (ii) reduce the total amount that the non-defaulting party must pay by set-off against the amount the defaulting counterparty owes; (iii) liquidate pledged collateral and use the proceeds to pay the defaulting party's net obligation to the non-defaulting party; (iv) suspend or delay the non-defaulting party's performance under the contract, or to accelerate the obligations of the defaulting party; and (v) alter the amount of collateral or margin that must be provided with respect to an exposure or demand a return of collateral. The Rules define the term default right to include the preceding rights along with any similar rights.[20] The Regulators noted that the term as proposed also included all such rights regardless of source, including rights existing under contract, statute, or common law.[21]

Not In-Scope QFCs.

Covered QFCs that do not provide for the default rights noted above are not in-scope. In addition, the definition of default right under the Rules excludes default rights related to same-day netting and contractual margin requirements that arise solely from the change in the value of the collateral or amount of an economic exposure. The Rules further provide that contractual rights to terminate without the need to show cause, including rights to terminate on demand and rights to terminate at specified intervals are excluded from the definition of default rights for purposes of the Rules' restrictions on cross-default rights.[22] Accordingly, the Regulators stated that the Rules make clear by limiting the definition of in-scope QFCs under the Rules to QFCs that include a transfer or default right that Covered Entities do not need to conform QFCs that have no transfer restrictions, direct default rights, or cross-default rights, as those QFCs have no provisions the Rules are intended to address.[23]

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[15] 12 C.F.R. § 47.3(b)(2). The OCC Rules provide an exception for certain entities. 12 C.F.R. § 47.3(b)(3).

[16] 12 C.F.R. § 382.2(b)(1)(i); § 382.2(b)(1)(ii).

[17] 12 C.F.R. § 382.2(b)(2). The FDIC Rules provide an exception for subsidiaries that parallel the exceptions provided under the OCC Rules.

[18] 12 C.F.R. § 252.81; § 47.2; § 382.1 (each citing to the definition of QFC under 12 U.S.C. § 5390(c)(8)(D)) (Section 210(c)(8)(D) of the Dodd-Frank Act)).

[19] 12 C.F.R. § 252.82(d); § 47.3(d); § 382.2(d).

[20] 12 C.F.R. §§ 252.81; 47.2; 382.1.

[21] Board Rules, 82 Fed. Reg. at 41899; OCC Rules, 82 Fed. Reg. at 56643; FDIC Rules, 82 Fed. Reg. 5024.

[22] 12 C.F.R. §§ 252.84; 47.5; 382.4.

[23] In addition, the Regulators noted that commenters had urged that QFCs that do not provide transfer restrictions or default rights should be excluded from coverage under the Rules since they do not give rise to the risk that counterparties will exercise their contractual rights in a manner inconsistent with the U.S. Special Resolution Regimes. They stated that these included cash market securities transactions, certain spot FX transactions, retail brokerage agreements, retirement/IRA agreements, margin agreements, options agreements, FX forward master agreements, and delivery versus payment client agreements. Commenters asserted that there were millions of

With respect to third parties (discussed in more detail below), the Rules do not apply if the Covered QFC: (i) 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 an Insolvency Proceeding and (ii) 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 an Insolvency 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.[24]

Covered QFCs and Compliance Schedule.

The Rules define a Covered QFC as an in-scope QFC that is entered by a Covered Entity on or after certain specified points in time.[25] Covered Entities will be required to conform new Covered QFCs entered into after the applicable compliance date on the following phased-in schedule: by January 1, 2019, if each party to the new Covered QFC is a Covered Entity, a Covered Bank, or a Covered FSI;[26] by July 1, 2019, if each party to the new Covered QFC (other than the Covered Entity) is a "Financial Counterparty" that is not a Covered Entity, a Covered Bank, or a Covered FSI;[27] and by January 1, 2020, if a party to the new Covered QFC (other than the Covered Entity) is not subject to an earlier deadline or if it is a Financial Counterparty that qualifies as a Small Financial Institution.[28]

In addition, if an entity becomes a Covered Entity after the effective date of the relevant Rules, such a "new Covered Entity" will be required to conform its Covered QFCs to reflect the requirements under the Rules over a similar two-year phase-in period based on the type of counterparty.[29]

Compliance Requirements for Already-Existing Covered QFCs.

The Rules provide that an existing QFC between a Covered Entity and a counterparty must be conformed with the Rules if the Covered Entity (or an affiliate that is a Covered Entity or an Excluded Bank) enters into another QFC with the counterparty or its consolidated affiliate on or after the first applicable compliance date.[30] The Regulators expressed the view that this strikes a balance between ensuring QFC continuity if a 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.[31]

Carve-out for Agency Transactions.

