

Final QFC Stay Rules

Visual Memorandum

December 21, 2017

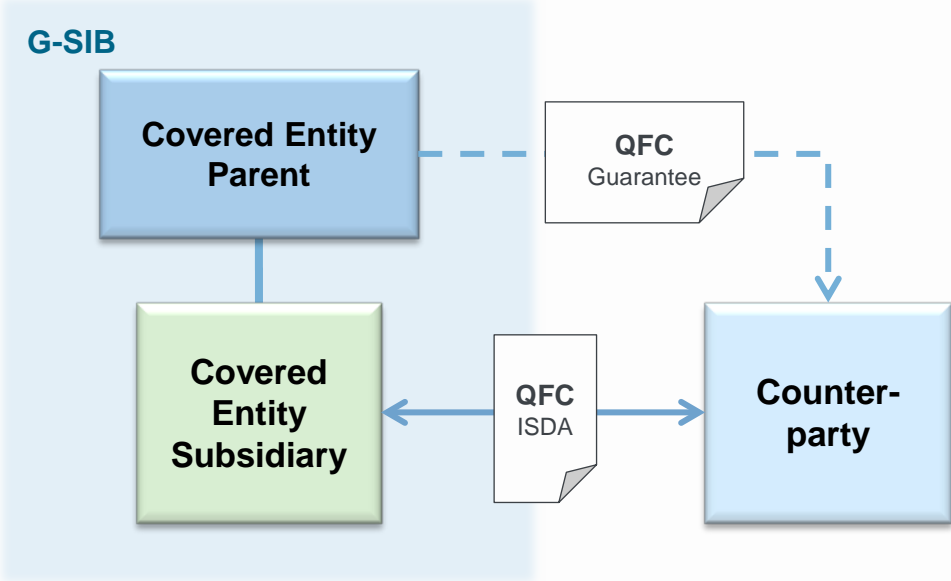



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I. Introduction

Introduction

Overview of the QFC Stay Rules

- The U.S. Banking Agencies have issued final **QFC Stay Rules** that are designed to **improve the resolvability and resilience** of U.S. global systemically important banking organizations (**G-SIBs**) and the U.S. operations of foreign G-SIBs by **mitigating the risk of destabilizing closeouts of qualified financial contracts (QFCs)**.
 - QFCs include derivatives, repos, securities lending agreements and many other types of commonly used financial contracts.
- The QFC Stay Rules provide for a phased-in compliance period based on counterparty type. The first compliance date is **January 1, 2019**. See [page 56](#) – [page 57](#) for more details.
- A copy of each of the QFC Stay Rules (each including an explanatory preamble) is available [here](#).

The **U.S. Banking Agencies** are the Board of Governors of the Federal Reserve System (**Fed**), the Federal Deposit Insurance Corporation (**FDIC**), and the Office of the Comptroller of the Currency (**OCC**) (collectively, the **Agencies**).

The term **QFC Stay Rules** in this visual memo refers to the final rules issued by all three Agencies.

The QFC Stay Rules of the Agencies are **substantively identical**. They apply to different legal entities within each G-SIB family, as described on [page 15](#) – [page 19](#).

Introduction

Overview of the QFC Stay Rules – The Cross-Default and Direct Default Problems

- A key goal of post-financial crisis regulatory reform has been ensuring that G-SIBs can be resolved and are not too big to fail.
- When a G-SIB is resolved, its QFC counterparties may have rights to terminate QFCs, which can be destabilizing and undermine this goal.
- These rights are generally categorized as “direct default rights” or “cross-default rights”:

The QFC Stay Rules are **intended to complement other measures** to improve the resolvability of G-SIBs, including resolution planning requirements and rules on total loss-absorbing capacity (**TLAC**), long-term debt and clean holding company requirements for G-SIBs. Please see our visual memo on the TLAC rule [here](#).

Direct Default Right

Right of a party to a QFC to terminate the QFC or exercise other default rights based on its direct counterparty becoming subject to an **insolvency proceeding (direct default)**.

Cross-Default Right

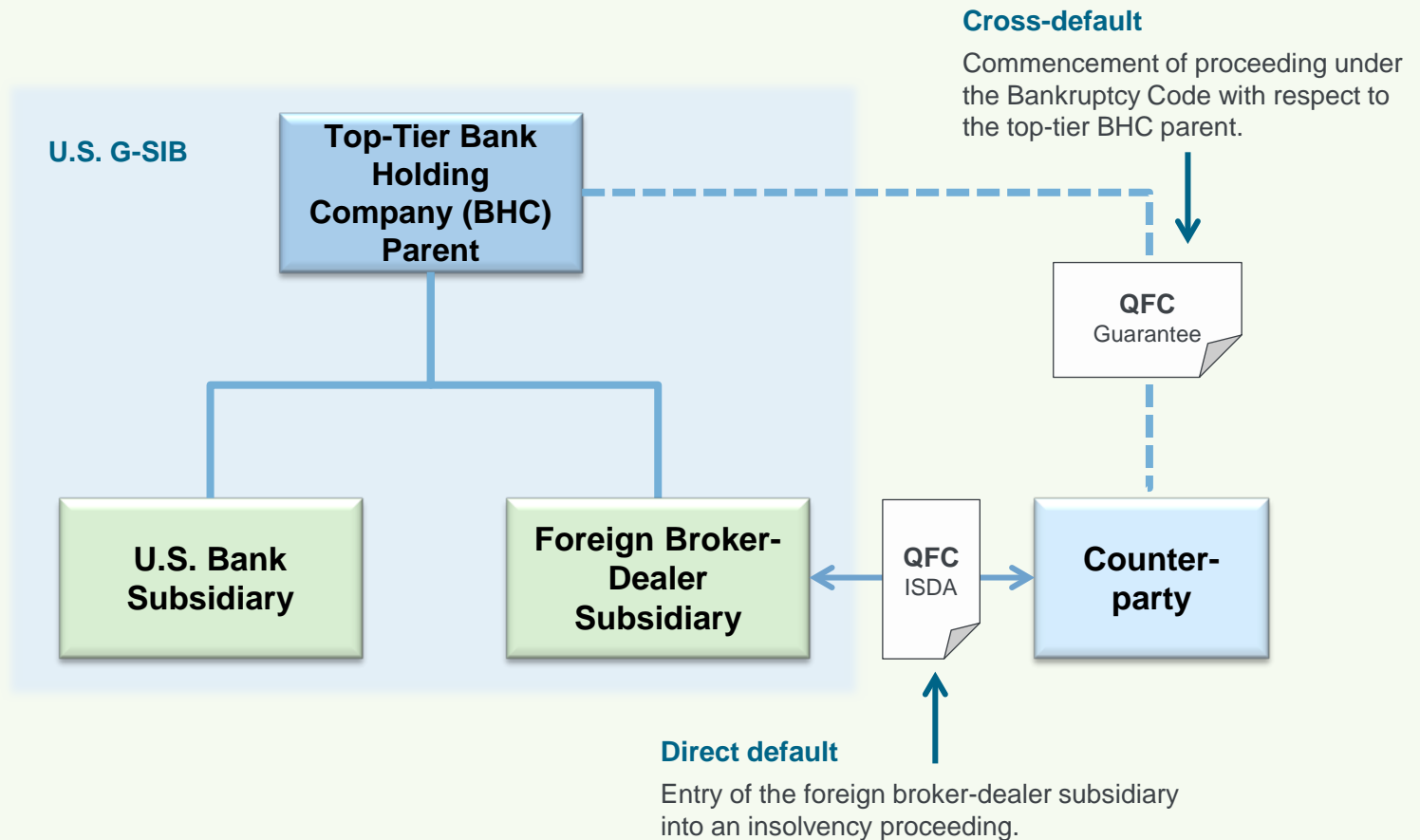
Right of a party to a QFC to terminate the QFC or exercise other default rights based on a parent or other affiliate of the direct counterparty becoming subject to an **insolvency proceeding (cross-default)**. Importantly, a cross-default right allows a party to a QFC to exercise these rights even though the direct party is performing on the QFC and a direct default on the QFC has not occurred.

By **insolvency proceeding**, we mean a receivership, insolvency, liquidation, resolution or similar proceeding.

- Both the Federal Deposit Insurance Act (**FDI Act**) and the **Orderly Liquidation Authority** under **Title II of the Dodd Frank Act (OLA)** contain provisions that mitigate the risk of **direct defaults**. In addition, OLA contains provisions that mitigate the risk of **cross-defaults**.
- The Bankruptcy Code, however, does not have comparable provisions, and the Protocols (defined below on [page 13](#)) and QFC Stay Rules are designed to address that weakness by contractual means.

Introduction

Overview of the QFC Stay Rules – Visual Representation of Direct & Cross Defaults



Introduction

Lehman – The Problem Raised by Cross-Default Rights

- **Lehman problem.** One of the destabilizing features of the Lehman Brothers bankruptcy was the **sudden termination of Lehman’s financial contracts**.
 - When the Lehman parent holding company filed for bankruptcy, counterparties exercised their **cross-default rights** under financial contracts with Lehman’s material operating subsidiaries based on the bankruptcy of the Lehman parent, which acted as guarantor.
 - This resulted in **substantial losses on Lehman’s derivatives book** and a significant **outflow of cash from Lehman’s material operating subsidiaries to counterparties** as Lehman’s subsidiaries attempted to satisfy their obligations under terminated contracts and respond to increased collateral demands under open contracts, impairing the continued viability of the operating subsidiaries.
 - Subsequently, other counterparties exercised **direct default rights** against Lehman’s material operating subsidiaries, including when the subsidiaries commenced their own bankruptcy or similar proceedings.
 - This led to **fire sales of collateral** that secured the terminated financial contracts, as well as **fire sales of assets** by Lehman’s subsidiaries in order to generate cash.

Introduction

Solutions to the Cross-Default and Direct Default Problems and Existing Gaps

- The QFC Stay Rules supplement provisions of existing law that govern the ability of counterparties to exercise their Cross-Default and Direct Default Rights:
 - **Resolution Under the Bankruptcy Code.** Attempts by creditors of a bankrupt entity to exercise their rights against the debtor outside of bankruptcy proceedings are generally blocked by the imposition of an **automatic stay**, but QFCs are generally **exempt** from this stay.
 - **The Single Point of Entry (SPOE) resolution strategy** adopted by U.S. G-SIBs solves the Direct Default Problem. This is because under the SPOE resolution strategy only the holding company enters bankruptcy proceedings, while its material operating subsidiaries do not fail. Instead they are recapitalized and continue to operate throughout the resolution period.
 - **Resolution Under U.S. Special Resolution Regimes.** In receivership proceedings under OLA and the bank resolution provisions of the FDI Act (**U.S. special resolution regimes**), the FDIC has the power to block any attempts by creditors of the failed institution to enforce their debts outside of receivership proceedings. The FDIC can do this by imposing a **temporary stay** on the ability of QFC counterparties to exercise certain default rights, and to transfer the QFCs of the failed institution to a third party or bridge institution.
- Certain important gaps, however, remain. The QFC Stay Rules are designed to mitigate these gaps.
 - SPOE does not solve the **Cross-Default Problem**, because the parent still files for bankruptcy.
 - The FDIC's stay-and-transfer powers under the U.S. Special Resolution Regimes **may not be recognized and given effect outside the United States**.

A step-by-step illustration of an **SPOE** resolution strategy is available [here](#).

Introduction

Overview of the QFC Stay Rules

- The QFC Stay Rules seek to eliminate these perceived impediments to an orderly resolution of a G-SIB and address the remaining gaps by:
 - Prohibiting **cross-default rights** based on the parent or other affiliate becoming subject to insolvency proceedings (the **Contractual Restrictions**); and
 - Requiring express recognition of the stay-and-transfer provisions of the **FDI Act** and **OLA**, mitigating the risk that those powers will be challenged in foreign jurisdictions when imposed upon the failure of a G-SIB (**Express Acknowledgement Requirements**).
- In **effect**, the QFC Stay Rules prohibit all market participants from entering into **any new QFCs** with a G-SIB unless the **new QFC** and **any existing QFCs** comply with the requirements of the QFC Stay Rules.
 - **Covered entities** must amend **any existing QFCs** with a particular counterparty if a **triggering event** occurs.

The default rights subject to the QFC Stay Rules' restrictions are described in greater detail on [page 29](#).

New QFCs. This includes putting on a new derivatives trade under an existing master agreement.

By **triggering event**, we mean that the covered entity or any of its covered affiliates becomes a party to any new QFC with the same counterparty or any of its consolidated affiliates on or after **January 1, 2019**.

This visual memo uses the term **covered entity** to refer collectively to all of the entities subject to the QFC Stay Rules.

