

ALERT MEMORANDUM

FDIC Revises QFC Recordkeeping Rules for IDIs in a “Troubled Condition”

July 21, 2017

On July 18, 2017, the Federal Deposit Insurance Corporation (“FDIC”) adopted a final rule (the “Final Rule”)¹ amending its recordkeeping requirements for qualified financial contracts (“QFCs”) for insured depository institutions (“IDIs”) in a “troubled condition.”²

Part 371 is intended to provide the FDIC with the information about a troubled IDI’s QFCs to allow the FDIC to exercise its authority as receiver under the Federal Deposit Insurance Act (“FDIA”) within the statutory time limits.³ The Final Rule more closely aligns the FDIC’s existing recordkeeping requirements under Part 371 with the final rule (the “Treasury QFC Rule”) adopted by the Secretary of the Treasury for QFC recordkeeping in connection with the Orderly Liquidation Authority (“OLA”). As a result, the Final Rule expands the information that IDIs in a troubled condition must maintain for their and certain of their subsidiaries’ QFCs compared to the prior Part 371, while aligning the format in which such information must be maintained to the requirements of the Treasury QFC Rule.

This alert memo discusses some of the key changes the FDIC made to its proposed rule (the “Proposed Rule”), issued in December 2016, to further align Part 371 with the Treasury QFC Rule, and provides a summary of the requirements of the Final Rule.⁴

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

WASHINGTON

Michael H. Krimminger
T: +1 202 974 1720
mkrimminger@cgsh.com

LONDON

Knox L. McIlwain
T: +1 212 225 2245
kmcilwain@cgsh.com

NEW YORK

Seth Grosshandler
T: +1 212 225 2542
sgrosshandler@cgsh.com

Igor Kleyman
T: +1 212 225 2996
ikleyman@cgsh.com

Truc Doan
T: +1 212 225 2305
tdoan@cgsh.com

¹ The Final Rule has not yet been published in the Federal Register, but can be accessed [here](#).

² The FDIC’s recordkeeping requirements for IDIs in a troubled condition are codified in 12 C.F.R. Part 371 (“Part 371”).

³ Under the FDIA, once the FDIC is appointed as a receiver for an IDI, the FDIC is required to determine whether to transfer, disaffirm, or repudiate the QFCs between such IDI and its counterparties by 5:00 p.m. Eastern time on the business day following the FDIC’s appointment as receiver. See 12 U.S.C. § 1821(e)(8)-(10). Under these provisions of the FDIA, the FDIC is required to transfer, disaffirm or repudiate all of the QFCs between the IDI and a counterparty and the counterparty’s affiliates, or none of the QFCs. This prevents the FDIC from cherry-picking the QFCs that it will transfer, disaffirm or repudiate between the IDI and a particular counterparty and its affiliates. Prior to that deadline, counterparties are stayed from exercising termination rights under QFCs.

⁴ Recordkeeping Requirements for Qualified Financial Contracts; Notice of Proposed Rulemaking, 81 Fed. Reg. 95496 (Dec. 28, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-12-28/pdf/2016-30734.pdf>.



CHANGES TO PROPOSED RULE

In response to comments, the FDIC adopted several important revisions to its Proposed Rule. Commenters stressed the importance of aligning the FDIC's Part 371 rules to the Treasury QFC Rule so that corporate groups with "records entities" subject to both sets of rules can develop consistent recordkeeping systems. The FDIC made the following changes to its Proposed Rule to more closely align the different recordkeeping rules:

- The FDIC created an exemptions process to allow an IDI Records Entity to request an exemption from one or more of the recordkeeping requirements. Final Rule, Section 371.5. The Treasury QFC Rule also includes an exemptions process, and this change will allow corporate groups to seek exemptions under both rules, to develop systems that apply consistently to all "records entities."
- The FDIC narrowed the scope of reportable subsidiaries to only those subsidiaries incorporated or organized under U.S. law. Final Rule, Section 371.2(s). As discussed below, "full scope entities" under the Final Rule are required to maintain records for QFCs entered into by their "reportable subsidiaries". Final Rule, Section 371.4(b).
- The Final Rule also limits "reportable subsidiaries" to those entities that are consolidated by a Records Entity under generally accepted accounting principles ("GAAP"). Final Rule, Section 371.2(u). The FDIC made this change in response to comments that the use of the "control" standard under the Bank Holding Company Act ("BHCA") to identify reportable subsidiaries (as would have been required by the Proposed Rule) was onerous to administer. Final Rule, Preamble Section II.C.4. Commenters made a similar request to apply an accounting consolidation standard for other aspects of the Final Rule. The Final Rule and the Treasury QFC Rule each require "records entities" to identify the "immediate parent" and "ultimate parent" of each counterparty, where "parent entity" is defined as an entity that "controls" another under the BHCA standard. Final Rule, Preamble Section II.C.6.
 - It will be a key challenge for Records Entities to identify their counterparties' parent entities using the BHCA standard, especially for counterparties that do not define affiliation in that way. Ultimately a Records Entity may need to ask its counterparty to identify such affiliates so it can satisfy the recordkeeping requirements.
- The FDIC increased the threshold of QFCs that a Records Entity can be a party to and still qualify for the *de minimis* exception from 19 QFCs (in the Proposed Rule) to 50. Final Rule, Section 371.4(d).
 - However, while numerically aligned with the *de minimis* exception in the Treasury QFC Rule, the Final Rule's exception does not exempt the Records Entity from compliance. Final Rule, Section 371.4(d). The Records Entity must still maintain daily records, but they can be maintained in a non-electronic form. Final Rule, Section 371.4(d).

