**MEMORANDUM TO:** Board of Directors

**FROM:** Bret D. Edwards
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Division of Resolutions and Receiverships

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**SUBJECT:** Final Rule Regarding the Recordkeeping Requirements for Qualified Financial Contracts -12 CFR Part 371

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**RECOMMENDATION:** That the Board of Directors (the "Board") of the Federal Deposit Insurance Corporation (the "FDIC") adopt and approve the publication of the attached Final Rule (the "final rule") titled *Recordkeeping Requirements for Qualified Financial Contracts*. The final rule amends and restates in its entirety 12 CFR Part 371 ("Current Part 371"), which was adopted by the Board in December, 2008.

**INTRODUCTION:** The Board adopted Current Part 371 in order to implement 12 U.S.C. 1821(e)(8)(H), which authorizes the FDIC, in consultation with the other federal banking agencies, to prescribe regulations requiring detailed recordkeeping with respect to qualified financial contracts ("QFCs") by insured depository institutions ("IDIs") in a troubled condition. The information is important to the FDIC in the event that such an IDI subsequently fails, as it enables the FDIC, as receiver, to make informed decisions with respect to the treatment of QFCs during the one-business-day stay period provided with respect to these contracts under the Federal Deposit Insurance Act.[1]

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[1] *See* 12 U.S.C. 1821(e)(10)(B).

Current Part 371 sets forth the process by which an IDI becomes subject to its recordkeeping requirements. Current Part 371 also sets forth, in table form, the QFC information that an IDI subject to the rule must maintain.

On December 28, 2016, the FDIC published a Notice of Proposed Rulemaking (the "NPR") which set forth a proposed rule (the "proposed rule") to amend and restate Current Part 371 in its entirety. The proposed modifications to Part 371 set forth in the proposed rule would have made certain changes to the recordkeeping requirements to conform recordkeeping requirements for certain IDIs to the comparable requirements of certain financial companies under the QFC recordkeeping rule adopted by the Treasury Department.[2] The proposed rule would also have updated the recordkeeping requirements for other IDIs and made other changes as discussed below.

In response to a comment letter received in respect of the NPR, the final rule contains several changes from the proposed rule, which are discussed below. As required by the governing statute (12 U.S.C. 1821(e)(8)(H)), FDIC staff has consulted with staff of the Board of Governors of the Federal Reserve System and the Office of Comptroller of the Currency regarding the final rule. Staff of the other banking agencies raised no objection to the final rule.

## DISCUSSION:

### I. General Background

In the eight and one-half years since Current Part 371 was adopted, the FDIC has obtained QFC information pursuant to Current Part 371 from many IDIs in a troubled condition ranging in size from large, complex institutions to small community banks. This information has

[2] 31 CFR part 148.

proved useful to the FDIC as receiver in making informed decisions relating to the QFCs of failed IDIs and in planning for the resolution of IDIs in a troubled condition.

On October 31, 2016, the Department of the Treasury published 31 CFR Part 148 ("Part 148"), which was formulated in consultation with FDIC staff and implements Section 210(c)(8)(H) of the Dodd-Frank Wall Street Reform and Customer Protection Act (the "Dodd-Frank Act").[3] Part 148 sets forth QFC recordkeeping requirements for FSOC-designated systemically important financial companies and their affiliates, other global systemically important bank holding company corporate groups, and other financial company corporate groups of which at least one member has total consolidated assets of $50 billion or more and, on a consolidated basis, a QFC portfolio that meets certain size thresholds.[4] The recordkeeping requirements of Part 148 are more extensive than those under Current Part 371 and were adopted on the recommendation of FDIC staff based on its experience under Current Part 371 in reviewing records maintained by certain large institutions with complex QFC portfolios. This experience also reinforced staff's understanding that large IDIs are likely to have complex QFC portfolios. The additional data required by Part 148, which, among other data sets, includes detailed information about collateral, guarantees and credit enhancements, will significantly enhance the ability of the FDIC, as receiver under Title II of the Dodd-Frank Act, to judiciously

[3] 12 U.S.C. 5390(c)(8)(H).