The Regulators recognized that in addition to entering into QFCs as principals, GSIBs may engage in QFCs as agent for other principals.[32] The proposed Rules would

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such types of QFCs and that remediation would be extremely burdensome and costly, and would provide no meaningful resolution benefits. The Regulators agreed with these comments.

[24] 12 C.F.R. §§ 252.84(a); 47.5(a); 382.4(a).

[25] 12 C.F.R. §§ 252.82(c)(1) and (f)(1); 47.3(c)(1) and (f)(1); 382.2(c)(1) and (f)(1).

[26] 12 C.F.R. §§252.82(f)(1); 47.3(f)(1); 382.2(f)(1).

[27] *Id.* Most buy-side counterparties are financial counterparties, which are defined to include investment companies registered with the Securities and Exchange Commission and a range of other entities. As such, this conformance date will affect most buy-side counterparties. 12 C.F.R. §§ 252.81; 47.2; 382.1.

[28] 12 C.F.R. §§ 252.82(f)(1); 47.3(f)(1); 382.2(f)(1). A "small financial institution" refers to an FDIC insured depository

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institution, an NCUA-insured credit union, and a specified farm credit system institution. 12 C.F.R. §§ 252.81; 47.2; 382.1.

[29] 12 C.F.R. §§ 252.82(f)(2); 47.3(f)(2); 382.2(f)(2).

[30] 12 C.F.R. §§ 252.82(c)(1)(ii) and (2)(ii); 47.3(c)(1)(i) and (2)(ii); 382.2(c)(1)(ii) and (2)(ii); Board Rules, 82 Fed. Reg. at 42912-4; OCC Rules, 82 Fed. Reg. 82 Fed. Reg. at 56657-9; FDIC Rules, 82 Fed. Reg. 50254-6. A consolidated affiliate means an affiliate of another company that (i) either consolidates the other company or is consolidated by the other company, on financial statements prepared in accordance with GAAP, International Financial Reporting Standards, or other similar standards; (ii) is along with the other company consolidated with a third company on a financial statement prepared in accordance with such standards; or (iii) for a company that is not subject to such standards, if consolidation would have occurred if such standards had applied. 12 C.F.R. §§ 252.81; 47.2; 382.1.

[31] Board Rules, 82 Fed. Reg. at 42913; OCC Rules, 82 Fed. Reg. at 56659; FDIC Rules, 82 Fed. Reg. at 50256.

[32] The Regulators noted that Rule's definition of a QFC includes security agreements and other credit enhancements, as well as

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 agent. In response to comments, the Rules provide that a Covered Entity does not become a party to a QFC solely by acting as agent to a QFC.[33] Thus, the Rules would not require a Covered Entity to conform a master securities lending arrangement (or the transactions under the agreement) to the requirements of the Rules if the only obligations of the Covered Entity under the agreement are to act as agent on behalf of one or more principals. However, such a QFC would nevertheless be a Covered QFC with respect to a principal that also was a Covered Entity. By contrast, the Rules do not exempt a QFC if the Covered Entity acting as agent also acts in another capacity such as a guarantor.[34] The Regulators explained that, in the case of a Covered Entity acting as agent, if the Covered Entity also entered an agreement that included an indemnification provision, the agency exemption would not include that agreement, but would still exclude the agreement where the Covered Entity is acting solely as agent.

Carve-out for QFCs of U.S. Entities Designating the U.S. Special Resolutions Regimes as Governing Law for QFC.

As discussed in more detail below, the Rules provide that a QFC that meets certain U.S. nexus requirements need not be conformed to reflect the required terms relating to the U.S. Special Resolution Regimes.

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master agreements. The Board gave the example of a GSIB subsidiary entering into a master securities lending agreement with a foreign bank as agent for a U.S. pension fund. The GSIB subsidiary would document its role as agent, often through an annex to the master agreement, and would generally provide its customer (the principal) a securities replacement guarantee or indemnification for any shortfall in collateral in the event of the default of the foreign bank. Board Rules, 82 Fed. Reg. at 42907; OCC Rules, 82 Fed. Reg.at 56651; FDIC Rules, 82 Fed. Reg. at 50250.

[33] 12 C.F.R. §§ 252.82(e)(1); 47.3(e)(1); 382.2(e)(1).