Introduction

Counterparties' Rights – Status Under Existing Laws

Regime	Direct Default	Cross-Default
Bankruptcy	<p>Current status: Counterparties are permitted to exercise termination rights immediately. QFCs are exempt from the Bankruptcy Code's automatic stay pursuant to special “safe harbor” provisions of the Bankruptcy Code.</p>	<p>Current status: The Bankruptcy Code does not stay the exercise of cross-default rights based on an affiliate's entering bankruptcy proceedings.</p>
FDIA Act	<p>Current status: The bank resolution provisions of the FDI Act impose a temporary (one business day) stay on the ability of QFC counterparties to exercise direct default rights based on the entry of an IDI into an FDIC receivership, and authorize the FDIC to transfer the QFCs of the failed institution to a third party or bridge bank without the consent of the counterparties. The temporary stay becomes permanent if the transfer is effected before the end of the temporary stay period.</p>	<p>Current status: Under the FDI Act, there is no ability for the FDIC to stay cross-default rights either against the bank that has been brought under FDIC receivership or an affiliate of the bank.</p>
OLA	<p>Current status: OLA imposes a temporary (one business day) stay on the ability of QFC counterparties to exercise direct default rights based on the entry of a covered financial company into OLA proceedings, and authorizes the FDIC to transfer the QFCs of the failed covered financial company to a third party or bridge financial company without the consent of the counterparties. The temporary stay becomes permanent if the transfer is effected before the end of the temporary stay period.</p>	<p>Current status: Section 210(c)(16) of OLA and FDIC regulations thereunder prohibit the exercise of cross-default rights based on the entry of a parent or other affiliate into OLA proceedings. If the QFC is supported by a guarantee, there is a temporary (one business day) stay on the ability of counterparties to terminate their QFCs based on a cross-default to the guarantor's entry into OLA proceedings, which stay will become permanent if the FDIC transfers the guarantee to a third party, including a bridge financial company, or otherwise provides adequate protection to the counterparty, before the end of the temporary stay period. Otherwise, the temporary stay will automatically terminate. If there is no guarantee, the cross-default is permanently overridden from the start.</p>

Introduction

Existing Solutions to the Direct and Cross-Default Problems and Remaining Gaps

Regime	Direct Default	Cross-Default
Bankruptcy	<p>Current Solution SPOE: The direct default problem is solved by the SPOE resolution strategy and the Federal Reserve's rule on total loss-absorbing capacity (TLAC) and clean holding company requirements.</p> <p>SPOE is the primary solution to this problem for U.S. G-SIBs since most QFCs are issued by U.S. G-SIB operating subsidiaries, and under the SPOE strategy, the material operating subsidiaries of a U.S. G-SIB would be kept out of insolvency proceedings and from otherwise directly defaulting on their financial contracts.</p>	<p>Current Solution No Current Solution.</p> <p>Remaining Gap Cross-default problem: The Bankruptcy Code does not contain a provision like Section 210(c)(16) of OLA addressing the cross-default problem.* If an affiliate of a material operating subsidiary enters into bankruptcy proceedings, its counterparties can exercise contractual rights to close out against the material subsidiary even if the subsidiary continues to perform on underlying contracts.</p>
FDIA Act	<p>Current Solution Stay and Transfer Powers: Under a multiple point of entry (MPOE) strategy, one or more of a G-SIB's operating subsidiaries enters into an insolvency proceeding. The FDIC's stay-and-transfer powers under the FDI Act solve this problem for insured depository institutions (IDIs).</p> <p>Remaining Gap Extraterritorial issue: The temporary stay on exercising direct default rights based on a direct party's entry into FDI Act proceedings, and the related transfer provisions, may not be recognized outside the United States.</p>	<p>Current Solution No Current Solution.</p> <p>Remaining Gap Cross-Default problem: If the parent or other affiliate of the IDI enters into insolvency proceedings, a counterparty to the IDI may, depending on the terms of the particular contracts involved, have the right to close out its QFCs even after the QFCs are transferred to a Bridge Bank, which could drain resources from the Bridge Bank. Counterparties to subsidiaries of the IDI can also exercise contractual rights to close out their QFCs based on the entry of the IDI into FDI Act proceedings, which could drain resources from the otherwise solvent subsidiaries.</p>
OLA	<p>Current Solution Stay and Transfers Powers: The FDIC's stay-and-transfer powers under OLA solve this problem.</p> <p>Remaining Gap Extraterritorial issue: OLA's prohibition on exercising direct default rights and its related stay-and-transfer provisions may not be recognized outside the United States.</p>	<p>Current Solution Override of Cross-Defaults: OLA's prohibition on cross-default rights based on an affiliate's entry into OLA proceedings, and its related transfer provisions, solve this problem.</p> <p>Remaining Gap Extraterritorial issue: OLA's prohibition on exercising cross-default rights and its related transfer provisions may not be recognized outside the United States.</p>

* A bill that has passed the House but not the Senate would add a similar provision to the Bankruptcy Code. A copy of the bill is [here](#).

Introduction

How the QFC Stay Rules Address the Remaining Gaps

Regime	Direct Default	Cross-Default
Bankruptcy	<p>Solution Under the QFC Stay Rules The QFC Stay Rules enhance the existing SPOE solution by mitigating the risk that the G-SIB's material operating subsidiaries themselves default or are forced to enter into bankruptcy proceedings as a result of QFC terminations. The QFC Stay Rules do not, however, impose any limitations on the ability of a counterparty to exercise termination rights if the material operating subsidiary itself enters ordinary bankruptcy proceedings.</p>	<p>Solution Under the QFC Stay Rules Subject to certain creditor protection conditions, covered QFCs must not (i) permit the counterparty to exercise any cross-default rights related, directly or indirectly, to a parent or other affiliate of the direct party to the covered QFCs becoming subject to insolvency proceedings, or (ii) prohibit the transfer of a parent guarantee or other affiliate credit enhancement upon the parent or other affiliate becoming subject to insolvency proceedings, subject to certain exceptions.</p>
FDIA Act	<p>Solution Under the QFC Stay Rules Covered QFCs must include a provision pursuant to which the counterparty contractually agrees that (i) any direct default rights are subject to the limits on the exercise of such rights under the FDI Act and (ii) any transfer of the covered QFCs to a third party, including a bridge bank or bridge financial company, will be effective to the same extent as it would be under the FDI Act.</p>	<p>Solution Under the QFC Stay Rules Same as above.</p>
OLA	<p>Solution Under the QFC Stay Rules Covered QFCs must include a provision pursuant to which the counterparty contractually agrees that (i) any direct default rights are subject to the limits on the exercise of such rights under OLA and (ii) any transfer of the covered QFCs to a third party, including a bridge bank or bridge financial company, will be effective to the same extent as it would be under OLA.</p>	<p>Solution Under the QFC Stay Rules Covered QFCs must include a provision pursuant to which the counterparty contractually agrees that (i) any cross-default rights are subject to the limits on the exercise of such rights under OLA and (ii) any transfer of a parent guarantee to a third party, including a bridge financial company, will be effective to the same extent as it would be under OLA.</p>

Introduction

The Global Development of Effective Resolution Mechanisms

- The QFC Stay Rules are part of a broader initiative by global regulators to enhance the resolvability of G-SIBs, including by way of requiring contractual amendments of financial contracts.
 - At the 2013 G-20 summit the leaders of the G-20 signed a declaration committing to make progress towards ending too big to fail and implementing certain guiding principles set forth in the Key Attributes of Effective Resolution Regimes issued by the Financial Stability Board (**FSB**).
 - Thereafter, regulatory authorities from France, Germany, Japan, Switzerland, the United Kingdom and the United States of America worked with ISDA to launch the first **ISDA Resolution Stay Protocol** in 2014, which provided for the contractual recognition of statutory stays under **Special Resolution Regimes (SRRs)** and contractual limitations on early termination rights due to cross-defaults under ISDA Master Agreements.
 - This was expanded in 2015 to cover repo and securities lending contracts (**SFTs**) under commonly traded standardized master agreements, which led to the launch of the **2015 ISDA Universal Resolution Stay Protocol**.

Introduction

Safe Harbor for Protocol Adherence

- The QFC Stay Rules provide a **safe harbor** for compliance by adherence to the **Universal Protocol** or a separate **U.S. Protocol** containing substantially identical terms (referred to collectively as the **Protocols**), see [page 51](#) for additional information.
 - The rationale for the safe harbor is that the Universal Protocol requires adherence with respect to all covered entities that have also adhered, rather than one subset. This, the Agencies believe, allows the Universal Protocol to address impediments on an industry-wide basis.
 - The Agencies expect that most counterparties will agree to be bound by the Protocols with respect to existing QFCs and strongly encourage this by safe harboring the Protocols, which offer **superior creditor protections** as compared to the QFC Stay Rules. Adhering parties may subsequently incorporate the terms of the Protocols into their new QFCs, in order to be able to continue entering into QFCs with the covered entities on Protocol terms. See [page 53](#) – [page 54](#) for examples of the superior creditor protections that the Universal Protocol offers.
- **Current Adherents.** To date, 25 G-SIBs (as defined by the FSB) have adhered to the Universal Protocol.
- Under the Protocols, adhering parties limit their default rights only with respect to covered entities. Default rights against adhering parties that are not covered entities are not affected.

From the Preamble to the Fed QFC Stay Rule:

Purpose of the Universal Protocol.

The Universal Protocol “extends, through contractual agreement, the application” of U.S. special resolution regimes “to all QFCs entered into by a GSIB and its subsidiaries, including QFCs entered into by covered entities outside of the United States,” and establishes “restrictions on cross-default rights” that are similar to those in the final rules.

Universal Protocol. The Universal Protocol as defined in the QFC Stay Rules includes not only the main body of the 2015 ISDA Universal Resolution Stay Protocol but also the **SFT Annex** and **Other Agreements Annex** published by ISDA as of May 3, 2016, and any other minor or technical amendments thereto.

II. Covered Entities

Covered Entities

- Between the Fed, FDIC and OCC QFC Stay Rules, all U.S. G-SIBs and their subsidiaries and all U.S. operations of non-U.S. G-SIBs are subject to the QFC Stay Rules, with limited exclusions as shown in the following slide.

	Covered Entities (Fed Rule)	Covered FSIs (FDIC Rule)	Covered Banks (OCC Rule) ^{***}
U.S. G-SIBs	<ul style="list-style-type: none"> BHCs identified as global systemically important BHCs under G-SIB surcharge rule All of their subsidiaries* (other than excluded entities) 	<ul style="list-style-type: none"> State savings associations or state nonmember banks (as defined under the FDI Act) that are direct or indirect subsidiaries of a U.S. G-SIB All of their subsidiaries* (other than excluded entities) 	<ul style="list-style-type: none"> National banks and Federal savings associations that are subsidiaries of a U.S. G-SIB All of their subsidiaries* (other than excluded entities)**
Foreign G-SIBs	<ul style="list-style-type: none"> U.S. subsidiaries of foreign G-SIBs U.S. branches (which includes FDIC-insured state-licensed branches, but not federal branches) and agencies of foreign G-SIBs 	<ul style="list-style-type: none"> State savings associations or state nonmember banks (as defined under the FDI Act) that are direct or indirect subsidiaries of a foreign G-SIB All of their subsidiaries* (other than excluded entities) 	<ul style="list-style-type: none"> National banks and Federal savings associations that are subsidiaries of a foreign G-SIB All of their subsidiaries* (other than excluded entities)** Federal branches or agencies of a foreign G-SIB

* The QFC Stay Rules continue to define “subsidiary” by reference to the BHC Act definition of control, rather than by reference to accounting consolidation principles. A subsidiary of a covered FSI and a subsidiary of a covered bank (other than an excluded entity) are also subject to the Fed QFC Stay Rule. The rules attempt to clarify which rule would apply to situations where there may be overlap. The Agencies also state that they intend to consult with each other and coordinate as needed regarding the implementation of these rules.

** The OCC QFC Stay Rule applies to the subsidiaries of covered banks insofar as a covered bank is responsible for making sure that its subsidiaries’ QFCs are conformed to the OCC QFC Stay Rule’s requirements.

*** The OCC QFC Stay Rule also applies to national banks and federal savings associations not under a BHC that have total assets of more than \$700 billion based on its most recent Call Report. As of the date of this memo, all such national banks and federal savings associations are subsidiaries of G-SIBs.

Covered Entities

Excluded Entities

- The Fed QFC Stay Rule excludes from its scope certain subsidiaries of a covered entity that are **excluded entities**, which are listed below. The FDIC QFC Stay Rule applies substantively similar exclusions to its definition of covered FSI, with some technical amendments, as does the OCC QFC Stay Rule to its definition of covered bank.

	U.S. G-SIBs	Foreign G-SIBs
Excluded Entities	<ul style="list-style-type: none"> Portfolio companies held under the merchant banking portfolio authority of section 4(k)(4)(H) of the BHC Act Portfolio companies held under the insurance company investment authority of section 4(k)(4)(I) of the BHC Act Subsidiaries held pursuant to provisions for debt previously contracted in good faith (DPC Subsidiaries) Portfolio companies held pursuant to the Small Business Investment Act of 1956 Certain companies engaged in the business of making public welfare investments under paragraph 11 of 12 U.S.C. § 24 	<ul style="list-style-type: none"> All foreign entities and offices U.S. subsidiaries that are: <ul style="list-style-type: none"> Section 2(h)(2) companies DPC branch subsidiaries Other excluded entities*

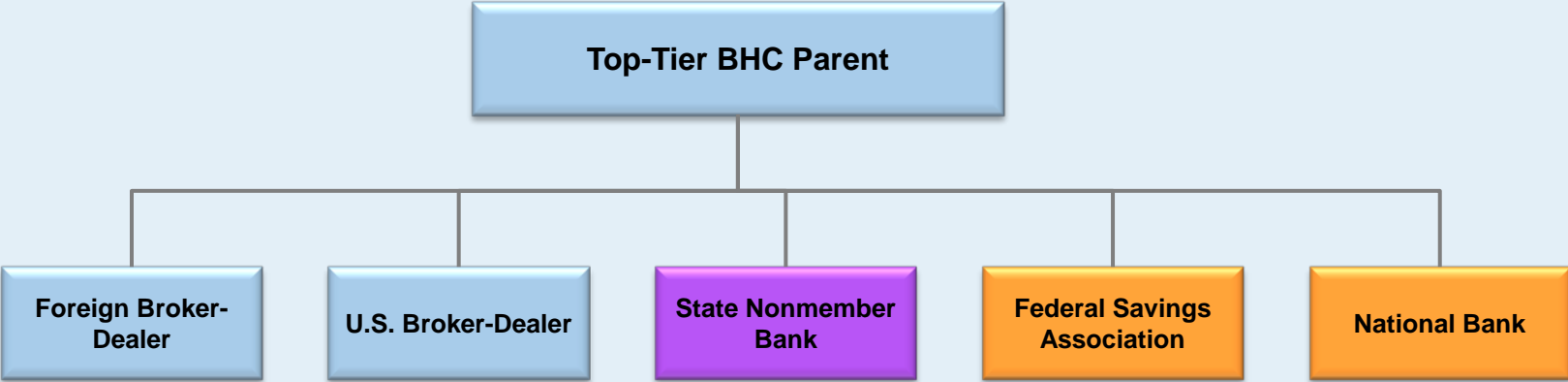
* The same list of subsidiaries are **excluded** for foreign G-SIBs as for U.S. G-SIBs.

