

The Banking Law Journal

Established 1889

An A.S. Pratt® PUBLICATION

APRIL 2017

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THE BANKING LAW JOURNAL

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ISBN: 978-0-7698-7878-2 (print)

ISBN: 978-0-7698-8020-4 (eBook)

ISSN: 0005-5506 (Print)

ISSN: 2381-3512 (Online)

Cite this publication as:

The Banking Law Journal (LexisNexis A.S. Pratt)

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An A.S. Pratt® Publication

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POSTMASTER: Send address changes to THE BANKING LAW JOURNAL LexisNexis Matthew Bender, 230 Park Ave, 7th Floor, New York, NY 10169.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL, A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207.

FDIC Proposes Modifications to QFC Recordkeeping Rules for IDIs in a Troubled Condition

*Michael H. Krimminger, Seth Grosshandler, Knox L. McIlwain, and Igor Kleyman**

This article provides an overview of the Federal Deposit Insurance Corporation's proposed amendments to its recordkeeping requirements for qualified financial contracts for insured depository institutions in a "troubled condition."

The Federal Deposit Insurance Corporation ("FDIC") recently proposed amendments (the "Proposed Rule")¹ to its recordkeeping requirements ("Part 371") for qualified financial contracts ("QFCs") for insured depository institutions ("IDIs") in a "troubled condition." The Proposed Rule is principally designed to more closely align Part 371 with the QFC recordkeeping requirements ("Treasury QFC Rule") adopted by the Secretary of the Treasury (the "Secretary") in connection with the Orderly Liquidation Authority ("OLA") under the Dodd-Frank Act.² The Proposed Rule does this primarily by expanding the scope of the records that must be maintained.

This article provides an overview of the Proposed Rule, including a discussion of changes to the existing rules under Part 371 and how the changes conform and, in some specific areas, depart from the Treasury QFC Rule. Comments on the Proposed Rule were due by February 27, 2017.

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¹ Recordkeeping Requirements for Qualified Financial Contracts; Notice of Proposed Rulemaking, 81 Fed. Reg. 95,496 (Dec. 28, 2016).

² Qualified Financial Contracts Recordkeeping Related to Orderly Liquidation Authority; Final Rule, 81 Fed. Reg. 75,624 (Oct. 31, 2016).

BACKGROUND ON THE PROPOSED RULE AND THE TREASURY QFC RULE

The FDIC adopted Part 371 in 2008 to ensure the FDIC would have access to key information regarding the QFCs of an IDI before and after the FDIC is appointed as receiver under the Federal Deposit Insurance Act (“FDIA”). 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.³ Prior to that deadline, counterparties are stayed from exercising termination rights under QFCs.

The Part 371 rules require an IDI in a troubled condition to maintain information about its QFC portfolio in a format that would assist the FDIC in making its determinations in a timely manner. While the FDIC’s authority over QFCs under the FDIA mirrors the FDIC’s authority under OLA, the “troubled condition” threshold applies only under the FDIA.

In the preamble to the Proposed Rule, the FDIC explains that its experience administering the Part 371 rules informed its participation in the development of the Treasury QFC Rule, including expanding the scope of records required to be maintained beyond what is currently in Part 371. The Proposed Rule seeks to conform Part 371 with the requirements of the Treasury QFC Rule to provide consistent data for financial groups subject to the Treasury QFC Rule, as well as to require the expanded scope of records to be maintained by covered IDIs that independently become subject to Part 371.

SCOPE OF PROPOSED RULE

- As noted above, the Proposed Rule—like Part 371 today—would apply only to IDIs in a “troubled condition.” The Proposed Rule would not change the Part 371 definition of “troubled condition.”⁴

³ 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.

⁴ Under the Proposed 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 Proposed Rule defines two different 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) is a member of a corporate group⁵ one or more members of which are required to maintain records under the Treasury QFC Rule.
 - As described in greater detail below, full scope entities would be required to comply with requirements that are substantially similar to requirements applicable to “records entities” under the Treasury QFC Rule.
 - IDIs are “excluded entities” under the Treasury QFC Rule. However, under the Proposed Rule, an IDI in a “troubled condition” would be subject to recordkeeping requirements virtually identical to those under the Treasury QFC Rule. As a result, if the IDI is a member of a corporate group that is subject to the Treasury QFC Rule, the recordkeeping standards applicable to the IDI and to the

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.