[34] The Regulators gave the example of securities lending authorization agreements (SLAAs), which provide 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. Board Rules, 82 Fed. Reg. at 42908; OCC Rules, 82 Fed. Reg. at 56652; FDIC Rules, 82 Fed. Reg. at 50250.

OVERVIEW OF U.S. INSOLVENCY AND U.S. SPECIAL RESOLUTION REGIMES

Bankruptcy Code.

The Bankruptcy Code contains "safe harbor" provisions that permit certain non-defaulting QFC parties to exercise contractual remedies *immediately* upon the insolvency of their counterparties, or their counterparties' credit support providers, notwithstanding the Bankruptcy Code's general imposition of an automatic stay of creditors' claims on the assets of the insolvent party. These safe harbor protected remedies include a contractual right to immediately: (i) terminate the transaction; (ii) set off and net obligations owed between the parties; and (iii) liquidate the insolvent party's collateral.

U.S. Special Resolution Regimes.

The U.S. Special Resolution Regimes impose more onerous, but temporary, stay requirements on QFCs than are provided for under the Bankruptcy Code. Specifically they:

- impose a "temporary stay period" during which QFC counterparties of a failed entity that is placed in an FDIC receivership are temporarily stayed from exercising termination, set off, and netting and collateral liquidation rights under QFCs solely by reason of, or incidental to, the placing of the failing entity into a Title II or FDIA resolution, insolvency, or financial condition – the stay continues until 5:00 PM (Eastern time) on the business day following the appointment of a receiver and

- permit the FDIC to transfer the QFCs of the failed entity that is in FDIC receivership to another financial institution that is not in an insolvency proceeding during the temporary stay period.

In addition, Title II permits the FDIC to enforce contracts of subsidiaries or affiliates of a failed covered financial company that are "guaranteed or otherwise supported by or linked to the covered financial company, notwithstanding any contractual rights based solely on the insolvency, financial condition, or receivership of" the failed subsidiary or affiliate. Accordingly, in a Title II resolution, the FDIC can avoid what the Rules call "cross-default" rights related to the insolvency of a counterparty's affiliated credit support provider. The FDIA, in contrast, does not contain a similar provision.

REQUIRED CONTRACTUAL PROVISIONS AND POTENTIAL IMPACT ON BUY-SIDE PARTIES TO IN-SCOPE COVERED QFCS

As described in more detail below, the Rules: (i) have the effect of requiring QFC counterparties to agree that their termination rights will be temporarily limited under the U.S. Special Resolution Regimes if their counterparties are placed in FDIC receivership and the QFC is transferred to another counterparty and (ii) extend the Title II OLA prohibition on the exercise of cross-default rights against all Covered Entities if an affiliate of the Covered Entity counterparty is placed in an Insolvency Proceeding.

Overview of Required Terms Relating to U.S. Special Resolution Regimes.

The Rules generally require that an in-scope Covered QFC explicitly provide that:

- 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 law of the U.S. or a state of the U.S. and

- 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 that could be exercised under the U.S. Special Resolution Regime, if the Covered QFC were governed by the laws of the U.S. or a state of the U.S.[35]

Thus, the Rules require that when a Covered Entity enters into a QFC with a counterparty, the counterparty must contractually agree to the application of the U.S. Special Resolution Regime upon the placement of the Covered Entity into an FDIC receivership. As a result, a party facing a Covered Entity that is placed in an FDIC receivership under Title II or the FDIA would by the terms of its QFC be subject to: (i) a temporary stay on the exercise of that party's default rights arising from the Covered Entity's entry into receivership and (ii) the transfer of the Covered QFC by the FDIC to another entity not subject to an insolvency or resolution proceeding during that period. After such a transfer, the non-insolvent party's default rights relating to this event would by the terms of the Covered QFC be permanently stayed.

Requirements Relating to U.S. Special Resolution Regimes

Below is a high-level description of how the rights of a buy-side entity that is a party to a QFC with different categories of Covered Entity counterparties change as a result of the application of each element of the Rules relating to the U.S. Special Resolution Regimes:

- A Covered Entity placed in an FDIC receivership under the OLA:
  - — *Existing Regime*: subject to temporary stay on the exercise of default rights based on OLA FDIC receivership.
  - — *Final Rules*: same as Existing Regime, plus the restrictions are contractually memorialized.
- A Covered Entity placed in a proceeding under the Bankruptcy Code:
  - — *Existing Regime*: not prevented from immediately exercising default rights arising from the counterparty's insolvency.
  - — *Final Rules*: same as Existing Regime.
- An Insured depository institution subsidiary of a GSIB placed in an FDIC receivership under the FDIA:
  - — *Existing Regime*: subject to temporary stay on the exercise of default rights based on FDIA FDIC receivership.
  - — *Final Rules*: same as Existing Regime, plus the restrictions are contractually memorialized.