The Federal Reserve declined to exempt U.S. branches and agencies of foreign G-SIBs or U.S. subsidiaries of foreign G-SIBs that are exempted from the requirement to be held under a U.S. IHC (required to be formed by the Fed's Regulation YY) pursuant to a Federal Reserve order. The Preamble to the Fed QFC Stay Rule states that "covering QFCs that involve any U.S. subsidiary, U.S. branch, or U.S. agency of a foreign GSIB will reduce the potentially disruptive cancellation of those QFCs if the foreign GSIB or any of its subsidiaries enters resolution."

Covered Entities

A Sample U.S. G-SIB

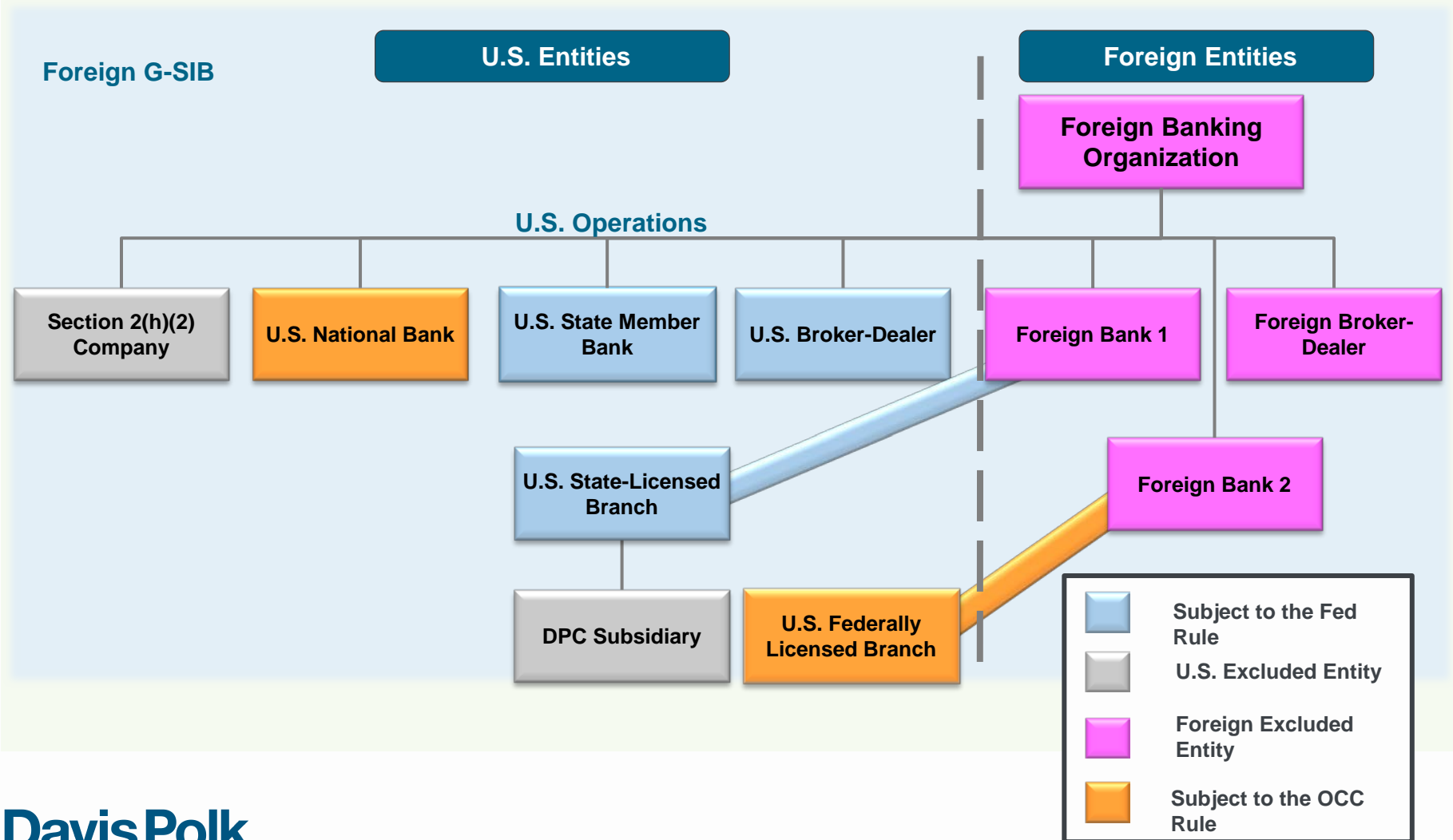
U.S. G-SIB



	Subject to the OCC Rule
	Subject to the Fed Rule
	Subject to the FDIC Rule

Covered Entities

U.S. Operations of a Sample Foreign G-SIB



Covered Entities

Determination of G-SIB Status

U.S. G-SIBs

A U.S. BHC and its subsidiaries are considered to be a **U.S. G-SIB** if the BHC is determined to be a global systemically important BHC pursuant to the Federal Reserve's capital rules relating to G-SIB surcharges (**G-SIB surcharge rule**).

Foreign G-SIBs

A top-tier foreign banking organization (**FBO**) and its subsidiaries are considered to be a **foreign G-SIB**, for the purposes of the Fed QFC Stay Rule, if the top-tier FBO is or controls:

- A nonbank financial company supervised by the Federal Reserve;
- Any BHC with ≥ \$50 billion in total consolidated assets; **or**
- Any foreign bank or company that has ≥ \$50 billion in total consolidated assets and that is a BHC or is treated as a BHC under Section 8 of the International Banking Act of 1978 (**IBA**);

and

- The **FBO determines** that its group has the characteristics of a foreign G-SIB under the assessment methodology and higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision (**BCBS methodology**); **or**
- The **Federal Reserve**, using information available to it, **determines** that:
 - The FBO would be a G-SIB under the BCBS methodology;
 - The FBO would be a G-SIB under the G-SIB surcharge rule; **or**
 - Any U.S. intermediate holding company controlled by the FBO would be a G-SIB under the G-SIB surcharge rule.

These are the categories of entities required by the Federal Reserve to submit resolution plans under Section 165(d) of the Dodd-Frank Act.

Both an **FBO** and a foreign company treated as a BHC under Section 8 of the IBA are a foreign bank or other company that is or controls a foreign bank that operates a branch, agency or commercial lending company subsidiary in the United States, or has a U.S. bank or Edge Act subsidiary.

The Fed QFC Stay Rule requires an FBO that determines, pursuant to the BCBS methodology, that it is a G-SIB to provide notice to the Federal Reserve related to its G-SIB status by January 1 of each year. The first required notice is due **January 1, 2018**.

III. Covered QFCs

Covered QFCs

Definitions

- **Definition of QFC.** The Fed QFC Stay Rule and the OCC QFC Stay Rule define QFC by incorporating by reference OLA's definition of a **QFC**. The FDIC QFC Stay Rule incorporates a substantively identical definition under the FDI Act.
 - Under these statutes, a QFC is defined very broadly to cover a wide variety of financial transactions, including without limitation swaps and other derivatives, repo and reverse repo transactions, securities lending and borrowing transactions, contracts for the purchase or sale of securities, CDs or mortgage loans, commodity contracts, forward contracts, certain spot transactions, and guarantees of or credit enhancements related to the foregoing.
 - Because the QFC definition includes guarantees of and credit enhancements related to other QFCs, certain requirements of the QFC Stay Rules distinguish between **direct QFCs** and QFCs that are guarantees and other **credit enhancements** of direct QFCs (**credit support**).

The definition of QFC can be found in [Section 210\(c\)\(8\)\(D\) of OLA](#).

A **direct QFC** means a QFC that is not a credit enhancement.

Covered QFCs

Definitions

- **Covered QFCs.** The QFC Stay Rules apply to **covered QFCs**, which are **in-scope** and meet certain triggering conditions.
 - An **in-scope QFC** means a QFC that explicitly restricts the transfer of a QFC from a covered entity or provides one or more **default rights** with respect to a QFC that may be exercised against a covered entity.
- **Triggering Conditions.** An **in-scope QFC** becomes a covered QFC under the following conditions:
 - It is a new QFC that a covered entity enters into, executes or otherwise becomes a party to on or after **January 1, 2019**; or
 - If a **covered entity or its affiliate** enters into a new QFC with an existing counterparty or a **consolidated affiliate of the counterparty** on or after **January 1, 2019**, then an existing in-scope QFC between the covered entity and that same counterparty entered into before **January 1, 2019** will become a covered QFC.

Definition of Covered Entity's Affiliates.

Similar to the definition of “subsidiary,” the QFC Stay Rules define “affiliate” of a covered entity by reference to the Bank Holding Company Act definition of control.

Consolidated Counterparty Affiliates.

The final rules limit the triggering event for remediation to affiliates of the counterparty that are consolidated under **U.S. GAAP or IFRS** (or would be consolidated if such principles applied).

Remediation triggered by entry into any new QFC.

Entry into **any new QFC** with an existing counterparty or the counterparty's consolidated affiliate would trigger the requirement to amend all **existing QFCs**.

* Although the QFC Stay Rules stagger the compliance deadline based on counterparty type, the rules' remediation requirements apply to **all** in-scope QFCs entered into by the covered entity with a counterparty prior to January 1, 2019, if the covered entity or any of its covered affiliates enter into a new QFC with the counterparty or the counterparty's consolidated affiliates **on or after January 1, 2019** (regardless of the type of counterparty). See [page 56](#) – [page 57](#) for additional details.

Covered QFCs

Exclusions

- **QFCs Where Covered Entity Acts Solely as Agent.** The QFC Stay Rules clarify that a QFC would not be covered under the rules solely because a covered entity is acting as the agent of a principal with respect to the QFC.
 - The QFC Stay Rules do not exempt a QFC with respect to which the agent also acts in another capacity, e.g., if the covered entity agent also acts as guarantor.
- **QFCs with No Explicit Default Rights or Transfer Restrictions.** QFCs that contain no **explicit** default rights or transfer restrictions exercisable against a **covered entity** are excluded from the scope of the QFC Stay Rules.
 - This should lessen the remediation burden with respect to QFCs such as cash market securities transactions, spot FX transactions and others that the QFC Stay Rules do not explicitly exempt or exclude.
 - The Agencies declined to exclude QFCs that do not contain default rights but that may contain transfer restrictions, except as noted below.

The Agencies declined to exempt securities lending authorization agreements, because the exercise of default rights with respect to these agreements may hinder the orderly resolution of a G-SIB and it is unclear how these beneficiaries would act in the event of a failure of their agent.

The QFC Stay Rules require counterparties to give up the right to exercise cross-default rights only with respect to **covered entities**, not with respect to **non-covered entities**.

The QFC Stay Rules do not exclude QFCs with **central banks** or other **sovereign entities**.

Covered QFCs

Exclusions

- **Existing Warrants.** The Final QFC Stay Rules exclude warrants that evidence a right to subscribe to or otherwise acquire a security of the **covered entity** or its **affiliates** that were issued prior to a designated date (under the Fed QFC Stay Rule, **November 13, 2017** (the **effective date**), under the FDIC QFC Stay Rule, **January 1, 2018**, and under the OCC QFC Stay Rule, **January 1, 2018**).
- **Retail Investment Advisory Agreements.** Investment advisory agreements with retail customers or counterparties are excluded from the scope of the QFC Stay Rules.
 - To qualify for the exception, an investment advisory agreement must not have any transfer restrictions except as required to comply with section 205(a)(2) of the Investment Advisers Act of 1940 and must not contain any default rights against the covered entity.

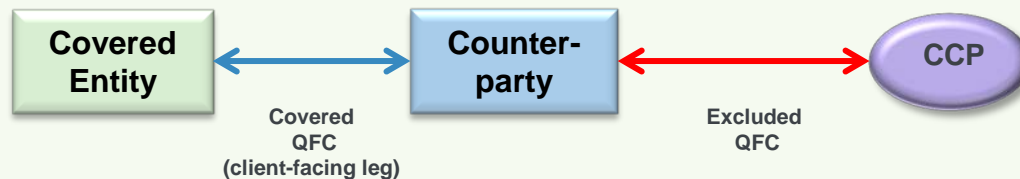
Warrants. The QFC Stay Rules do not exclude warrants on third-party reference assets.

Retail Customer or Counterparty. The Fed QFC Stay Rule defines retail customer or counterparty by reference to Regulation WW. The FDIC QFC Stay Rule and the OCC QFC Stay Rule use substantively identical definitions.

Covered QFCs

Exclusions

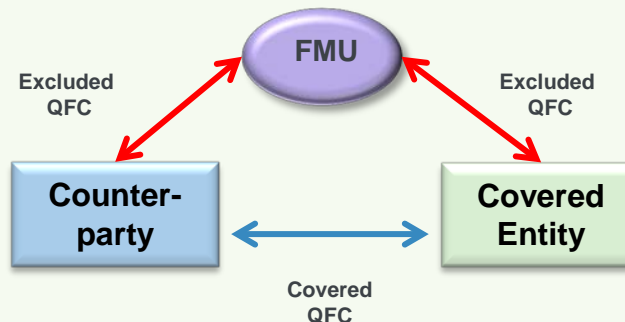
- QFCs with CCPs.** QFCs to which a CCP is party are excluded from the scope of the QFC Stay Rules.
 - The QFC Stay Rules do not exclude the client-facing leg of cleared swaps under the European principal-to-principal model.