SCOPE OF FINAL RULE

- The Final Rule establishes recordkeeping requirements for an IDI that qualifies as a "Records Entity." Final Rule, Section 371.1(a).

- A Records Entity is defined as any IDI that meets the following conditions:
 - The IDI is notified by its Federal banking agency or the FDIC that it is in a “troubled condition;”⁵ and
 - The IDI receives written notice from the FDIC that it is subject to the Part 371 recordkeeping requirements. Final Rule, Section 371.2(r).
- A key difference between Part 371 and the Treasury QFC Rule is that Part 371 is only triggered if the IDI becomes in a “troubled condition,” whereas a “records entity” under the Treasury QFC Rule must be able to maintain records at all times. Final Rule, Preamble Section II.C.1. However, given the systems development implications, Part 371 likely will require corporate groups to consider whether it is more cost effective to build all-inclusive systems for compliance with the Treasury QFC Rule or defer implementation of systems for their IDIs until the “troubled condition” threshold is triggered.

In the preamble to the Final Rule, the FDIC noted that it expects corporate groups subject to the Treasury QFC Rule to use the same information

technology infrastructure developed for the Treasury QFC Rule for an IDI that becomes subject to Part 371. The Final Rule also requires Part 148 affiliates to compile their records consistently with their affiliates pursuant to the Treasury QFC Rule. Final Rule, Section I.

- The Final Rule defines two categories of Records Entities, subject to different recordkeeping requirements: (1) full scope entities and (2) limited scope entities.
- Full Scope Entities. A full scope entity is a Records Entity that either: (1) has total consolidated assets at least equal to \$50 billion, or (2) consolidates, or is consolidated by or with an entity that is a “records entity” under the Treasury QFC Rule, under U.S. GAAP or other applicable accounting standards (a “Part 148 affiliate”). Final Rule, Section 371.1(i).
 - Full scope entities are required to comply with requirements that are substantially similar to requirements applicable to “records entities” under the Treasury QFC Rule and must also maintain records for QFCs entered into by their “reportable subsidiaries.”⁶

⁵ The Final Rule does not change the definition of “troubled condition” in Part 371. Under the Final Rule, an IDI would be in a “troubled condition” if it:

- (1) has a composite rating, as determined by its appropriate Federal banking agency, of 3 in its most recent report of examination (but only for an IDI with at least \$10 billion of total consolidated assets), has a composite rating of 4 or 5 under the Uniform Financial Institution Rating System, or in the case of an insured branch of a foreign bank, an equivalent rating;
- (2) is subject to a proceeding initiated by the FDIC for termination or suspension of deposit insurance;
- (3) is subject to a cease-and-desist order or written agreement issued by the appropriate Federal banking agency, as defined in 12 U.S.C. § 1318(q), that requires action to improve the financial condition of the IDI or is subject to a proceeding initiated by the appropriate Federal banking agency which contemplates the issuance of an order

that requires action to improve the financial condition of the IDI, unless otherwise informed in writing by the appropriate Federal banking agency;

(4) is informed in writing by the IDI’s appropriate Federal banking agency that it is in troubled condition for purposes of 12 U.S.C. § 1831i on the basis of its most recent report of condition or examination, or other information available to its appropriate Federal banking agency; or

(5) is determined by the appropriate Federal banking agency or the FDIC in consultation with the appropriate Federal banking agency to be experiencing a significant funding difficulties or liquidity stress, notwithstanding the composite rating of the IDI by its appropriate Federal banking agency in its most recent report of examination.