Exception to Required Terms Relating to U.S. Special Resolution Regimes for QFCs Subject to U.S. Law.

Commenters argued that QFCs should be exempt from the stay-and-transfer term requirements if the QFCs are governed by U.S. law, such as with the

[35] 12 C.F.R. §§ 252.83(b); 47.4(b); 382.3(b).

standard form repurchase and securities lending agreement published by SIFMA. They contended that counterparties to such agreements are already subject to the stay-and-transfer provisions of the FDIA and Title II as mandatory provisions of U.S. law, and that requiring an amendment of these QFCs to include express provisions contained in the Rules would be redundant and would not provide any material benefit in regard to resolutions, but would significantly increase the remediation burden on Covered Entities. Other commenters proposed a nexus with the U.S. test for purposes of providing an exclusion from the Rules.

In response to these comments, the Regulators exempted from the term requirements relating to the U.S. Special Resolution Regimes a QFC that meets certain U.S. nexus requirements. A QFC qualifies for this exception if:

- It designates the U.S. Special Resolution Regimes as part of the law governing the QFC. This is accomplished where (i) the QFC explicitly provides that the Covered QFC is governed by the laws of the U.S. or a state of the U.S.[36] and (ii) the QFC 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; and
- Each party to the Covered QFC, other than Covered Entity is: (i) an individual domiciled in the U.S., including any state; (ii) a company that is incorporated in or organized under the laws of the U.S. or any state; (iii) a company the principal place of business of which is located in the U.S., including any state; or (iv) a U.S. branch or U.S. agency.[37]

The Regulators stated that the requirement regarding a contractual provision specifying applicable law would help ensure that foreign courts will enforce the stay-and-transfer provisions of the U.S. Special Resolution Regimes. They further stated that the location requirements would help ensure that the FDIC will be able to quickly and easily enforce the stay-and-transfer provisions of the U.S. Special Resolution Regimes.[38]

General Requirements Relating to Cross-Default Provisions in Other Insolvency Proceedings.

The Rules provide that 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 an Insolvency Proceeding (i.e., cross-default rights in QFCs) and
- may not prohibit the transfer of a 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 an Insolvency 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.[39]

For purposes of these provisions, a “direct party” means a Covered Entity that is a party to the direct QFC.[40] A “direct QFC” is a QFC that is not a credit enhancement, provided that, for a QFC 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.[41] An “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.[42]

Provisions Relating to Other Insolvency Proceedings

Below is a high-level description of how the rights of a buy-side entity that is a party to a QFC with different categories of Covered Entity counterparties change as a result of the application of each element of the Rules

[36] The Regulators noted that a contract that explicitly provides that one or both of the U.S. Special Resolutions 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 Rule. Thus, the Regulators noted that a Covered QFC would not qualify for the exemption if it stated that it was governed by the laws of New York State but also stated that it was not governed by U.S. federal law. Board Rules, 82 Fed. Reg.at 42901 n.154; OCC Rules, 82 Fed. Reg. at 56645 at n. 94; FDIC Rules, 82 Fed. Reg.at 50243 n. 120.

[37] 12 C.F.R. §§ 252.83(a); 47.4(a); 382.3(a).

[38] Board Rules, 82 Fed. Reg. at 42901; OCC Rules, 82 Fed. Reg. at 56645; FDIC Rules, 82 Fed. Reg. at 50243.

[39] 12 C.F.R. §§ 252.84(b); 47.5(b); 382.4(b).

[40] 12 C.F.R. §§ 252.84(c)(1); 47.5(c)(1); 382.4(c)(1).

[41] 12 C.F.R. §§ 252.84(c)(2); 47.5(c)(2); 382.4(c)(2).

[42] 12 C.F.R. §§ 252.84(c)(3); 47.5(c)(3); 382.4(c)(3).

relating to third-party entities placed in an Insolvency Proceeding.