In addition, the QFC Stay Rules require that any U.S. Protocol not contain an exclusion for the client-facing leg of cleared swaps under the European model, but permit the exclusion to remain in the Universal Protocol.

- QFCs with Other FMUs.** QFCs to which each party, other than the covered entity, is an FMU, are also excluded.

- This means that the QFC Stay Rules would not exclude 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 a QFC.



FMU is defined as a 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. This is the same definition used in **Title VIII of the Dodd-Frank Act.**

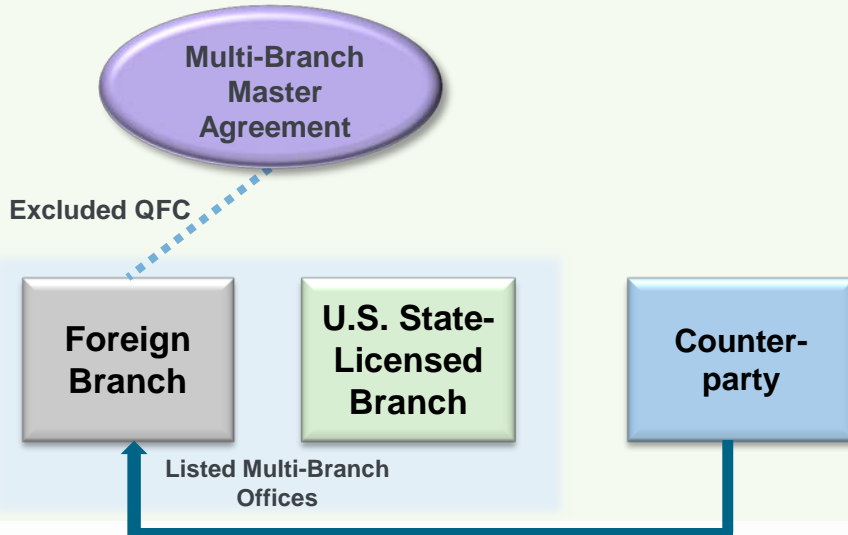
Covered QFCs Exclusions

- Multi-branch master agreements.** If a foreign bank multi-branch master agreement is a covered QFC solely because the master agreement permits QFCs to be entered into at a U.S. branch or agency of a foreign G-SIB, then it will be considered a covered QFC under the QFC Stay Rules only with respect to such QFCs **booked at** such U.S. branches or agencies. The purpose of this exclusion is to ensure that foreign G-SIBs will only be required to comply with the QFC Stay Rule with respect to QFCs of the foreign bank that could directly affect the obligations of its U.S. branches or agencies.

This provision does not appear in the FDIC QFC Stay Rule, presumably because it is not relevant to the entities covered by this rule.

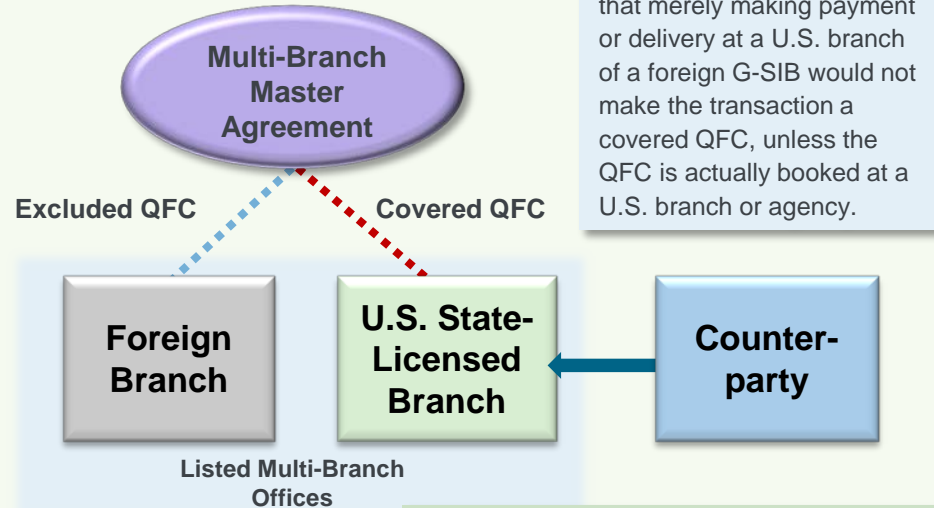
Example 1

The Fed QFC Stay Rule **excludes covered QFCs under a multi-branch master agreement** that are **not in fact booked at** a covered U.S. branch, merely because the master agreement permits QFCs to be entered into at a U.S. branch.



Example 2

The **multi-branch master agreement would be a covered QFC** with respect to covered QFC transactions that are **booked at** a covered U.S. branch.



The Fed QFC Rule clarifies that merely making payment or delivery at a U.S. branch of a foreign G-SIB would not make the transaction a covered QFC, unless the QFC is actually booked at a U.S. branch or agency.

The Universal Protocol amends the entire multi-branch master agreement, including transactions booked at non-U.S. branches.

Covered QFCs

Approval of Other Exemptions

- The QFC Stay Rules add a mechanism for the relevant Agency to exempt by order a covered entity from the obligation to conform one or more QFCs or types of QFCs to one or more of the operative requirements of the relevant QFC Stay Rule.
- The Agencies will consider the following factors in deciding whether to approve such a request:
 - The potential impact of the exemption on the ability of the covered entity or its affiliates to be resolved in a rapid and orderly manner;
 - The compliance burden that the exemption would achieve; and
 - Any other factors the Agencies deem relevant.
- Although coordination between the Agencies on this approval mechanism is not required under the QFC Stay Rules, the Agencies state in the Preambles to the QFC Stay Rules that they “intend to consult with each other and coordinate as needed regarding implementation of the final rule.”

IV. Default Rights

Definition of Default Right

- A **default right**, with respect to a QFC, includes the following:
 - A right, regardless of source, including by statute, contract or common law, of a non-defaulting party to:
 - **Liquidate, terminate, cancel, rescind** or **accelerate** a QFC or transactions under a QFC;
 - **Set off** or net amounts owed thereto (excluding same-day payment netting);
 - Exercise **remedies in respect of collateral** or other credit support or property related thereto (including the purchase and sale of property);
 - **Demand payment or delivery** in respect thereof (other than a right or operation of a contractual provision arising solely from a change in value of collateral or margin or a change in the amount of an economic exposure);
 - **Suspend, delay** or **defer** payment or performance thereunder;
 - **Modify** the obligations of a party thereunder; or
 - Any similar right.
 - A right or contractual provision that **alters the amount of collateral or margin** that must be provided with respect to an exposure thereunder, including by altering:
 - Any initial amount;
 - Threshold amount;
 - Variation margin;
 - Minimum transfer amount;
 - Margin value of collateral; or
 - Any similar amount,
 - A right or contractual provision that:
 - Entitles a party to **demand** the **return** of any collateral or margin transferred by it to the other party;
 - **Modifies** a transferee's **right to reuse** collateral or margin (if such right previously existed); or
 - Any similar rights,
In each case, **other than** a right or operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an economic exposure.

The definition of **default right** is the same as that used in the **TLAC** rule as well as that used in the **Universal Protocol**.

V. Express Acknowledgement Requirements

Express Acknowledgement Requirements

- The QFC Stay Rules require a covered QFC to include express recognition of (1) the limitations on the counterparty's exercise of default rights and (2) the effectiveness of the powers of the FDIC to transfer contracts, in each case in a resolution proceeding under OLA or the FDI Act. In particular, covered QFCs must expressly provide that:

1 Limited Exercise of Default Rights

In the event the covered entity or its affiliate becomes subject to a proceeding under the FDI Act or OLA (each, a **U.S. special resolution regime**), default rights may be exercised against the covered entity to no greater extent than would be permitted under the U.S. special resolution regime if the covered QFCs were governed by U.S. law.

AND

2 Effective Transfer

In the event the covered entity becomes subject to a proceeding under a U.S. special resolution regime, the transfer of the covered QFCs from the covered entity will be effective to the same extent as it would be under the U.S. special resolution regime if the covered QFCs were governed by U.S. law.

The purpose of this requirement is to reduce the risk that the stay-and-transfer provisions under the U.S. special resolution regimes will be challenged counterparty located in foreign jurisdictions. See [page 9 – page 11](#) for more detail.

Applies with respect to the covered QFC and any interests in and obligations under, and any property securing, the covered QFC.

Express Acknowledgement Requirements

- **Exemption from the Express Acknowledgment Requirement for QFCs with U.S. Nexus.** The QFC Stay Rules exempt from the **Express Acknowledgement Requirements** QFCs that are:
 - Explicitly governed by U.S. law, provided that the QFC does not expressly exclude either of the U.S. special resolution regimes (e.g., the contract cannot be governed by New York law, but exclude federal law); and
 - Entered into with a counterparty that is incorporated or organized in, domiciled in, or whose principal place of business is located in the United States, or is a U.S. branch or agency of an FBO.

QFCs that can benefit from this exemption still need to be remediated if they contain default rights prohibited under the **Contractual Restrictions**.

VI. Contractual Restrictions

Contractual Restrictions

General Prohibition

- **General Prohibition.** The QFC Stay Rules have **two basic prohibitions**, subject to certain **creditor protections**.

Cross-Defaults

The QFC Stay Rules prohibit a covered QFC from permitting the counterparty to exercise any **default right** that is related, **directly or indirectly**, to an **affiliate** of the direct party **becoming subject to an insolvency proceeding**, whether domestic or foreign (**cross-default**).

Although we refer to these as **cross-defaults**, they are **significantly broader** than what may be typically thought of as cross-defaults, due to the **direct or indirect** nexus. For example, an indirect cross-default could include not only a default right that expressly references the insolvency of an affiliate, but also a default right that could be directly or indirectly tied to an affiliate (e.g., a **ratings downgrade** of the direct party in response to the failure of a parent BHC).

Transfers

The QFC Stay Rules prohibit a covered QFC from restricting the **transfer** of any **guarantee or other credit support (covered credit support)** furnished by the parent or other covered affiliate (**covered support provider**) upon or following the covered support provider becoming subject to an **insolvency proceeding**, **unless** the transfer would result in the counterparty benefiting from the covered credit support **in violation of any applicable laws**.

The covered QFC must require the counterparty to bear the **burden of proof**, after an affiliate of the direct party enters insolvency proceedings, that its **exercise of default rights is permitted** under the QFC.

Exemption for Certain Cross-Default Rights. For purposes of the Contractual Restrictions, the definition of default right does not include any default right that allows a party to terminate the contract on demand or at the party's option at a specified time, or from time to time, without the need to show cause.

The Contractual Restrictions do not restrict the ability of QFCs, including overnight repos, to terminate at the end of the contract term.

For example, an equity swap with optional early termination rights.

Contractual Restrictions

Creditor Protections

- Notwithstanding these prohibitions, the QFC Stay Rules permit:
 - **Direct Default Rights.** The exercise of direct default rights in the event of:
 - direct party insolvency proceedings (see [page 39](#) and [page 40](#));
 - direct QFC payment or delivery default (see [page 39](#) and [page 40](#)); or
 - credit support payment or delivery default (see [page 39](#)).
 - **Cross-Default Rights.** The exercise of cross-default rights if there is:
 - no transfer of covered credit support to a transferee and the credit support provider is in insolvency proceedings other than Chapter 11 (see [page 41](#) and [page 42](#));
 - a transfer of covered credit support to a transferee who enters insolvency (see [page 41](#) and [page 43](#));
 - covered credit support cherry picking (see [page 41](#) and [page 44](#)); or
 - a partial asset transfer to a transferee of covered credit support (see [page 41](#) and [page 45](#)).
 - **IDI Credit Support.** A covered direct QFC and related credit support may permit the exercise of a cross-default right related directly or indirectly to a **covered support provider that is an IDI becoming subject to an FDIC receivership under the FDI Act** in limited scenarios (see [page 46](#) and [page 47](#)).
- In order to exercise a default right permitted by these creditor protections after an affiliate of the direct party has entered an insolvency proceeding, a counterparty bears the **burden of proof** that the exercise is permitted ([page 48](#)).
- The QFC Stay Rules provide a process for **approval of enhanced creditor protections**, if the Federal Reserve, FDIC, and OCC determine these protections would prevent or mitigate risks to financial stability of the United States ([page 49](#)).

QFCs Exempt from the Contractual Restrictions

- **Exemption for QFCs with No Cross-Defaults or Credit Support Transfer Restrictions.** The following covered QFCs are not required to be amended in order to conform with the requirements of **§ 252.84** of the Fed QFC Stay Rule, **§ 382.4** of the FDIC QFC Stay Rule and **§ 47.5** of the OCC QFC Stay Rule:
 - A QFC that does not explicitly provide for any default right that is related, directly or indirectly, to an affiliate of the direct party becoming subject to any receivership, insolvency, liquidation, resolution or similar proceedings; and
 - A QFC that does not explicitly prohibit the transfer of any covered affiliate credit enhancement or any obligation thereunder, or any property securing the enhancement, to a transferee upon or following an affiliate of the direct party becoming subject to a receivership, insolvency, liquidation, resolution or similar proceedings.

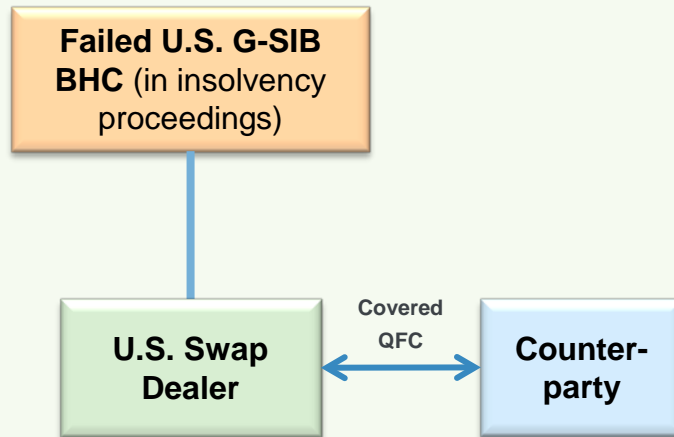
QFCs under this exemption still need to meet the **Express Acknowledgement Requirement** unless they benefit from an exemption from that requirement.