[4] Part 148 subjects to its recordkeeping requirements any financial company (other than an excluded entity as defined in 31 CFR 148.2(f) or one that has no QFCs) that (i) is subject to a determination that the company shall be subject to Federal Reserve supervision and enhanced prudential standards pursuant to 12 U.S.C. 5323; (ii) is subject to a designation as, or as likely to become, systemically important pursuant to 12 U.S.C. 5463; (iii) is identified as a global systemically important bank holding company pursuant to 12 CFR Part 217; or (iv) has total assets on a consolidated basis equal to or greater than $50 billion, and on a consolidated basis has (1) total gross notional derivatives outstanding equal to or greater than $250 billion or (2) derivative liabilities equal to or greater than $3.5 billion. Part 148 also requires that QFC records be maintained for all members of the corporate group (other than any excluded entity or a company with no QFCs) of any such financial company.

exercise its rights and responsibilities relating to QFCs within the statutory one-business-day stay.

Part 148's recordkeeping requirements do not apply to the QFCs of IDIs that are members of these corporate groups since QFC recordkeeping of IDIs is governed by Part 371.[5]

## II. Changes to Part 371 included in NPR

### A. QFC Information for Large IDIs in a Troubled Condition and IDIs in a Troubled Condition that are part of Part 148 Reporting Groups

Under the proposed rule, IDIs in a troubled condition with $50 billion or more in total consolidated assets and IDIs in a troubled condition that are members of corporate groups that are subject to Part 148 ("Part 148 affiliates") would have been required to maintain the same QFC information, in form and substance, as that required by Part 148. Part 148, as compared to Current Part 371, requires the maintenance of more QFC information in a format more aligned with current technology. Such expanded recordkeeping is appropriate for large IDIs because such IDIs are more likely to have complex and extensive QFC portfolios. Staff believes that such expanded recordkeeping also is appropriate for IDIs that are Part 148 affiliates, regardless of the size of such IDIs, in order to ensure consistency of reporting across the entire corporate group. Harmonizing the Part 371 requirements with the Part 148 requirements will enable IDIs that are Part 148 affiliates to lower the cost of complying with Part 371 by enabling such IDIs to comply with Part 371 by using the information technology infrastructure developed by their affiliates to comply with Part 148. Consistency of reporting across the corporate group will also enable the FDIC to better analyze how an IDI's QFC positions relate to QFC positions of other

[5] The Part 148 recordkeeping requirements also do not apply to subsidiaries of IDIs that are not (i) functionally regulated (as defined in 12 U.S.C. 1844(c)(5)); (ii) security-based-swap dealers as defined in 15 U.S.C. 78c(a)(71)); or (iii) major security-based swap participants (as defined in 15 U.S.C. 78c(a)(67)).

receivership and could be especially valuable since Part 148 does not require that information be maintained as to reportable subsidiaries.

### B. QFC Information for Smaller IDIs

The proposed rule proposed to make limited changes to the QFC recordkeeping requirements for smaller, "limited scope" IDIs (less than $50 billion in total assets and not a Part 148 affiliate), as it is less likely that these IDIs would have QFC positions of a magnitude and complexity that would justify the added burden of subjecting them to the more extensive recordkeeping requirements for larger IDIs. Accordingly, two new tables that include detailed information as to collateral and provisions of governing agreements and that would be required to be maintained by other IDIs were not proposed to be required from smaller IDIs that are not members of corporate groups subject to Part 148. The two data tables that correspond to the tables set forth in Current Part 371 were proposed to be applicable to smaller IDIs under the proposed rule with modifications that enhance their usefulness. The changes include several new rows that require additional information. Most of this new information, while not expressly required under Current Part 371, is information that an IDI would maintain in order to provide the data required under Current Part 371. It is possible, however, that in some instances the new data proposed to be maintained may not be maintained by smaller entities under Current Part 371. For example, the NPR proposed that the next margin payment date and the amount of such payment be required to be set forth in the data tables. Some smaller IDIs may not themselves track these requirements in advance of a margin call being made, although this information should be readily accessible to them.

The proposed rule also included revised tables with rows for information as to QFCs that are themselves guarantees or other types of credit enhancements, including information as to the

members of the corporate group and thus will provide useful information in the receivership of the IDI.