- A Covered Entity with credit support from an affiliate placed in an FDIC receivership under the OLA:
  - *Existing Regime*: FDIC may prevent party from exercising cross-default rights relating to affiliate's insolvency.
  - *Final Rules*: same as Existing Regime, plus contractually prohibited from exercising cross-default relating to affiliate's insolvency.
- A Covered Entity with credit support from an affiliate placed in a proceeding under the Bankruptcy Code:
  - *Existing Regime*: may immediately exercise cross-default rights arising from affiliate's insolvency.
  - *Final Rules*: different from the Existing Regime in that the party is prohibited by the terms of the QFC from exercising cross-default rights arising from affiliate's insolvency.
- A Covered Entity with credit support from an affiliate placed in an FDIC receivership under the FDIA:
  - *Existing Regime*: may immediately exercise cross-default rights arising from affiliate's insolvency.
  - *Final Rules*: different from the Existing Regime in that the party is prohibited by the terms of the QFC from exercising cross-default rights arising from affiliate's insolvency.

Exceptions to Cross-Default Provisions for General Creditor Protections.

The Rules contain several significant exceptions to the prohibition of cross-default provisions. The categories of creditor protections under the exceptions are intended to allow creditors to exercise cross-default rights outside of an orderly resolution of a GSIB and therefore would not be expected to undermine such a resolution. These exceptions apply to a covered direct QFC and a covered affiliate credit enhancement that supports the covered direct QFC.

One exception provides that a Covered QFC may permit the exercise of default rights based on the direct party's becoming subject to an Insolvency Proceeding.[43] The Regulators explained that this provision helps ensure that if a direct party to a QFC were to enter into bankruptcy, its QFC counterparties could exercise any relevant 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 Bankruptcy Code's safe harbor provisions.

Two other exceptions provide that a Covered QFC may permit the exercise of default rights where: (i) the direct party, a covered affiliate support provider, or a transferee assumes a credit enhancement to satisfy its payment or delivery obligations under the direct QFC or credit enhancement[44] and (ii) the covered affiliate support provider or transferee does not satisfy a payment or delivery obligation pursuant to a covered affiliate credit enhancement that supports the covered direct QFC.[45]

The Regulators stated that the exceptions for general creditor protections are intended to help ensure that the Rules permit a Covered Entity's QFC counterparties to protect themselves from imminent financial loss, and does not create a risk of delivery gridlocks or daisy-chain effects. According to the Regulators, the exceptions help ensure that a Covered Entity's QFC counterparty would not risk the delay and expense associated with becoming involved in a bankruptcy proceeding.[46]

Additional Creditor Protections for Supported QFCs.

The Rules provide that in the case of 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 an Insolvency Proceeding if:

- the covered affiliate support provider that remains obligated under the covered affiliate credit

[43] 12 C.F.R. §§ 252.84(d)(1); 47.5(d)(1); 382.4(d)(1).

[44] 12 C.F.R § 252.84(d)(2); § 47.5(d)(2); § 382.4(d)(2).

[45] 12 C.F.R § 252.84(d)(3); § 47.5(d)(3); § 382.(d)(3).

[46] Board Rules, 82 Fed. Reg. at 42905; OCC Rules 82 Fed. Reg. at 56645; FDIC Rules 82 Fed. Reg. at 50247.

enhancement becomes subject to an Insolvency Proceeding, other than a Chapter 11 proceeding;

- subject to the FDIA creditor provision,[47] the transferee, if any, becomes subject to an Insolvency Proceeding;
- the covered affiliate support provider does not remain, and a transferee does not become, obligated immediately prior to entering the Insolvency Proceeding with respect to: (i) the covered affiliate credit enhancement; (ii) all other covered affiliate enhancements provided by the covered affiliate support provider in support of other covered direct QFCs between the direct party and the supported party under a specified affiliate credit enhancement; and (iii) all other 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 referred to in the preceding clause; *or*
- 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 Insolvency Proceeding, will be transferred or sold to the transferee in a timely manner.[48]

Prohibited Terminations.

The Rules provide that, in the case of a legal dispute as to a party's right to exercise a default right under a Covered QFC, the Covered QFC must provide that, after an affiliate of the direct party has entered into a resolution proceeding:

- 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
- the party seeking to exercise the default right must meet a clear and convincing evidence standard, a similar standard, or a more demanding standard.[49]

The Regulators stated that the purpose of this requirement is to deter the QFC counterparty of a Covered Entity from thwarting the purpose of the Rules 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.[50]

Compliance through Protocol Adherence

The Rules provide that Covered Entities may satisfy the requirements under the Rules by conforming covered QFCs to the ISDA 2015 Universal Resolution Stay Protocol ("Universal Protocol").[51] Though the Universal Protocol differs from the requirements of the Rule, the Regulators were satisfied that the Universal Protocol would "increase the likelihood that the resolution of a

[47] Notwithstanding certain other provisions of 12 C.F.R § 252.84, § 47.5, and § 382.4 with respect to a covered direct QFC that is supported by a covered affiliate credit enhancement, the covered direct QFC and the covered affiliate credit enhancement may permit the exercise of a default right that is related, directly or indirectly, to the covered affiliate support provider becoming subject to FDIA proceedings: (i) after the FDIA stay period, if the covered affiliate credit enhancement is not transferred pursuant to 12 U.S.C. § 1821(e)(9)-(10) and any regulations thereunder or (ii) during the FDIA 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 the covered affiliate support provider and were treated in the same manner as the covered affiliate credit enhancement. 12 C.F.R. §§ 252.84(h); 47.5(h); 382.4(h).