Contractual Restrictions

General Prohibition – Example for Cross-Defaults

Prohibited Cross-Defaults (U.S.)

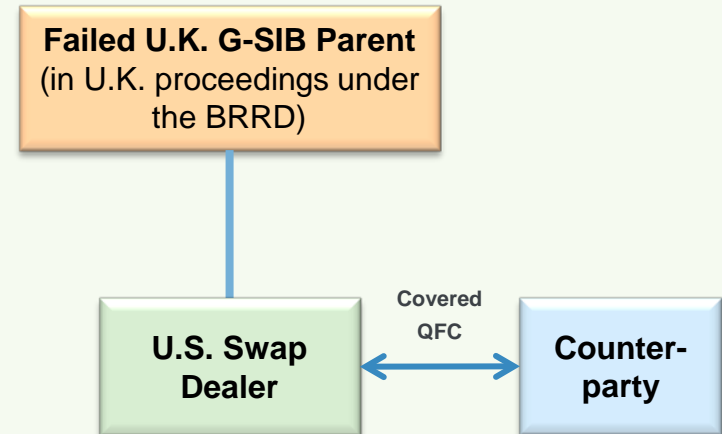
The U.S. Swap Dealer's covered QFCs may not permit the exercise of default rights directly or indirectly related to the G-SIB BHC becoming subject to insolvency proceedings.



Counterparty cannot terminate this Covered QFC based directly or indirectly on the G-SIB BHC's insolvency.

Prohibited Cross-Defaults (Non-U.S.)

The U.S. Swap Dealer's covered QFCs, similarly, may not permit the exercise of default rights directly or indirectly related to the non-U.S. G-SIB parent becoming subject to local insolvency proceedings.



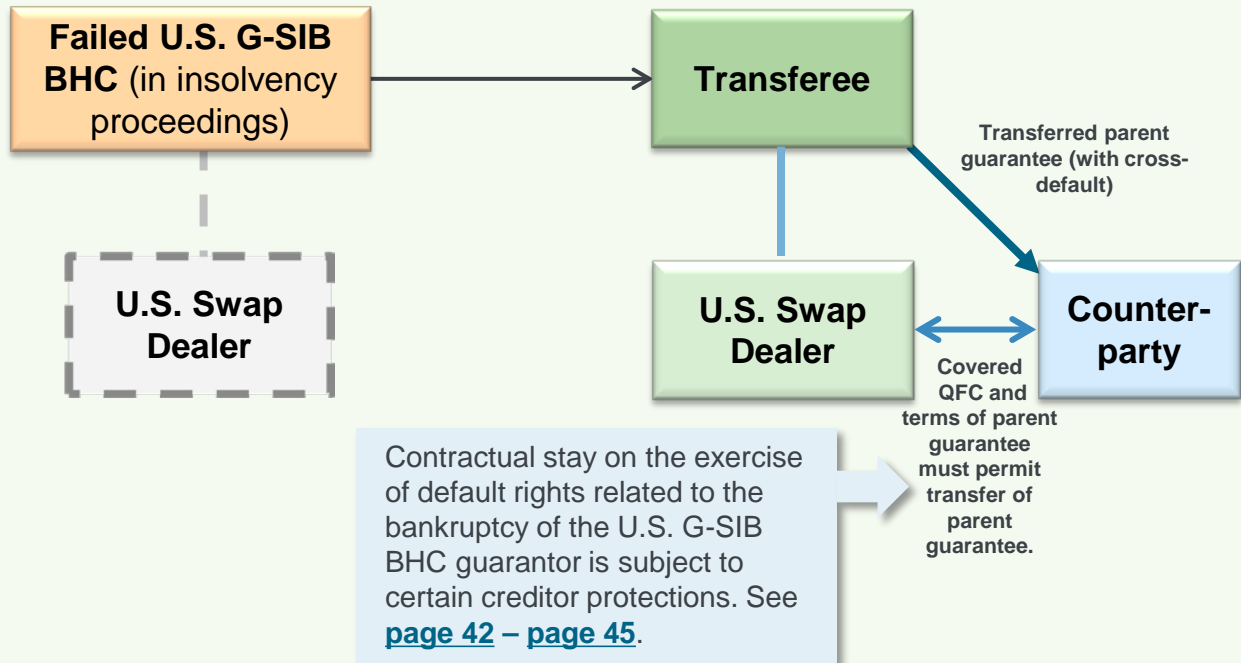
Counterparty cannot terminate this Covered QFC based directly or indirectly on the G-SIB BHC's insolvency.

Contractual Restrictions

General Prohibition – Example for Guaranteed QFCs

Transfer Prohibition Not Permitted

The U.S. Swap Dealer's covered QFCs may not prohibit the transfer of the parent guarantee of the U.S. Swap Dealer's covered QFC upon the parent's insolvency.



Contractual Restrictions

Creditor Protections – Direct Default Rights

- **Direct Default Exceptions.** A covered QFC and related credit support may permit the immediate exercise of a default right, without the imposition of a contractual stay, that arises as a result of:

1 Direct Party in Insolvency

The direct party itself becoming subject to a receivership, insolvency, liquidation, resolution or similar proceeding.

2 Direct Party Payment or Delivery Default

The direct party's failure to satisfy a payment or delivery obligation under the covered QFC or another contract between the same parties that gives rise to a default right under the covered QFC.

3 Credit Support Payment or Delivery Default

Failure of a covered support provider (such as the parent) or a party to whom the covered credit support has been transferred (**transferee**) to satisfy a payment or delivery obligation under the **covered credit support** for the covered **direct QFC**.

As a reminder, OLA and the FDI Act generally stay direct default rights, so if the covered entity that is a direct party enters into one or the other of the U.S. special resolution regimes, direct default rights against that covered entity would be stayed.

On the other hand, if the direct party becomes subject to a bankruptcy proceeding, then the QFC counterparty can exercise its direct default rights immediately. The QFC rules **do not interfere** with the exercise of **direct default rights** under the **Bankruptcy Code**.

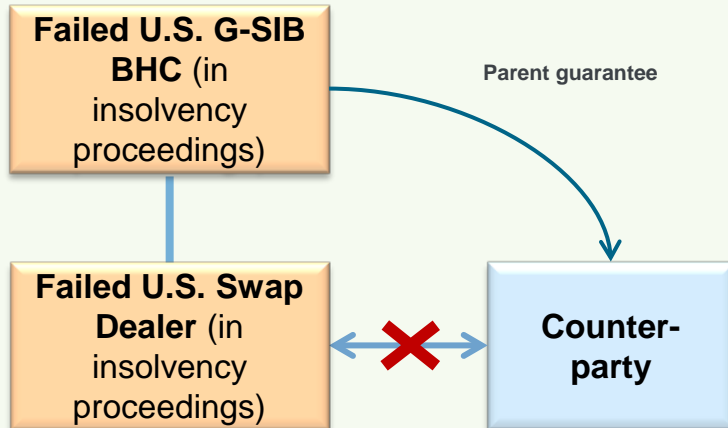
These creditor protections mean that the counterparty will not need to continue to transact with a direct party that does not **remain open and operating** or does not **continue to satisfy all of its payment and delivery obligations** under the QFC, including the posting of margin.

Contractual Restrictions

Creditor Protections – Examples of Direct Default Rights

1 Direct Party in Insolvency

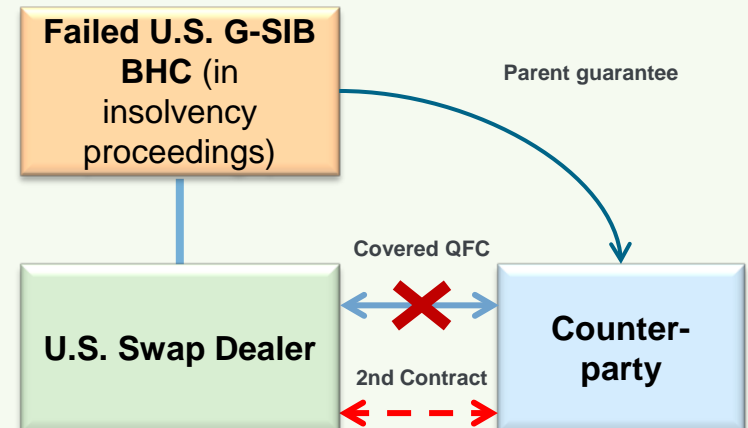
The U.S. Swap Dealer becomes subject to an insolvency proceeding (direct default).



Covered QFC may permit the counterparty to exercise default rights based on an insolvency default by the direct party.

2 Direct Party Payment or Delivery Default

The U.S. Swap Dealer fails to satisfy a payment or delivery obligation under the covered QFC or another contract with the covered QFC counterparty (direct party defaults).



Covered QFC may permit the counterparty to exercise default rights based on direct party payment or delivery defaults under either of these contracts.

Contractual Restrictions

Creditor Protections – Supported Direct QFCs

- **Cross-Default Exceptions. Additional creditor protections** exist if the covered direct QFC is supported by a **guarantee or other covered credit support** provided by a covered support provider. In this case, the covered direct QFC and related covered credit support may permit the counterparty to exercise a default right related, directly or indirectly, to the insolvency of the covered support provider **after a temporary stay period** in the following limited circumstances:

The **temporary stay period** is the period of time beginning when the covered support provider enters into insolvency proceedings and ending at the **later of 5:00 p.m. EST on the next business day and 48 hours**. This is generally intended to align with the stays under the **FDIA** and **OLA**, but is not exactly the same.

1 Covered Support Provider Insolvency

The credit support is not transferred to another entity by the end of the stay period, **and** the covered support provider (e.g., the parent) becomes subject to an insolvency proceeding **other than Chapter 11 of the Bankruptcy Code**.

2 Transferee Insolvency

The covered credit support is transferred to another entity and the transferee becomes subject to an insolvency proceeding (subject to creditor protections related to FDI Act proceedings on [page 46](#)).

3 Covered Credit Support Cherry-Picking

The covered support provider does not remain, and no transferee becomes, obligated under the covered credit support to the same, or substantially similar, extent as the covered support provider was prior to entry into insolvency proceedings, with respect to:

- The covered credit support for the supported QFC; **and**
- All other covered credit support provided by the covered support provider (e.g., the parent) for covered QFCs between the direct party and the same QFC counterparty or affiliates of the counterparty.

No cherry-picking. This provision is meant to prevent a transferee of the covered support provider from cherry-picking only those QFCs of a given counterparty that are favorable to it.

4 Partial Asset Transfer

If the covered credit support is transferred and:

- All of the covered support provider's direct and indirect ownership interests in the direct party are **not** transferred to the transferee; **or**
- Reasonable assurance has **not** been provided that substantially all of the covered support provider's assets (excluding assets reserved for the payment of costs of administration in the proceeding) will be transferred or sold to the transferee in a timely manner.

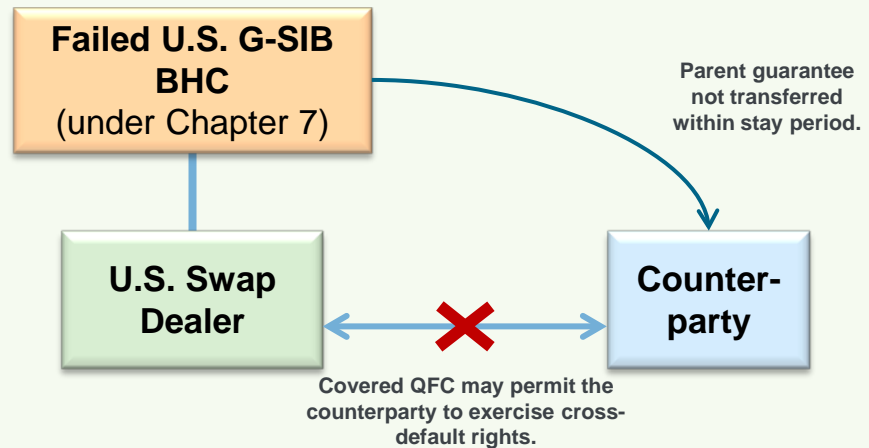
Nature of transferee. While this provision requires that substantially all of the assets of the covered support provider be transferred to the transferee to ensure the transferee can make required payments, it does not impose any other requirements regarding the nature or status of the transferee.

Contractual Restrictions

Creditor Protections – Supported Direct QFCs – Example 1

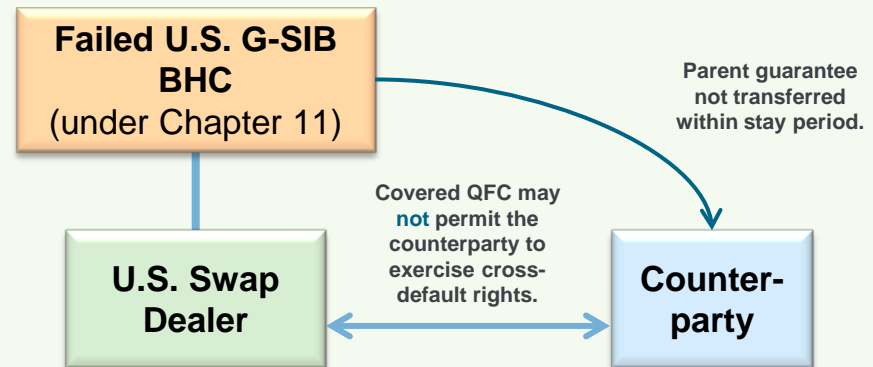
1a Covered Support Provider in Chapter 7

If the covered credit support is not transferred by the end of the temporary stay period, and the failed U.S. G-SIB BHC is subject to a liquidation proceeding under Chapter 7 of the Bankruptcy Code, then the covered QFC may permit the counterparty to exercise its default rights.