The principal new QFC information requirements for these institutions under the proposed rule were (i) new tables that require specified information about the governing agreement for each QFC, including governing law and whether the agreement includes a cross-default to a third party; (ii) tables that require more detailed information about collateral, including the location of the collateral and a breakdown of collateral by item type; (iii) information about guarantees and other credit enhancements and, in the case of QFCs that are themselves guarantees or other credit enhancements, information about the QFCs that are guaranteed or credit-enhanced; (iv) information as to the next margin payment date; (v) identification of the governing master agreement or other netting agreement; (vi) information as to the entity holding the collateral for the QFCs; (vii) information about other positions to which a QFC relates, such as a loan whose interest rate is hedged by the QFC; (viii) a table for each counterparty (the "Counterparty Table") listing the parent entities of the counterparty, in lieu of the Current Part 371 requirement that the IDI provide a list of affiliates of a counterparty with which it has entered into QFCs; and (ix) a table for the IDI and each of its affiliates (the "Corporate Organizational Table") listing the parent entities of the IDI and its affiliates, in lieu of the organizational chart required by Current Part 371.

The proposed rule would have required these IDIs also to report QFC information for subsidiaries ("reportable subsidiaries") that are not functionally regulated subsidiaries, security-based swap dealers or major security-based swap participants. This information would enable the FDIC to analyze positions of other members of a corporate group that may affect an IDI in

guarantor and the underlying guaranteed QFCs, and new rows relating to credit enhancements issued in favor of the IDI. This information is not required to be set forth in the data tables of Current Part 371 but is the type of information that would be expected to be maintained in the ordinary course of business and be readily available to an IDI. Likewise, the proposed rule would have required information as to positions of the IDI or an IDI affiliate to which the QFC relates, as well as information as to the trade date of the QFC, all of which is information that would be expected to be maintained by and readily available to the IDI. Similarly, while the Counterparty Table and Corporate Organization Table (including, in each case, the required identification of immediate and ultimate parent entities) are new, these Tables were proposed in lieu of affiliation information required, in a different form, by Current Part 371. The proposed rule also would have eliminated requirements for information that has proved unclear or not useful under Current Part 371, specifically, the description of the purpose of a position and the documentation status of the position.

The proposal also would have required that the information be maintained in the same format as the longer tables for larger banks, which is more flexible and makes better use of available technology. For example, the shorter tables for smaller banks would include two "look-up" tables (the longer tables would include four look-up tables), where information common across tables or rows would be entered once in a look-up table to ensure consistency and reduce error and thus allow repetitive data to be updated throughout the tables by simply making a single change in the applicable look-up data table entry. These two proposed look-up tables would provide information that is included in the IDI organization chart and lists of counterparty and IDI affiliates required under Current Part 371 and, accordingly, the proposed

rule proposed to eliminate the requirements for delivery of an organization chart and lists with information as to counterparty and IDI affiliates.

Overall, the proposed revisions increased the reporting requirements on institutions that have $50 billion or more in total consolidated assets or are a member of a corporate group required to conform to the Part 148 recordkeeping requirements. For limited scope IDIs, the proposed revisions included significantly fewer revisions to the requirements under Current Part 371 and were not expected to cause significant additional burden to smaller institutions that do not have complex QFC portfolios.

### C. Cease and Desist Orders and Written Agreements to Improve Financial Condition

As noted above, by law, QFC recordkeeping is required only with respect to IDIs "in a troubled condition." No change was proposed to the definition of "troubled condition." That definition includes IDIs with composite ratings of 4 or 5 and, for IDIs with $10 billion of more in total consolidated assets, composite ratings of 3; IDIs subject to proceedings for the suspension or termination of deposit insurance; IDIs subject to cease-and-desist orders or written agreements, or proceedings contemplating the same, requiring action to improve financial condition; IDIs that are informed that they are in troubled condition for purposes of 12 U.S.C. 1831i; and IDIs that have been determined to be experiencing significant deterioration of capital, significant funding difficulties or liquidity stress.[6] Although, in practice QFC recordkeeping requirements have been imposed primarily on the basis of an IDI's composite rating, one of the five prongs of the definition of troubled condition in Current Part 371 is that an IDI is subject to a cease-and-desist order or written agreement issued by its appropriate federal banking agency

[6] This definition is based on the definition of troubled condition under 12 CFR 303.101(c), which requires from institutions in troubled condition and certain other IDIs advance notice of appointment of directors or senior executive officers.

that requires action to improve its financial condition or is subject to a proceeding initiated by such agency that contemplates the issuance of such an order. The preamble to the proposed rule as well as the preamble to the final rule provide additional background on what constitutes an order or agreement to improve financial condition to make clear that such an order or agreement can include consent agreements and stipulations and to clarify that cease-and-desist orders, written agreements, consent orders, and stipulations can be construed as requiring improvement to the financial condition of an IDI even if they do not specifically refer to the IDI's financial condition or need to raise additional capital.