[48] *Id*. at §§ 252.84(f); 47.5(f); 382.4(f).

[49] *Id*. at §§ 252.84(i); 47.5(i); 382.4(i).

[50] Board Rules, 82 Fed. Reg. at 42907; OCC Rules, 82 Fed. Reg. at 56651; FDIC Rules, 82 Fed. Reg. at 50249.

[51] 12 C.F.R. §§ 225.86(a); 47.6(a); 382.5(a). The Board and the FDIC commented that Section 1 of the Universal Protocol, which provides a mechanism to opt-in to the U.S. OLA and other special resolution regimes, satisfied the concerns underlying the U.S. Special Resolution Regimes provision of the Rules, and Section 2 of the Universal Protocol, which requires adherents to forego, with some exceptions, cross-default rights and transfer restrictions, satisfied the concerns underlying the Insolvency Proceeding provision of the Rules. Board Rules, 82 Fed. Reg. at 42908; FDIC Rules, 82 Fed. Reg. at 50249.

GSIB under a range of scenarios could be carried out in an orderly manner."[52]

Commenters had argued that the Regulators should also allow compliance with the forthcoming U.S. Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol ("U.S. JMP"). According to certain GSIB commenters, because they were unable to participate in the drafting of the Universal Protocol, the Regulators should permit adherence to the U.S. JMP, which would be narrower in scope than the Universal Protocol, to satisfy obligations under the Rules. The Regulators agreed and determined that Covered Entities could also satisfy their obligations under the Rules by adhering to a new protocol to be created that complies with certain requirements described by the Regulators (a "U.S. Protocol"), such as the U.S. JMP.

Commenters argued that the new protocol should be narrower than the Universal Protocol in two main respects: the scope of special resolution regimes to which an entity would be bound[53] and the requirement for universal adherence. With respect to the scope of special resolution regimes contemplated by the Universal Protocol, commenters were concerned that counterparties may not be able to comply with the requirements of a Protocol-Eligible regime because such compliance might run up against their fiduciary obligations. The Regulators responded by requiring the U.S. Protocol to include only the Identified Regimes and U.S. special resolution regimes, noting that these were "the only special resolution regimes specifically identified in the Universal Protocol, as defined in the [Proposal]."[54] As such, the U.S. Protocol does not have to require compliance with stay provisions of Protocol-Eligible regimes.

With respect to the requirement for universal adherence, commenters argued for a less strict approach, requesting instead that adherence to the protocol should be on an entity-by-entity basis. lternatively, commenters suggested that universal adherence should be limited to entities identified on a "static list," and that entities not included on the list could comply with the protocol on an entity-by-entity basis. The commenters also noted that universal adherence to the protocol would be overbroad in that it could capture non-covered QFCs. The Board responded by confirming that the U.S. Protocol would only have to apply to Covered Entities. However, the Regulators rejected the entity-by-entity and "static list" approaches, explaining these approaches would "obviate one of the primary benefits of the Universal Protocol: Universal adherence."[55]

Exclusion of Certain Additional QFCs from the Requirements of the Rule

Covered Entities are not required to conform certain Covered QFCs to the requirements of the Rules. These Covered QFCs are discussed below.

Exclusion for Certain Foreign Bank Multi-Branch Master Agreements.

The Board and OCC took note of comments requesting that the Board and OCC Rules limit their application to certain QFCs of foreign GSIBs that are not closely connected to the foreign GSIB's U.S. operations. In that regard, the Board and OCC Rules address foreign bank multi-branch master agreements. This is an agreement that permits a U.S. branch or U.S. agency and another place of business of a foreign bank that is outside the U.S. to enter transactions under the agreement.[56] The Board and OCC Rules provide that with respect to a U.S. branch or U.S agency of a foreign GSIB, a foreign bank multi-branch master agreement that is a Covered QFC solely because it 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 only with respect to such agreements or transactions booked at such U.S. branches and U.S agencies.[57] Thus, a foreign GSIB's multi-branch master agreement would not be a Covered QFC solely because the payment or delivery can be made to such a U.S. branch or U.S. agency. To ensure that the Board and OCC Rules only reach QFCs that are "sufficiently close" to the U.S., the Board and OCC Rules exclude certain QFCs of foreign GSIBs that have operations in the United States. The

[52] Board Rules, 82 Fed. Reg. at 42909; FDIC Rules, 82 Fed. Reg. at 50251.