⁵ Under the Proposed Rule, a “corporate group” includes an entity and all “affiliates” of that entity, i.e., any entity that controls, is controlled by or is under common control with such entity. An entity “controls” another entity if: (1) the entity directly or indirectly or acting through one or more persons owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the other entity; (2) the entity controls in any manner the election of a majority of the directors or trustees of the other entity; or (3) the Board of Governors of the Federal Reserve System has determined, after notice and opportunity for hearing in accordance with 12 C.F.R. § 225.31, that the entity directly or indirectly exercises a controlling influence over the management or policies of the other entity.

corporate group will be virtually the same. When the corporate group is building a system to comply with the Treasury QFC Rule, it may wish to consider the comparative costs and benefits between building a system only covering the corporate group or expanding it to include the IDI to be prepared if the IDI is ever defined as in a “troubled condition” in the future.

- The use of a standalone \$50 billion consolidated asset threshold to define IDIs that could be Records Entities is a departure from the Treasury QFC Rule. Although the original proposal for the Treasury QFC Rule defined any entity that had \$50 billion in consolidated assets as a “records entity,” the final Treasury QFC Rule added additional thresholds based on derivatives volumes and exposures to further narrow the coverage of the rule.
- The inclusion of a blanket \$50 billion threshold in the Proposed Rule may reflect the FDIC’s concerns that it will always be the receiver for IDIs and that IDIs with over \$50 billion in assets will always pose greater difficulties. However, a volume or exposure-based threshold would still be valuable in limiting the full scope of compliance to those IDIs with larger QFC portfolios.
- *Limited Scope Entities.* A limited scope entity includes any Records Entity that is *not* a full scope entity.
 - As described in greater detail below, limited scope entities would be required to comply with a subset of the recordkeeping requirements applicable to full scope entities and “records entities” under the Treasury QFC Rule.
- The Proposed Rule would include a *de minimis* exception from the requirement to record and maintain records in an electronic form if the Records Entity has fewer than 20 open QFC positions. For full scope entities, the *de minimis* exception would include the QFCs of the Records Entity’s subsidiaries (with some exceptions) as well.
 - A Records Entity that avails itself of the *de minimis* exception would still need to record and maintain the records required by the Proposed Rule, though not in an electronic form, so long as all required records are capable of being updated on a daily basis.
 - There are two principal differences between the *de minimis*

exception in the Treasury QFC Rule and in the Proposed Rule:

- First, the Treasury QFC Rule sets the *de minimis* exception threshold at 50 or fewer QFCs.
- Second, the Treasury QFC Rule would eliminate the preponderance of the record keeping requirements for “records entities” qualifying for the *de minimis* exception. The Proposed Rule only relieves the IDI from maintaining the records in an electronic form.
- There was no explanation in the preamble for the variation.
- If a Records Entity (and its subsidiaries, as applicable) at any time have 20 or more open QFC positions, the Records Entity would have to come into compliance within 270 days (or 60 days if it is an accelerated Records Entity, as discussed below).

INFORMATION THAT MUST BE MAINTAINED

Form and Availability

- As discussed above, the Proposed Rule would impose different requirements for full scope entities and limited scope entities.
- A Records Entity would be required to maintain records in electronic form and be capable of producing those records, based on the immediately preceding day’s end-of-day values and information, no later than 7:00 a.m. (Eastern Time) each day. Under the Proposed Rule, the FDIC would be required to notify the Records Entity in writing when such records are to be made available (and the period of time covered by the request) and to provide the Records Entity at least eight hours to respond to the request.
- A Records Entity would be required to maintain historical records for a period of not less than five business days.
- The Proposed Rule also 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.

Requirements for Full Scope Entities

- The Proposed Rule would require a full scope entity to maintain records with respect to QFCs to which it is a party substantially similar to the requirements under the Treasury QFC Rule:
 - The Proposed Rule sets out four tables in appendices with

required data fields that must be maintained, on a daily basis, based on previous end-of-day records and values. These tables would require information related to: (1) position-level data; (2) counterparty netting set data; (3) legal agreements; and (4) collateral detail data.