1b Covered Support Provider in Chapter 11

If the covered credit support is not transferred by the end of the temporary stay period, and the failed U.S. G-SIB BHC is subject to a proceeding under Chapter 11 of the Bankruptcy Code, then the covered QFC may **not** permit the counterparty to exercise its default rights.*



* So long as there is no cherry-picking of other covered QFCs between the U.S. Swap Dealer and the counterparty or the counterparty's affiliates.

No administrative priority requirement. Unlike the Universal Protocol, the QFC Stay Rules do not contain a requirement that the counterparty's claim under the covered credit support against the failed U.S. G-SIB BHC must be elevated to administrative priority status.

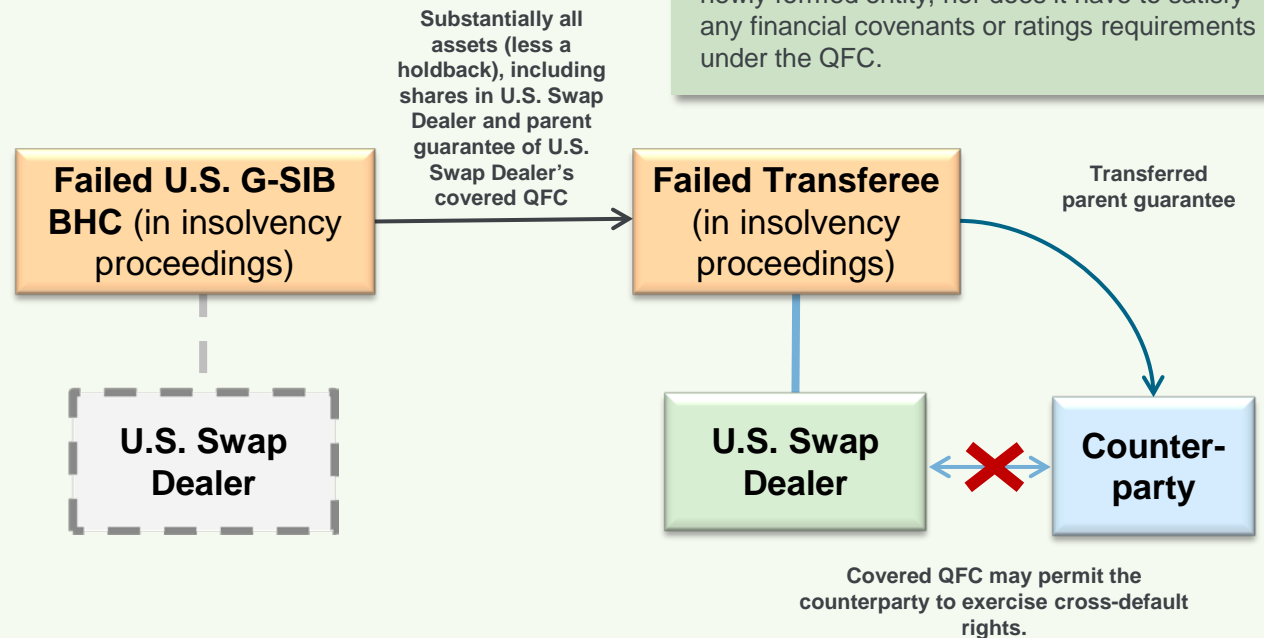
Contractual Restrictions

Creditor Protections – Supported Direct QFCs – Example 2

2

Transferee Insolvency

If the parent guarantee is transferred (either to a third party or an affiliate of the covered support provider), and the transferee becomes subject to an insolvency proceeding, then the covered QFC may permit the counterparty to exercise its default rights.

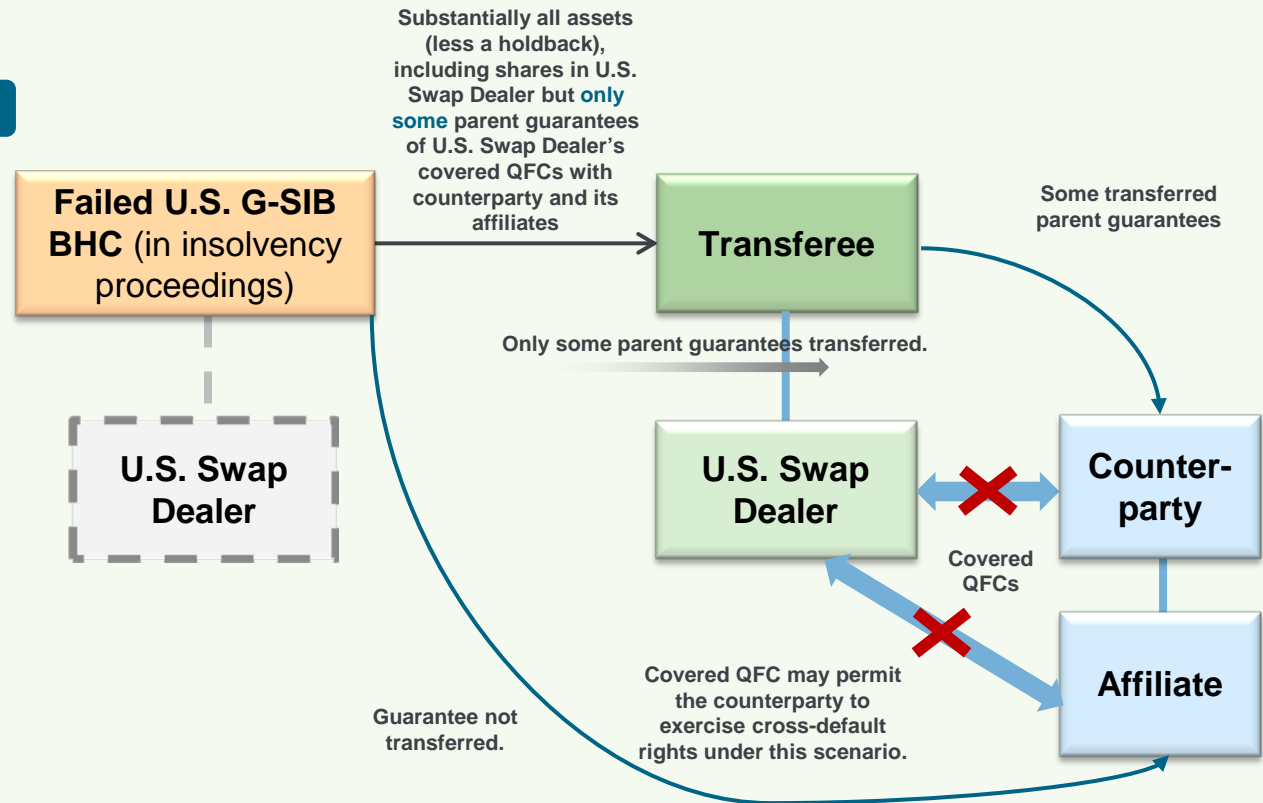


Contractual Restrictions

Creditor Protections – Supported Direct QFCs – Example 3

3 Credit Support Cherry-Picking

If a parent guarantee of a covered QFC is transferred to a transferee, the transferee must become obligated to the same extent as the U.S. G-SIB BHC parent was prior to entering insolvency proceedings with respect to **all of the guarantees provided by the parent** for covered QFCs between the U.S. Swap Dealer and the counterparty **and** between the U.S. Swap Dealer and the counterparty's affiliates.



Contractual Restrictions

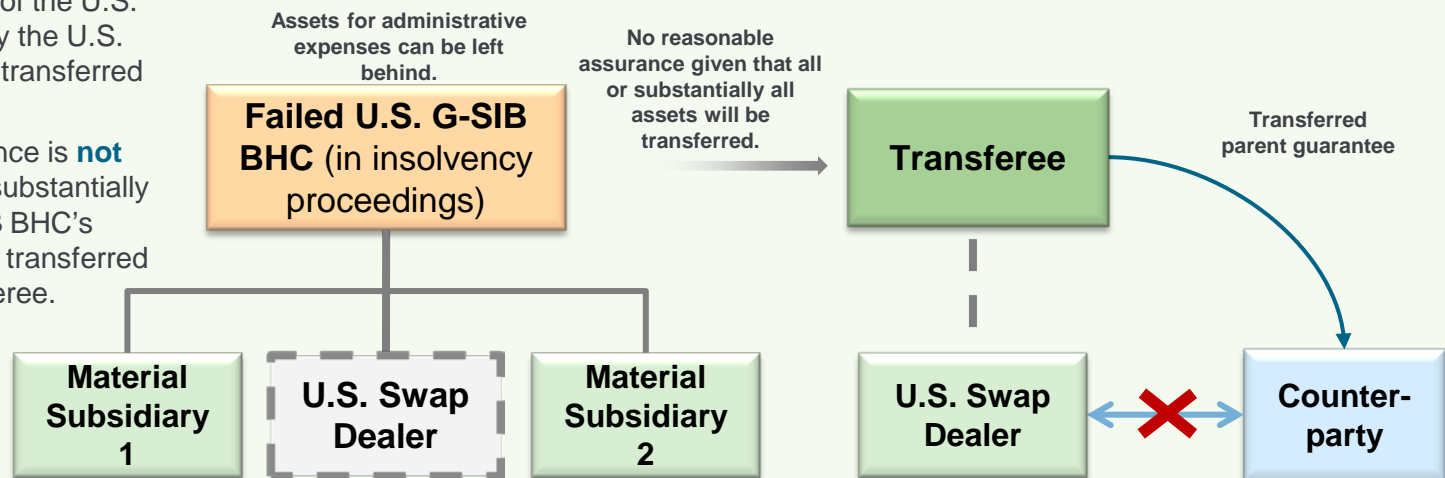
Creditor Protections – Supported Direct QFCs – Example 4

4

Partial Asset Transfer

The covered QFC may permit the counterparty to exercise its cross-default rights if:

- All of the direct and indirect ownership interests of the U.S. Swap Dealer held by the U.S. G-SIB BHC are **not** transferred to the transferee; **or**
- Reasonable assurance is **not** provided that all or substantially all of the U.S. G-SIB BHC's assets will be timely transferred or sold to the transferee.



Covered QFC may permit the counterparty to exercise cross-default rights under this scenario.

Contractual Restrictions

Creditor Protections – IDI Credit Support

- **FDI Act Proceedings.** A covered direct QFC and related credit support may permit the exercise of a **cross-default right** related directly or indirectly to a **covered support provider that is an IDI becoming subject to an FDIC receivership under the FDI Act** in the following scenarios:

1 Failure to Transfer

After the temporary stay period under the FDI Act, if the covered IDI credit support has not been transferred to a bridge bank or third-party transferee by the end of the temporary stay period under the FDI Act.

2 Suspension of Performance Consistent with FDI Act

During the temporary stay period under the FDI Act, to the extent the default right permits the counterparty to suspend performance under the covered QFC to the same extent as the counterparty would be entitled to do under the FDI Act if it were party to a direct QFC with the covered IDI support provider.

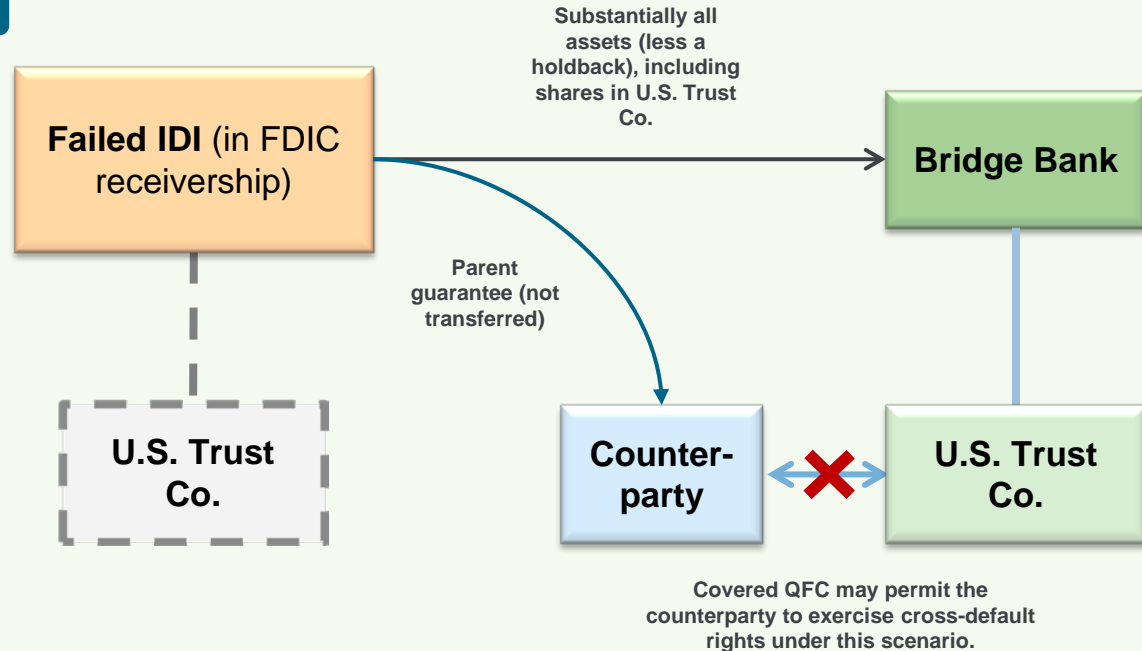
The **temporary stay period** under the FDI Act runs until **5:00 p.m. EST on the business day** following the appointment of the FDIC as receiver.

Contractual Restrictions

Creditor Protections – IDI Credit Support – Example

Failure to Transfer

If the IDI parent's guarantee of the U.S. trust company's covered QFC is not transferred to a bridge bank by the end of the temporary stay period under the FDI Act, then the covered QFC may permit the counterparty to exercise its cross-default rights based on the IDI becoming subject to an FDIC receivership under the FDI Act.