⁶ A “reportable subsidiary” is any subsidiary of a full scope entity that: (1) is not (i) a functionally regulated subsidiary as defined in 12 U.S.C. 1844(c)(5), (ii) a security-based swap dealer, or (iii) a major security-based swap participant;

- In response to comments, the FDIC limited the scope of “reportable subsidiaries” from the Proposed Rule to include only those subsidiaries that are organized or incorporated under U.S. federal or state law and that are consolidated by the Records Entity. Final Rule, Preamble Section II.C.4. This narrowing of scope more closely aligns the entity scope with the Treasury QFC Rule, which limits the definition of “records entity” to U.S.-organized financial companies. Treasury QFC Rule, 148.2(n).
- Limited Scope Entities. A limited scope entity is any Records Entity that is not a full scope entity. Final Rule, Section 371.2(l).
 - Limited scope entities are required to comply with only a subset of the recordkeeping requirements applicable to full scope entities, similar to the requirements in existing Part 371, but are permitted to maintain the more extensive records required for full scope entities. Final Rule, Section 371.4(a).
- As noted above, the Final Rule includes a *de minimis* exception to the requirement that records be kept electronically if the Records Entity, and its reportable subsidiaries, if relevant, have 50 or fewer open QFC positions and all required records are capable of being updated on a daily basis. Final Rule, Section 371.4(d).
 - If an institution availing itself of the *de minimis* exception subsequently has greater than 50 QFC positions, it must comply with the Final Rule within 270 days and must provide the FDIC a directory of the electronic files that will be used to maintain the necessary information within three days of exceeding the 50 QFC threshold. Final Rule, Section 371.4(d).

(2) is incorporated or organized under U.S. federal law or the laws of a state; and (3) is consolidated (or required to be consolidated) by the records entity on its financial

- Although the FDIC raised the threshold level of QFC positions from the Proposed Rule, the Part 371 *de minimis* exception is significantly narrower than the parallel exception in the Treasury QFC Rule.

Under the Treasury QFC Rule, a “records entity” under the *de minimis* threshold is exempt from the vast majority of recordkeeping requirements, whereas under Part 371, the Records Entity must continue to maintain daily records but not necessarily in an electronic format. Treasury QFC Rule, Section 148.3(c).

INFORMATION THAT MUST BE MAINTAINED

- The Final Rule adopts the information requirements substantially as set forth in the Proposed Rule.
- Records Entities must maintain QFC records in an electronic format as prescribed by tables to the Final Rule. Final Rule, Section 371.3(a)(1). Full scope entities are required to maintain the information set out in four tables substantially similar to those in the Treasury QFC Rule. These tables significantly expand the information required for QFCs under existing Part 371. The requirements for limited scope entities are narrower and closer to existing Part 371. Final Rule, Preamble Section III.A.
 - Records Entities are also required to maintain “master data lookup tables” for their corporate group’s organization, the identity of their counterparties and their counterparties’ immediate and ultimate parent entities, and (only for full scope entities) information regarding booking locations and safekeeping agent locations. Final Rule, Appendix A and Appendix B.
 - Under the Final Rule, Records Entities are required to identify the immediate and

statements prepared in accordance with U.S. GAAP or other applicable accounting standards.

ultimate parent entity of their counterparties, where parent company is defined by reference to the definition of “control” under the BHCA. Final Rule, Section 371.2(f). The FDIC did not accommodate requests from commenters to apply a different standard of “control” for identifying the affiliates of counterparties. Final Rule, Preamble Section II.C.4.

- As with the Proposed Rule, the Records Entity must be capable of producing the required records, based on the immediately preceding day’s end-of-day values and information, no later than 7:00 a.m. (Easter Time) each day, so long as the FDIC provides the Records Entity with at least eight hours to respond to the request. Final Rule, Section 371.3(c).
- A Records Entity is also required to maintain historical records for a period of not less than five business days. Final Rule, Section 371.3(a)(5). Further, like the Proposed Rules, the Final Rule includes requirements to identify points of contact, maintain copies of legal agreements with respect to QFCs and a list of vendors supporting QFC-related activities. Final Rule, Sections 371.3(b), 371.4(a)(5), 371.4(b)(9), 371.4(a)(6), 371.4(b)(10).