- The Proposed Rule would also require full scope entities to maintain and use “master data lookup tables” to report certain information that is common to different entities and transactions, including: (1) a corporate organization master table; (2) a counterparty master table; (3) booking location master table; and (4) safekeeping agent master table.
- The data set required for full scope entities is essentially the same as the requirements under the Treasury QFC Rule.
- The Proposed Rule would also require full scope entities to maintain this data with respect to QFCs to which its subsidiaries are a party, other than for a subsidiary that is: (1) a functionally regulated subsidiary (as defined in 12 U.S.C. 1844(c)(5)); (2) a security based swap dealer; or (3) a major security-based swap participant.

Requirements for Limited Scope Entities

- The Proposed Rule would require a limited scope entity to maintain a subset of the records required to be maintained by full scope entities, though limited scope entities can elect to comply with the broader requirements applicable to full scope entities.
- Limited scope entities would only be required to maintain tabular information for position-level data and counterparty netting set data and master data lookup tables only for its corporate organization and its counterparties’ organization.
- As a result, the data tables for limited scope entities include substantially fewer rows of information than what is required for full scope entities (and for “records entities” under the Treasury QFC Rule).
 - In the position-level data table, limited scope entities would only need to express data in U.S. dollars rather than local currencies, would not need to report on the fair value asset classification under accounting standards and would not need to report on credit enhancements that benefit a QFC counterparty.
 - In the counterparty netting set data table, limited scope entities would not need to keep information about collateral that is subject to rehypothecation, information about the identity of the

safekeeping agent or information about credit enhancements that benefit a QFC counterparty.

SCOPE OF PRODUCTS

- The Proposed Rule would require a Records Entity to maintain records for all QFCs to which it is a party.
- Although this scope of products matches that of the Treasury QFC Rule, the Proposed Rule, unlike the Treasury QFC Rule, does not include a process pursuant to which a Records Entity could seek an exemption from certain recordkeeping requirements.
 - Given the absence of an exemption process, it is conceivable that an IDI that is a Records Entity (under the Proposed Rule) could be subject to recordkeeping requirements that are not consistent with the requirements applicable to its affiliates that are subject to the Treasury QFC Rule.

COMPLIANCE

- Under the Proposed 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.
- A Records Entity that is an “accelerated Records Entity”⁶ would be required to maintain all required records within 60 days after it becomes a Records Entity.
- Any other Records Entity would be required to maintain required records within 270 days after it becomes a Records Entity.
- The Proposed Rule would allow the FDIC to grant one or more extensions of time for compliance. For accelerated Records Entities, a

⁶ An “accelerated Records Entity” is a Records Entity that: (1) has a composite rating, as determined by its appropriate federal banking agency in its most recent report of examination, 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; or (2) is determined by the appropriate federal banking agency or by the FDIC in consultation with the appropriate federal banking agency to be experiencing a significant deterioration of capital or significant funding difficulties or liquidity stress, notwithstanding the composite rating of the institution by its appropriate federal banking agency in its most recent report of examination.

single extension cannot be for longer than 30 days, whereas other Records Entities can obtain a single extension for up to 120 days.

- The Proposed 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.

PROPOSED RULE—KEY TAKEAWAYS

Scope of Records Entities

- Under the Proposed Rule, only an IDI that is in a “troubled condition” (a “Records Entity”) must maintain records, whereas under the Treasury QFC Rule, a “records entity” must comply with recordkeeping requirements following the compliance deadline, even if it is not in a troubled condition.
- There are two types of Records Entities under the Proposed Rule, subject to different requirements:
 - *Full scope entities*: Records Entities that: (1) have at least \$50 in total consolidated assets, or (2) are members of a corporate group where at least one other member is a “records entity” under the Treasury QFC Rule.
 - *Limited scope entities*: All other Records Entities.
 - *De minimis Exception*: Records Entities with fewer than 20 QFCs are not required to maintain records in an electronic form.

Scope of Products

- Like the Treasury QFC Rule, the Proposed Rule would require a Records Entity to maintain records for all QFCs to which it is a party.
 - A full scope entity also must maintain records for its subsidiaries with limited exceptions.
- The Proposed Rule, unlike the Treasury QFC Rule, does not include a process for a Records Entity to seek an exemption from recordkeeping requirements, such as exemptions for certain product types.

Compliance Deadlines

- A Records Entity must comply within 270 days of becoming a Records Entity.
- An “accelerated Records Entity” (an IDI under greater risk of failure)

must comply within 60 days of becoming an accelerated Records Entity.