[53] The Universal Protocol provides that adherents will be bound by the stay provisions of "Identified Regimes" and "Protocol-Eligible regimes." Identified Regimes include France, Germany, Japan, Switzerland, the United Kingdom, and the United States. Protocol-Eligible regimes include countries with resolution regimes that satisfy the requirements of the Universal Protocol.

[54] Board Rules, 82 Fed. Reg at 42910; OCC Rules, 82 Fed. Reg. at 56654; FDIC Rules, 82 Fed. Reg. at 50253.

[55] Board Rules, 82 Fed. Reg. at 42910; OCC Rules, 82 Fed. Reg. at 56654; FDIC Rules, 82 Fed. Reg. at 50253.

[56] 12 C.F.R. §§ 252.86(b); 47.7(b).

[57] *Id.* at §§ 252.86(a); 47.7(a).

Rule excludes from the definition of covered QFC any foreign GSIB's multi-branch master agreement that allows QFCs to be entered into at U.S. branch or U.S. agency locations, provided that these QFCs are not booked at the U.S. branch or U.S. agency. This exclusion differs from the Proposal in that the Proposal would have considered QFCs that allowed payment or delivery to be made at a U.S. branch or U.S. agency to be a covered QFC even if booked abroad.

Commenters requested that the Board and OCC include this exclusion in the respective Rules because they were concerned that "the ability to make payments or delivery alone [at a U.S. branch or a U.S. agency of a foreign GSIB] does not make a QFC sufficiently closely connected to the United States." These commenters also argued that requiring foreign GSIBs to amend QFCs that permitted payment or delivery in the United States would not increase U.S. financial stability because these kinds of QFCs would generally not be subject to resolution in the U.S. The Board and OCC accepted the commenters arguments, noting that they intended the Board and OCC Rules to cover only those QFCs that "could have the most direct effect" on the United States.[58]

QFCs with Central Counterparties and Financial Market Utilities.

The Rules provide that a Covered Entity is not required to conform a Covered QFC as to which (i) a central counterparty (CCP) is a party or (ii) each party (other than the Covered Entity) is a Financial Market Utility (FMU) (as defined below).

Under the Rules, a CCP is a counterparty (such as a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts.[59] In this context, commenters asked the Regulators 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. The Regulators did not extend the CCP exclusion to the client-facing leg of a cleared transaction because of its view that bilateral trades between a GSIB and a non-CCP counterparty are the types of transactions the Rules intend to address, and because nothing in the Rules 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.

Commenters asked the Regulators to exclude from the requirements of the Rules all QFCs that are cleared, processed, or settled through an FMU, or that are entered into subject to the Rules of an FMU. The Rules provide that if one or more FMUs are the only counterparties to a covered QFC, the Covered Entity is not required to conform the QFC. As a result, an FMU's default rights and transfer restrictions under the Covered QFC are not affected by the Rules.

Under the Rules, an FMU is generally 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.[60]

The Regulators noted that the FMU 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 Rule is intended to address default rights of non-FMU parties. Thus, if two Covered Entities engage in a bilateral QFC that is facilitated by an FMU and, in the course of the facilitation each Covered Entity maintains a QFC solely with the FMU, then the Rules would not apply to each QFC between the FMU and each Covered Entity, but the requirements of the Rules would apply to the bilateral QFC between the two Covered Entities. The Regulators explained that 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 remain subject to the Rules' requirements.

Exclusion for Certain Retail Investment Advisory Contracts.

Commenters also requested that the Regulators exclude QFCs that do not contain any default or cross-default rights but that may contain certain transfer restrictions. They said these would include investment advisory agreements with retail customers that contain transfer restrictions required by section 205(a)(2) of the Investment Advisers Act but no direct or cross-default rights, underwriting agreements, and client onboarding agreements. Some commenters cited prime brokerage agreements and margin loan agreements as examples of

[58] Board Rules, 82 Fed. Reg. at 42898; OCC Rules, 82 Fed. Reg. at 56643.

[59] 12 C.F.R. § 252.81; § 47.2; § 382.1.