SCOPE OF PRODUCTS

- Like the Proposed Rule, the Final Rule would require a Records Entity to maintain records for all open QFCs to which it is a party. Final Rule, Section 371.4(a)(5), 371.4(b)(9). Full scope entities must also maintain records for all QFCs to which a reportable subsidiary is a party. Final Rule, Section 371.4(b).
- As discussed in greater detail below, in response to comments the FDIC adopted a process for a Records Entities to seek an exemption from one or more of the requirements under the Final Rule. In the preamble to the Final Rule the FDIC specifically encouraged entities to seek exemptions for certain types of QFCs if the maintenance of records is “overly burdensome in

comparison to the benefits to be obtained from such data.” Final Rule, Preamble Section II.C.6.

PROCESS FOR REQUESTING EXEMPTIONS FROM RECORDKEEPING REQUIREMENTS

- The Final Rule includes a process for a Records Entity to submit a written exemption request from certain requirements of the recordkeeping rule to the FDIC, which may then grant or deny the request at its sole discretion. Final Rule, Section 371.5.
- An exemptions request must specify certain elements, including: (1) the requirements from which the Records Entity is requesting to be exempt; (2) whether the exemption is sought to apply solely to the Records Entity or to one or more identified reportable subsidiaries of the Records Entity; (3) the reasons why it would be appropriate for the FDIC to grant the exemption; (4) the reasons why granting the exemption will not impair or impede the FDIC’s ability to fulfill its statutory obligations under the FDIC or the FDIC’s ability to obtain a comprehensive understanding of the QFC exposures of the Records Entity and its reportable subsidiaries; and (5) any additional information that the FDIC may require. Final Rule, Section 371.5.
- The exemptions process aligns the Final Rule with the Treasury QFC Rule. The FDIC declined, however, to automatically extend an exemption granted by the Treasury for a “records entity” under the Treasury QFC Rule to Records Entities under the Final Rule, even though the FDIC is involved in determining whether an exemption under the Treasury QFC Rule should be granted. Final Rule, Preamble Section II.C.1. Accordingly, if a corporate group subject to the Treasury QFC Rule obtains an exemption from the Treasury, the IDI Records Entities subject to the Final Rule (and their reportable subsidiaries) would need to separately seek and be granted an exemption from

the FDIC to benefit from the exemption for purposes of Part 371.

COMPLIANCE PERIODS

- As under the Proposed Rule, under the Final Rule, a Records Entity would be required to provide the FDIC, within three business days of becoming a Records Entity, contact information for the person at the Records Entity “who is responsible for recordkeeping” under the Proposed Rule as well as a directory of the electronic files that will be used to maintain the information required by the Proposed Rule. Final Rule, Section 371.1(c).
- As a procedural matter, IDIs may want to make this determination in advance to ensure they would be able to satisfy this requirement in a timely fashion.
- The compliance deadlines vary based on whether a Records Entity is identified by the FDIC as an “accelerated Records Entity.” An “accelerated Records Entity” is defined as a records entity with a composite 4 or 5 under the CAMELS system or as “experiencing a significant deterioration of capital or significant funding difficulties or liquidity stress”. Such an entity must comply within the shorter of (i) 60 days after it becomes an accelerated Records Entity or (ii) 270 days from when it becomes a Records Entity. Final Rule, Section 371.1(c)(2)(iii).
- Any other Records Entity would be required to maintain required records within 270 days after it becomes a Records Entity. Final Rule, Section 371.1(c)(2)(i).
- The Final Rule allows the FDIC to grant one or more extensions of time for compliance. Final Rule, Section 371.1(d). For accelerated Records Entities, a single extension cannot be for longer than 30 days, whereas other Records Entities can

obtain a single extension for up to 120 days. Final Rule, Sections 371.1(d)(1) and 371.1(d)(2).

- As with the Proposed Rule, the Final Rule also includes transition provisions for entities that are subject to current Part 371 at the time that the amended requirements become effective as well as Records Entities that change status from a limited scope entity to a full scope entity, or vice versa. Final Rule, Sections 371.4(c), 371.6.

OTHER RESOURCES

- Our alert memorandum on the Treasury QFC Rule can be found [here](#) and our alert memorandum on the FDIC’s Proposed Rule can be found [here](#).⁷

...

CLEARY GOTTLIB

⁷ Treasury Adopts Substantially Revised Final QFC Recordkeeping Rule (Oct. 28, 2016), *available at* <https://www.clearygottlieb.com/news-and-insights/publication-listing/treasury-adopts-substantially-revised-final-qfc-recordkeeping-rule>; FDIC Proposes

Modifications to QFC Recordkeeping Rules for IDIs in a Troubled Condition (Jan. 17, 2017), *available at* <https://www.clearygottlieb.com/news-and-insights/publication-listing/fdic-proposes-modifications-to-qfc-recordkeeping-rules-for-idis-in-a-troubled-condition>.