### D. Time for Compliance with Part 371

Current Part 371 requires IDIs to comply with the recordkeeping requirements of the regulation within 60 days after written notification by the institution's appropriate federal banking agency or the FDIC that it is in troubled condition under Part 371 or to obtain one or more extensions of up to 30 days each. Each extension must be requested no less than 15 days prior to the then-current deadline for compliance. Based on the FDIC's experience, large banks that have become subject to Current Part 371 may require 270 days or more to comply with the recordkeeping requirements. The need for FDIC staff and, in most cases, for the Board, to consider these extension requests each month has proved cumbersome and time-consuming. The NPR proposed to retain the current timing requirements for all accelerated records entities, i.e., IDIs with a composite 4 or 5 rating or that are determined by their appropriate federal banking agency or the FDIC to be experiencing significant deterioration of capital or significant funding difficulties or liquidity stress. For these IDIs, for which the risk of near-term failure is greater than for other IDIs in troubled condition, the value of retaining the 60-day compliance deadline and 30-day extension period outweighs the administrative burden of the process. However, for

other entities, the NPR proposed to provide for a 270-day compliance period, with extension periods of up to 120 days each. These longer time periods are appropriate for an IDI with a composite rating of 3 or that does not otherwise meet the definition of accelerated records entity. It should be noted that only institutions with $10 billion or more in total assets may be deemed to be "in a troubled condition" based upon a composite rating of "3." These institutions are more likely to have larger and more complex QFC portfolios that will require the additional time to satisfy the recordkeeping requirements. Under the rule as proposed in the NPR, all requests for extension must include a description of the progress toward compliance and a plan for completion.

### E. Process by which an IDI Becomes Subject to Part 371

Under Current Part 371, an IDI must comply with the recordkeeping requirements of the regulation following written notification by the institution's appropriate federal banking agency or the FDIC that it is in troubled condition under Part 371. As proposed in the NPR, the rule would specify that an IDI does not become subject to the recordkeeping requirements of Part 371 until it receives (i) written notice from the appropriate federal banking agency or the FDIC that the institution is in troubled condition and (ii) written notice from the FDIC that the IDI is subject to Part 371. Requiring that the FDIC notify the IDI that it is subject to the recordkeeping requirements of Part 371 will make it clear to IDIs in a troubled condition when they must begin to comply with Part 371. In addition, it will facilitate efficient administration of Part 371 by the FDIC.

### F. Transition Provisions

The proposed rule included transition provisions for larger IDIs that are subject to the recordkeeping requirements of Current Part 371 at the time the amendments to Current Part 371

become effective. Smaller, limited scope IDIs that are subject to the recordkeeping requirements of Current Part 371 at the time the amendments become effective would not be affected by the amendments and could choose to comply with Current Part 371 as in effect immediately prior to the final rule becoming effective.

For larger IDIs, the NPR differentiated between those larger IDIs that are and are not maintaining the records required by Current Part 371 at that time. The larger IDIs that are maintaining records as required by Current Part 371 immediately prior to the effective date of the amendments to Current Part 371 would have 270 days (or, if the IDI is an accelerated records entity, 60 days) following the effective date of the amendments to comply with Part 371 as amended. In the interim, such IDIs would be required to continue the recordkeeping required by Current Part 371. Larger IDIs that are not maintaining the records required by Current Part 371 immediately prior to the effective date of the amendments to Current Part 371 would have 270 days (or, for accelerated records entities, 60 days) from the date they first became subject to Current Part 371 to comply with the revised recordkeeping requirements of Part 371.

### G. Other Changes

The proposed rule included several other less significant revisions to Part 371. These include (among others) clarification that, for end-of-day values for any day, an IDI must be capable of providing QFC records to the FDIC no later than 7:00 am on the following day, provided that the FDIC gives at least eight hours advance notice, and a requirement that the IDI maintain each set of daily records for at least five business days. The attached preamble to the final rule gives a full description of all significant changes included in the final rule.