[60] The Rules exclude certain entities from the definition of FMU. 12 C.F.R. §§ 252.81; 47.2; 382.1.

transactions that generally do not have default or cross-default rights but that may have transfer restrictions.

In response to these comments, the Rules provide that a Covered Entity is not required to conform an investment advisory contract with a retail customer or counterparty that does not explicitly restrict the transfer of the contract (or any QFC entered pursuant thereto or governed thereby, or any interest or obligation or interest 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 Advisers Act.[61] The Regulators did not provide exemptions for other types of agreements that were identified by commenters.

Exclusion for Warrant Agreements.

Commenters also sought an exclusion for certain capital-markets-related contracts, including warrants or a certificate representing a call option, typically on a security or basket of securities. Commenters noted that while warrants issued in capital markets may contain direct default and cross-default rights along with transfer restrictions, remediating outstanding warrant agreements would be difficult since it may be difficult, if not impossible, to obtain the consent of holders of the instrument to amend its terms. Commenters also argued that it is not possible for an issuer to determine whether a particular investor in such instruments has also entered into other QFCs with a dealer or any of its affiliates for purposes of complying with the mechanism for complying with the Rule. Commenters suggested that the remediation requirements of the Rules should only apply to such instruments issued after the effective date of the Rules.

The Regulators agreed that these types of contracts would be burdensome to conform and that it is unlikely that excluding such contracts from the requirements of the Rules would impair the orderly resolution of a GSIB. As a result, the Rules provide that a warrant that evidences a right to subscribe to or otherwise acquire a security of the Covered Entity or an affiliate of the Covered Entity that was issued prior to the effective date of the Rules will not be subject to the conformance requirements.[62]

Authority to Exempt QFCs by Order.

The Rules permit the Regulators to 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 the Rules taking into account (i) the potential impact of the exemption on the ability of the Covered Entities, or affiliates of the Covered Entities, 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; (ii) the burden the exemption would relieve; and (iii) any other factor the respective Regulator deems relevant.[63]

The Regulators declined to provide in the Rules an exclusion for certain categories of transactions requested by commenters. In that regard, some commenters had urged the exclusion of all contracts for the purchase of commodities in the ordinary course of business (such as energy supply contracts) or physical delivery commodity contracts more generally. The Regulators declined to provide this relief. They did note that the Rules respond 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.[64]

The Regulators also noted that one commenter requested exclusion of overnight transactions, especially overnight repurchase agreements, contending that these transactions pose little risk of creating negative liquidity effects and that an exclusion for these transactions could increase the likelihood that such contracts would remain viable funding sources in times of liquidity stress. The Regulators observed that while they were not granting that request, they believed that the Rules would have a limited, if any, effect on such transactions, as the Rules provide a number of exemptions that may apply to overnight repos and similar transactions, and the default rights provision does not restrict the ability of QFCs, including overnight repos, to terminate at the end of the term of the contract.[65]

Commenters asked the Regulators to exclude QFCs with sovereign entities and central banks from the Rules for a range of reasons. The Regulators declined to do so. They stated that excluding such QFCs would be inconsistent with Title II and the FDIA. The Regulators also expressed concern that the mass termination of such QFCs has the potential to undermine the resolution of a

[61] 12 C.F.R. §§ 252.88(c)(1); 47.8(c)(1); 382.7(c)(1).

[62] 12 C.F.R. §§ 252.88(c)(2); 47.8(c)(2); 382.7(c)(2).

[63] *Id.* §§ 252.88(d); 47.8(d); 382.7(d).

[64] Board Rules, 82 Fed. Reg. at 42895; OCC Rules, 82 Fed. Reg. at 56639; FDIC Rules, 82 Fed. Reg. at 50238.

[65] Board Rules, 82 Fed. Reg. at 42895 n. 110; OCC Rules, 82 Fed. Reg. at 56639 n. 49; FDIC Rules, 82 Fed. Reg. at 50238 n. 77.

GISB and the financial stability of the U.S.[66]

CONCLUSION

While the Rules ultimately limit the rights of buy-side counterparties to Covered QFCs, the Regulators asserted in their respective adopting releases that the Rules are intended to allow for the orderly resolution of GSIBs in the event of their failure. As each relevant compliance deadline approaches, buy-side counterparties must consider the new compliance challenges as a result of having more limited default rights in connection with Covered QFCs. ■

[66] Board Rules, 82 Fed. Reg. at 42899; OCC Rules, 82 Fed. Reg. at 56643; and FDIC Rules, 82 Fed. Reg. at 50241.

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