Contractual Restrictions

Burden of Proof

Requirements

- A covered QFC must provide that whenever a counterparty seeks to exercise any default rights after an affiliate of the direct party becomes subject to an insolvency proceeding:

Requirement 1

The counterparty must bear the **burden of proof** that the exercise of such default rights is permitted under the covered QFC; **and**

Requirement 2

The counterparty will satisfy its burden of proof only if it establishes by “**clear and convincing**” evidence, or a similar or more demanding evidentiary standard,^{*} that the burden of proof has been met.

- This requirement is meant to deter the QFC counterparty from thwarting the purpose of the QFC Stay Rules by exercising a default right based on an affiliate of the covered entity becoming subject to an insolvency proceeding **under the guise of other default rights** that are unrelated to the affiliate’s becoming subject to an insolvency proceeding.
- As a reminder, counterparties will continue to be able to exercise default rights unrelated to the insolvency or resolution of an affiliate, but will still bear the **burden of proof**.

^{*} The “similar” evidentiary standard for the burden of proof is intended to provide for the application of a similar standard in jurisdictions that do not recognize the “clear and convincing” standard.

Contractual Restrictions

Enhanced Creditor Protections

- A covered entity may request that the Agencies approve alternative provisions for or amendments to covered QFCs with **greater creditor protections** than allowed under the rules' creditor protection exceptions. The QFC Stay Rules enumerate **10 factors** that the Agencies may consider in evaluating a proposal.
- The Agencies may approve alternative credit protection provisions if the proposal, as compared to a covered QFC that complies with the contractual restrictions in the QFC Stay Rules or that is amended pursuant to the Universal Protocol or the U.S. Protocol, would **prevent or mitigate risks to the financial stability** of the United States that could arise from the failure of a U.S. G-SIB or the U.S. operations of a foreign G-SIB and would **protect the safety and soundness of the covered entities** to at least the same extent.
- To support its request, the covered entity must:
 - **Provide an analysis.** The analysis of the proposed enhanced creditor protections must address each of the QFC Stay Rules' **10 listed factors**.
 - **Provide a legal opinion.** The written legal opinion must verify that the proposed provisions or amendments would be valid and enforceable under applicable law of the relevant jurisdictions.
 - **Provide any other requested information.** The Agencies reserve the right to request any other relevant information.

From the Preamble to the QFC Stay Rules:

"Creditor protections that apply broadly to a range of QFCs and covered entities would increase the chance that all of a GSIB's QFC counterparties would be treated the same way during a resolution of that GSIB and may improve the prospects for an orderly resolution of that GSIB. By contrast, proposals that would expand counterparties' rights beyond those afforded under existing QFCs would conflict with the proposal's goal of reducing the risk of mass unwinds of GSIB QFCs."

The first two factors concern the potential impact of the requested creditor protections on G-SIB resiliency and resolvability.

The next four factors concern the potential scope of the proposal:

- Whether "the set of conditions or the mechanism in which they are applied facilitates, on an industry-wide basis, contractual modifications to remove impediments to resolution and increase market certainty, transparency, and equitable treatment...";
- Coverage of existing and future transactions;
- Coverage of multiple forms of QFCs or multiple covered entities; and
- Whether it would permit adherence with respect to only one or a subset of covered entities.

The next three factors focus on the impact of requested creditor protections for QFC counterparties that benefit from covered credit support.

The last factor is whether the proposed enhancement provides the counterparty with additional default rights or other rights.

The considerations enumerated in the QFC Stay Rules suggest there will be a **high bar** for approval of any proposed alternative with enhanced creditor protections, unless it operates on an industry-wide basis.

VII. Alternative Compliance Through the Protocols

Alternative Compliance Through Adhering to the Protocols

- The QFC Stay Rules allow parties to conform covered QFCs to the rules either by amending each QFC bilaterally to comply with the rules' contractual requirements and restrictions or through adherence to either the **Universal Protocol or the U.S. Protocol**. The Agencies have indicated that they strongly encourage compliance through adherence to the Protocols.

Section 1 of the Universal Protocol: Amends agreements to contractually opt into certain qualifying special resolution regimes

Express Acknowledgement Requirements of the Final Rules

Section 2 of the Universal Protocol: Introduces stays and overrides default rights directly or indirectly related to an affiliate entering into certain U.S. insolvency proceedings.

Contractual Restrictions of the Final Rules

The **Universal Protocol** amends existing QFCs between adhering parties. Once parties adhere to the Universal Protocol, future QFCs between such parties would be compliant with the rules if they incorporate the Universal Protocol provisions by reference.

- The Universal Protocol largely tracks the requirements of the QFC Stay Rules, but there are some notable differences:
 - The **scope of the cross-defaults overridden** under the Universal Protocol is **narrower** than under the QFC Stay Rules.
 - The Universal Protocol contains **enhanced creditor protections**. Counterparties who do **not adhere** to the Universal Protocol or the U.S. Protocol **do not get the benefit** of such enhanced creditor protections.
 - The Universal Protocol uses a narrower definition of **affiliate** (majority ownership) as compared to the QFC Stay Rules (BHC Act definition of control).
 - The Universal Protocol provides for an opt-in to certain non-U.S. special resolution regimes in addition to the FDI Act and OLA.
- [Page 53](#) and [page 54](#) provide some highlights of the differences between the Protocols and the cross-default provisions of the QFC Stay Rules. See [Appendix: Comparison to Section 2 of the Protocols](#) for more details.

Bilateral Amendment. While parties can comply with the QFC Stay Rules by bilaterally amending covered QFCs, parties who do not adhere to the Universal or U.S. Protocol **cannot** comply with the QFC Stay Rules by incorporating the terms of the Universal Protocol into the QFC, since those provisions are not themselves compliant with the QFC Stay Rules, absent the safe harbor for adherence to the Protocols.

FBO Home Country Jurisdictional Module Not Sufficient. The Preambles to the QFC Stay Rules note that in the case of a foreign G-SIB, “[t]he jurisdictional modular protocols for other count[ries] do not satisfy the requirements of the final rule[s].”

Compliance through the U.S. Protocol

- **U.S. Protocol.** The QFC Stay Rules also allow a covered QFC to be compliant with the rules if it is amended by a new U.S. Protocol.
- The QFC Stay Rules provide that the U.S. Protocol may differ from the Universal Protocol in certain limited respects, but otherwise must be substantively identical to the Universal Protocol. Specifically, the QFC Stay Rules provide that any U.S. Protocol:
 - May limit application of the provisions of the Universal Protocol to covered entities and excluded banks;
 - Must include recognition of the U.S. special resolution regimes and the other **Identified Regimes**, but does not need to include the other **Protocol-Eligible Regimes**;
 - May not permit parties to adhere on a firm-by-firm or entity-by-entity basis and may not have a “static” list of covered entities;
 - May allow opt-outs by protocol adherents to be effective only to the extent that the affected covered QFCs otherwise conform to the requirements of the rules;
 - May no longer contain the sunset opt-out provision with respect to U.S. special resolution regimes, as it no longer applies following the release of the QFC Stay Rules;
 - Must not include the exemption in Section 2 of the Universal Protocol regarding the client-facing leg of a principal-to-principal cleared swap transaction; and
 - May include minor and technical differences from the Universal Protocol.

Other **Identified Regimes**: U.K., France, Germany, Japan, Switzerland

Protocol-Eligible Regimes. ISDA defines these as resolution regimes of other jurisdictions that satisfy the requirements of the Universal Protocol. Adhering parties may opt into these regimes under the Universal Protocol by adhering to specific Country Annexes.

Opt-outs as provided under Section 1 and/or Section 2 of the Universal Protocol

Comparison to Section 2 of the Protocols

Key Differences in Creditor Protections

Protocols	Final Rules
If parent guarantor is in bankruptcy and guarantee is <u>not</u> transferred:	
✓ Court must issue order elevating guarantee claims to administrative priority status.	➤ No comparable requirement.
✓ Court order must also authorize parent to perform under the guarantee and allow default rights to be exercised if direct party or parent materially breaches the covered QFC or related guarantee.	➤ No comparable requirement.
✓ Court order must also allow default rights to be exercised if direct party fails to pay a closeout amount owed to any other covered QFC counterparty and parent fails to satisfy its guarantee obligations with respect to such covered QFC.	➤ No comparable requirement.
✓ If guarantor is not the ultimate parent entity organized in the United States, counterparty may terminate after the temporary stay period.	➤ No comparable requirement.
If parent guarantor is in bankruptcy and guarantee <u>is</u> transferred:	
✓ Transferee must be a newly formed entity not controlled by the bankruptcy estate of the parent or must be an unaffiliated third party that satisfies any contractual requirements with respect to ratings or other financial covenants.	➤ No comparable requirement.
✓ Transferee must satisfy all material payment and delivery obligations to each of its creditors during the stay period.	➤ No comparable requirement.
✓ Court order authorizing the transfer of all or substantially all of the assets of parent (or the net proceeds thereof), less a holdback for administrative expenses, to the transferee as soon as practicably possible must be entered by the end of the stay period.	➤ No court order required, only reasonable assurances that all or substantially all of the assets of parent (or the net proceeds thereof), less a holdback for administrative expenses, will be transferred to the transferee in a timely manner.

Comparison to Section 2 of the Protocols

Key Differences in Creditor Protections

Protocols

Final Rules

For guaranteed QFCs, conditions that must continue to be satisfied with respect to direct party

- ✓ Following the temporary stay period, the direct party must continue to be duly registered and licensed with the principal regulatory bodies having jurisdiction over its business related to covered QFCs.

Scope of cross-default rights subject to override or prohibition (subject to creditor protection conditions)

- ✓ Only default rights with respect to a covered QFC that are related directly or indirectly to an affiliate of the direct party becoming subject to insolvency proceedings under Chapter 11 or Chapter 7 of the Bankruptcy Code, SIPA or the FDI Act are overridden.
- ✓ Default rights with respect to a covered QFC that are triggered by an affiliate becoming subject to foreign insolvency proceedings would not be overridden unless this occurs after the U.S. parent has entered into Chapter 11 proceedings.

- No comparable requirement.

- Default rights with respect to a covered QFC that are related directly or indirectly to an affiliate of the direct party becoming subject to any insolvency proceedings, whether domestic or foreign, are prohibited.

- Default rights with respect to a covered QFC that are triggered by an affiliate at any time becoming subject to foreign insolvency proceedings are prohibited.

VIII. Compliance Period

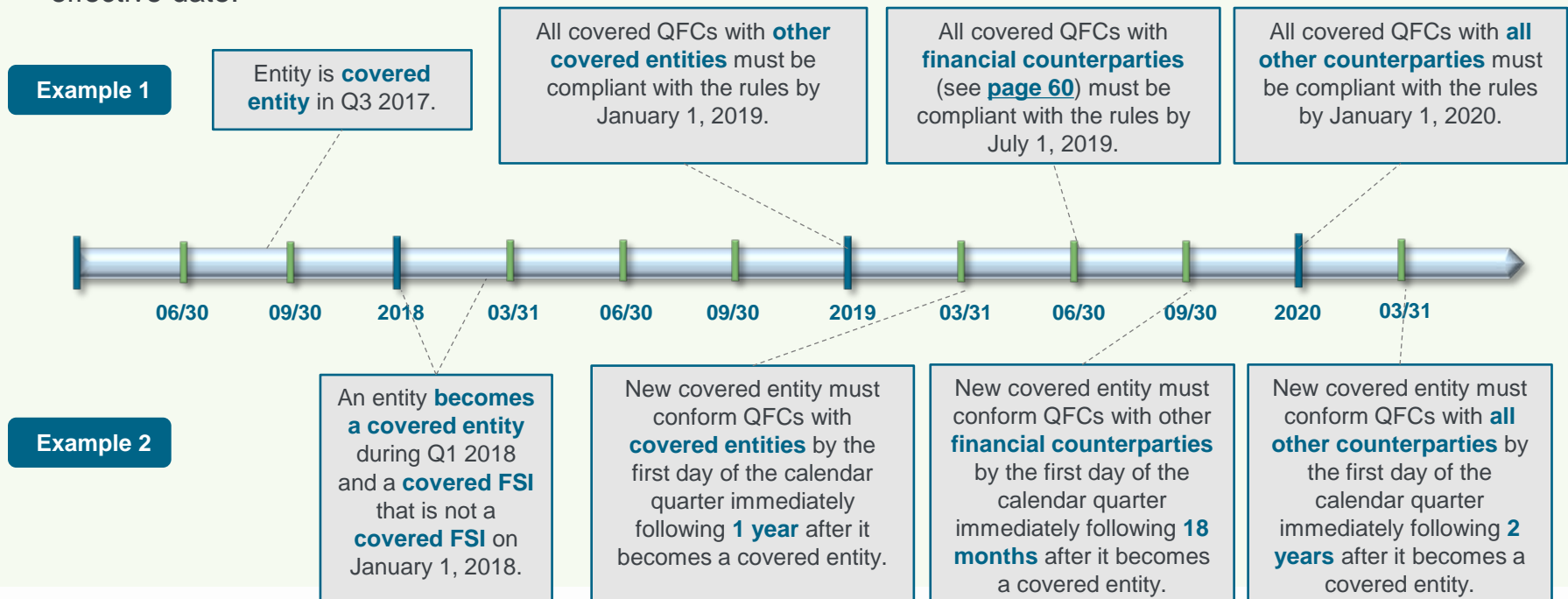
Phased-In Compliance Period

- **Counterparty Type.** The QFC Stay Rules provide for a phased-in compliance period based on counterparty type.
 - **1st Wave.** Covered entities will have to conform covered QFCs with other covered entities by **January 1, 2019**.
 - **2nd Wave.** Covered entities will have to conform covered QFCs with financial counterparties other than small financial institutions (see [page 58](#)) as defined in the rules by **July 1, 2019**.
 - **3rd Wave.** Covered entities will have to conform covered QFCs with **all other counterparties**, including general corporate counterparties, small financial institutions, central banks and sovereign entities, by **January 1, 2020**.
- **Interaction between the Compliance Schedule and the Trigger for Retroactive Remediation.** Despite incorporating a phased-in compliance schedule, the QFC Stay Rules treat continued trading (of **any QFC**, not just in-scope QFCs) after the first compliance date (**January 1, 2019**) as the trigger for requiring remediation of existing QFCs with all counterparty types. The phased-in compliance period only affects the deadline by which a covered QFC must be made compliant with the rules' requirements.
 - For example, if a covered entity enters into a QFC with a general corporate counterparty on January 1, 2019, the new QFC and all existing QFCs entered into with the corporate counterparty or the corporate counterparty's consolidated affiliates before January 1, 2019 are covered QFCs that must be conformed to the rules by no later than **January 1, 2020**.