## III. **Comments on the Proposed Rule.**

The FDIC received one comment letter, submitted by two industry trade associations, in response to the NPR. The letter (the "TCH/SIFMA Letter") was strongly supportive of the proposal to harmonize the recordkeeping requirements applicable to full scope entity IDIs under Part 371 with the recordkeeping requirements under Part 148 applicable to other entities in the same corporate group and stated that "[s]uch harmonization is important as a matter of sound policy and as a practical matter for our members."

The TCH/SIFMA Letter suggested several changes to the proposed rule. FDIC staff found many of the suggestions to be useful and the final rule includes changes, discussed under "*IV. The Final Rule*" below, that were made in response to the Letter.

The TCH/SIFMA Letter proposed other changes, discussed in detail in the attached preamble to the final rule, that staff did not find appropriate. These include a proposal that exemptions from recordkeeping granted by the Treasury Department under Part 148 automatically apply under Part 371 unless the FDIC expressly prohibits their applicability; a proposal that the *de minimis* exception to the recordkeeping requirements, under which IDIs with less than a specified number of QFCs are exempted from the requirement that records be kept electronically, exempt an IDI from all recordkeeping requirements; a proposal that only entities with QFC activity above specified thresholds be treated as full scope entities; a proposal that the NPR's requirement that an IDI maintain QFC records relating to certain subsidiaries' QFCs not be included in the final rule; a proposal that the period for compliance with Part 371 by full scope IDIs be extended beyond the 270 day period proposed in the NPR; a proposal that reporting of certain QFCs, such as short-dated cash transactions, exchange traded products, spot foreign exchange transactions and transactions with retail customers, be exempted from the rule;

and a proposal that the final rule not continue (as under Current Part 371) to define affiliates of counterparties by using the Bank Holding Company Act definition used in the FDIA to determine affiliates for purposes of the all or none QFC transfer rule, but instead determine counterparty affiliates using a consolidation standard. In general, these comments do not take into account the differences between Part 371 and Part 148, in particular, the fact that an IDI does not become subject to Part 371 until it is in troubled condition and, thus, when failure of the institution is not merely a distant, theoretical possibility. Part 148, on the other hand, applies to members of large corporate groups with significant QFC activity regardless of whether the companies are encountering problems or are under any sort of special regulatory scrutiny. In addition, some of the comments do not take into account the fact that the term "QFC" and the term "affiliate" are defined by statute and, thus, in order to fully comply with governing statutes the FDIC must use the statutory definitions. Finally, the comment requesting that exemptions under Part 148 automatically apply to Part 371, absent action to the contrary by the FDIC, ignores the importance of the FDIC administering its own regulations without qualification by virtue of action by a different governmental entity. The analysis of these points is set forth in detail in the attached preamble to the final rule.

## IV. **The Final Rule**

The final rule reflects the following changes from the proposed rule made in response to the TCH/SIFMA Letter:

- The final rule contains a process by which an IDI that becomes subject to Part 371 can request exemptions from one or more recordkeeping requirements. This change will give the FDIC useful flexibility in administering Part 371 and will

enable the FDIC, if it deems it to be prudent, to extend exemptions granted under Part 148 to an IDI subject to Part 371;

- The final rule increases the ceiling, from 19 QFC positions to 50 QFC positions, for applicability of the *de minimis* exception to the requirement that records be kept electronically;
- The final rule excludes, from the universe of IDI subsidiaries as to which an IDI subject to Part 371 would be required to maintain QFC records, foreign subsidiaries and unconsolidated subsidiaries;
- The time for compliance with Part 371, as revised by the final rule, for most IDIs that are consolidated affiliates of a company that is a member of a corporate group that is subject to Part 148 is extended until the compliance date under Part 148 for other members of the corporate group, if the IDI is subject to Part 371 at the time the final rule becomes effective and is in compliance with Part 371 as in effect immediately prior to the time when the final rule becomes effective, provided that the IDI is not an accelerated records entity; and
- The final rule would use a standard based on consolidation with a company subject to Part 148, rather than the Bank Holding Company Act affiliate definition, to categorize an IDI subject to Part 371 with less than $50 billion in total assets as a full scope entity.

**CONCLUSION:** Staff recommends that the Board approve the final rule and authorize publication of the final rule in the *Federal Register*.

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