Small financial institution is defined in the rule as an insured bank, an insured savings association, a farm credit institution, or a credit union with assets of \$10bn or less.

Phased-In Compliance Period

- Phased-In Compliance Period.** The QFC Stay Rules provide for a phased-in compliance period based on counterparty type.
- New covered entities.** An entity that becomes a covered entity after the final rules are issued will benefit from a similar phased-in compliance period, as illustrated below. There is no phased-in compliance period, however, for an existing covered entity that becomes an affiliate of another covered entity group after the effective date.



Definition of Financial Counterparty

Under the QFC Stay Rules, the definition of **financial counterparty** includes the counterparty types listed below:

- A bank holding company or an affiliate thereof;
- A savings and loan holding company;
- A U.S. intermediate holding company established or designated for purposes of compliance with a final rule;
- A nonbank financial company supervised by the Federal Reserve;
- A depository institution;
- An organization organized under the laws of a foreign country that engages directly in the business of banking in the U.S.;
- A Federal or State credit union;
- An institution that functions solely in a trust or fiduciary capacity;
- An industrial loan company, an industrial bank, or other similar institution;
- A state-licensed or state-registered credit or lending entity (including a finance company, among others, but excluding entities registered or licensed solely on account of financing the entity's direct sales of goods or services to customers);
- A state-licensed or state-registered money services business;
- A regulated entity under the Federal Housing Enterprise Financial Safety and Soundness Act or for which the Federal Housing Finance Agency is the primary federal regulator;
- Any institution chartered in accordance with the Farm Credit Act;
- A CFTC-registered swap dealer or major swap participant;
- A SEC-registered security-based swap dealer or major swap participant;
- A securities holding company;
- A broker or dealer;
- An investment adviser;
- A registered investment company;
- A business development company;
- A private fund, an entity that relies on Section 3(c)(5) exemption from the Investment Company Act, and any issuer that is deemed not to be an investment company pursuant to Investment Company Act Rule 3a-7;
- A commodity pool, a commodity pool operator or a commodity trading advisor;
- A floor broker or a floor trader;
- An introducing broker;
- A futures commission merchant;
- An employee benefit plan, including a government plan;
- An entity organized as an insurance company or subject to supervision as such by a State or foreign insurance regulator; and
- Any entity that would be a financial counterparty as defined in this list were it organized under the laws of the U.S.

This definition is the same as that in the **CFTC's Margin Rule**.

IX. Amendments to Definitions in the Capital and Liquidity Rules

Amendments to Definitions in the Capital and Liquidity Rules

- The QFC Stay Rule makes **technical amendments** to certain definitions in the capital rules and the liquidity coverage ratio (**LCR**) rule related to the recognition of **netting agreements** and **collateral**.
 - Each of the agencies makes similar technical amendments to the relevant definitions in their own capital rules and LCR rule.
- Under the agencies' **capital rules**, a banking organization is permitted to recognize, for the purpose of calculating its own capital requirements, the risk-mitigating benefits of **financial collateral** and **netting agreements** for certain collateralized transactions, provided that the relevant agreements provide the banking organization with certain enforceable **default rights**.
- **Absent these amendments**, for a QFC counterparty that is itself a banking organization subject to the capital and LCR rules, a covered entity's compliance with the general prohibitions under the proposed rule would deny the banking organization counterparty the benefits of netting and collateral recognition for its own capital and LCR requirements.

Capital and Liquidity Benefits of Netting and Collateral Recognition: Recognizing netting and collateral arrangements for capital purposes generally reduces the amount of capital that banking organizations must maintain against the credit risk of repo and securities lending and borrowing transactions, margin loans and OTC derivatives. Banking organizations can also net derivatives cash inflows and outflows under netting agreements for LCR purposes.



The technical amendments would preserve the banking organization counterparty's capital and LCR treatment of the QFC, which otherwise would have been affected by the covered entity's compliance with the QFC Stay Rule.

- The Federal Reserve stated that that this treatment (absent any amendments) would **not accurately reflect the risk** posed by the affected QFCs, since the implementation of consistent restrictions on default rights in G-SIB QFCs would increase the prospects for the orderly resolution of a failed G-SIB and thereby protect U.S. financial stability.

Amendments to Definitions in the Capital and Liquidity Rules

- **General “No-Stay” Requirement:** Under the relevant definitions, banking organizations can generally only recognize collateralized transactions and netting agreements where the banking organization’s rights to the collateral or under the netting agreements **cannot be stayed or avoided** under applicable law in the event of the counterparty’s default, including the counterparty’s bankruptcy.
- The capital and LCR rules also provide for **exceptions** to this general “no-stay” requirement to accommodate certain **restrictions on default rights** that are important to the prudent resolution of the counterparty, including a **limited stay under a special resolution regime** such as OLA, the FDI Act and comparable foreign resolution regimes.
- The QFC Stay Rules amended the relevant definitions to **extend the no-stay exceptions** to accommodate the restrictions on certain default rights required under the final rule.
- As amended, the no-stay exceptions permit restrictions where the banking organization’s relevant **default rights**—that is, the rights to accelerate, terminate and closeout on a net basis all transactions under the related collateral or netting agreement and to liquidate or set off collateral promptly upon an event of default of the counterparty—are **limited to the extent necessary to comply** with the QFC Stay Rules’ general prohibitions on cross-defaults and transfers.

Definitions Amended: The QFC Stay Rules amend the following defined terms in each of the agencies’ capital rules:

- Collateral agreement;
- Eligible margin loan;
- Qualifying master netting agreement; and
- Repo-style transaction.

The final rules also amend the definition of qualifying master netting agreement in each agencies’ LCR rule.

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Appendix: Comparison to Section 2 of the Protocols

Appendix: Comparison to Section 2 of the Protocols

Topic	Requirements Under the Protocols	Final Rule Requirements
<p>General Prohibition on Cross-Default Rights</p>	<p>Default rights related directly or indirectly to an affiliate of the direct party becoming subject to U.S. insolvency proceedings under Chapters 7 or 11 of the Bankruptcy Code, SIPA or the FDI Act are not exercisable.</p>	<p>Default rights related directly or indirectly to an affiliate of the direct party becoming subject to any insolvency proceeding, including a foreign proceeding.</p>
<p>Creditor Protection – Direct Default Rights</p>	<p>A counterparty may still exercise direct default rights when:</p> <ul style="list-style-type: none"> • The direct party becomes subject to insolvency or resolution proceedings (other than special resolution regimes subject to the contractual recognition provisions of Section 1 of the Universal Protocol); • The direct party fails to satisfy a payment or delivery obligation under the QFC; or • The covered support provider, e.g., parent or affiliate guarantor, fails to satisfy a payment or delivery obligation under the covered credit support. 	<p>As described on page 39, a counterparty may exercise substantially similar direct default rights.</p>
<p>Creditor Protection – Cross-Default Rights for Supported QFCs</p>	<p>Default right overrides apply only if the insolvency proceedings to which the covered support provider has become subject are Chapter 11 proceedings (or, in the case of a covered support provider that is an IDI, a proceeding under the FDI Act). Otherwise, counterparty under supported QFC may terminate immediately.</p>	<p>As described on page 41, the QFC Stay Rules have a substantially similar limitation, but it applies only if there is no transfer of the covered credit support. In addition, the counterparty must still wait until the end of the stay period before terminating.</p>

The Universal Protocol does not prohibit the exercise of cross-defaults related to an affiliate's **foreign insolvency proceedings** unless the U.S. parent first enters U.S. insolvency proceedings. The scope of domestic proceedings covered under the QFC Stay Rules are also broader.

Appendix: Comparison to Section 2 of the Protocols

Topic	Requirements Under the Protocols	Final Rule Requirements	
Stay Conditions If Covered Credit Support Is Not Transferred	By the end of the stay period , the bankruptcy court must enter the following: <ul style="list-style-type: none"> An order providing that the parent remains obligated with respect to the covered credit support and all covered contracts between the direct party and the counterparty, as well as all covered contracts between the direct party and the counterparty's affiliates, to the same extent as prior to the proceeding. 	Substantially similar, except the QFC Stay Rules refer to the " same or similar extent " and no court order is required.	The stay period has the same definition under both the Universal Protocol and the QFC Stay Rules.
	<ul style="list-style-type: none"> An order elevating claims under the guarantee or other credit support to administrative priority status. 	No comparable requirement.	
	<ul style="list-style-type: none"> An order authorizing the parent to perform its obligations under the covered credit support and allowing the counterparty to terminate its covered contract with the direct party without court approval if the direct party or the parent support provider fails to meet any of its material obligations to the counterparty under the covered contract or related covered credit support. 	No comparable requirement.	
	<ul style="list-style-type: none"> An order authorizing the counterparty to exercise its default rights if there has been a closeout of a covered contract between the same direct party (i.e., the same operating subsidiary) and another stayed counterparty, and the direct party fails to pay the closeout amount thereunder when due and the parent support provider also fails to satisfy its obligations when due under any related covered credit support. 	No comparable requirement.	

Appendix: Comparison to Section 2 of the Protocols

Topic	Requirements Under the Protocols	Final Rule Requirements
Stay Conditions If Covered Credit Support Is Transferred	<p>The transferee must be either:</p> <ul style="list-style-type: none"> • A bridge company established for the purpose of being a transferee of the assets of the parent in Chapter 11 proceedings, that is not controlled by the bankrupt parent’s estate; or • An unaffiliated third party that would be required to satisfy any ratings conditions or other financial covenants applicable to the covered support provider under the contract. 	<p>No comparable requirement.</p>
	<p>The transferee must satisfy all material payment and delivery obligations to each of its creditors during the stay period.</p>	<p>No comparable requirement.</p>
	<p>By the end of the stay period, the bankruptcy court must have issued an order providing for the transfer or sale to the transferee of all or substantially all of the assets of the covered support provider (or the net proceeds thereof), minus a holdback for the costs of administering the estate, “as soon as practicably possible.”</p>	<p>No court order required, but the counterparty may exercise its default rights after the stay period if reasonable assurances were not provided that all or substantially all of the assets of the covered support provider (or the net proceeds thereof), minus a holdback for the costs of administering the estate, will be transferred or sold to the transferee in a timely manner. See page 45.</p>
	<p>All of the direct and indirect ownership interests held by the covered support provider in the direct party must be transferred to the transferee by the end of the stay period.</p>	<p>As described on page 45, the QFC Stay Rules have a substantially similar requirement.</p>
	<p>All of the covered credit support for the supported contracts between the counterparty and the direct party and between the counterparty’s affiliates and the direct party must be transferred to the transferee by the end of the stay period.</p>	<p>As described on page 41 and page 44, the QFC Stay Rules have a substantially similar requirement.</p>

Appendix: Comparison to Section 2 of the Protocols

Topic	Requirements of the Protocols	Final Rule Requirements
	<p>If the transferred credit support is secured, the transferee must comply with all provisions regarding attachment, enforceability, perfection and priority of the security interest.</p>	<p>No comparable requirement.</p>
	<p>The transferee must not be in insolvency or resolution proceedings.</p>	<p>As described on page 41 and page 43, the QFC Stay Rules have a substantially similar requirement.</p>
<p>Stay Conditions for all Supported QFCs – Direct Party Must Remain Duly Licensed</p>	<p>Following the stay period, the direct party must be and remain duly registered and licensed with the same regulatory agencies that have principal supervisory authority over the relevant business.</p>	<p>No comparable requirement.</p>
<p>Creditor Protection – Cross-Default Rights under FDI Act Proceedings</p>	<p>If the covered support provider is an IDI, and the covered credit support is transferred to a bridge company or other transferee pursuant to the FDI Act, the counterparty is subject to the same default right limits as if it were party to a direct QFC with the IDI.</p>	<p>As described on page 46, the QFC Stay Rules have a substantially similar requirement.</p>

Appendix: Comparison to Section 2 of the Protocols

Topic	Requirements of the Protocols	Final Rule Requirements	
<p>Burden of Proof</p>	<p>For the counterparty to exercise a default right, it must prove by clear and convincing evidence that the default right is not related, directly or indirectly, to an affiliate becoming subject to U.S. insolvency proceedings.</p>	<p>As described on page 48, the QFC Stay Rules require that a covered QFC must provide that, after an affiliate of the direct party enters insolvency proceedings, the party seeking to exercise any default right must bear the burden of proof, by clear and convincing evidence or a similar or higher burden of proof, that the exercise of the default right is permitted under the covered QFC.</p>	<p>The Universal Protocol's application is narrower than the QFC Stay Rules here. The QFC Stay Rules also apply this burden of proof to direct default rights, unlike the Universal Protocol.</p>
<p>Transfer Restrictions</p>	<p>Contractual rights prohibiting the transfer of covered credit support are overridden.</p>	<p>As described on page 34 the QFC Stay Rules have a substantially similar requirement.</p>	