

FEDERAL RESERVE SYSTEM

12 CFR Part 237

Docket No. R-1458; RIN 7100 AD 96

Prohibition Against Federal Assistance to Swaps Entities (Regulation KK)

AGENCIES: Board of Governors of the Federal Reserve System (“Board”)

ACTION: Final rule.

SUMMARY: The Board is adopting a final rule that treats an uninsured U.S. branch or agency of a foreign bank as an insured depository institution for purposes of section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and establishes a process by which a state member bank or uninsured state branch or agency of a foreign bank may request a transition period to conform its swaps activities to the requirements of section 716 of the Dodd-Frank Act.

DATES: This rule is effective on January 31, 2014.

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SUPPLEMENTARY INFORMATION:

On June 5, 2013, the Board sought comment on an interim final rule that addressed the application of section 716 of the Dodd-Frank Act (“section 716”) to swaps

entities that are uninsured U.S. branches or agencies of foreign banks and established the process by which a state member bank and an uninsured state branch or agency of a foreign bank may request transition period relief in order to conform its swaps activities to the requirements of section 716 (“interim final rule”).

Section 716 generally prohibits the provision of “Federal assistance” to any “swaps entity” with regard to any swap, security-based swap, or other activity of the swaps entity.¹ “Federal assistance” is defined by section 716 to include “advances from any Federal Reserve credit facility or discount window that is not part of a program or facility with broad-based eligibility under section 13(3)(A) of the Federal Reserve Act” and Federal Deposit Insurance Corporation (“FDIC”) insurance or guarantees.² For purposes of section 716, the term “swaps entity” generally includes any swap dealer, security-based swap dealer, major swap participant, or major security-based swap participant that is registered under the Commodity Exchange Act or the Securities Exchange Act of 1934, as applicable.³

Section 716 includes several provisions applicable to insured depository institutions. It provides a specific exclusion from the definition of “swaps entity” for any insured depository institution that is a major swap participant or major security-based swap participant,⁴ and provides that the prohibition on Federal assistance does not apply to an insured depository institution that limits its swaps activities to certain specified

¹ See Section 716(a) of the Dodd-Frank Act; 15 U.S.C. § 8305(a).

² Section 716(b) of the Dodd-Frank Act; 15 U.S. C. § 8305(b).

³ *Id.*

⁴ *Id.* This exclusion is available to major swap participants and major security-based swap participants that are not otherwise swap dealers or security-based swap dealers.

activities.⁵ Section 716 provides insured depository institutions with a transition period to facilitate compliance with the requirements of the section. By its terms, section 716 applies to insured depository institutions only with respect to swaps and security-based swaps entered into after the expiration of the transition period.

The provisions of section 716 became effective on July 16, 2013.⁶

I. Description of Final Rule

A. Treatment of uninsured U.S. branches and agencies of foreign banks

As discussed in the interim final rule, the structure, language, and purpose of section 716 create an ambiguity as to whether the term “insured depository institution” includes uninsured U.S. branches and agencies of foreign banks for purposes of the various provisions of section 716. The term “insured depository institution” is not defined for purposes of these provisions. Section 2 of the Dodd-Frank Act provides that “except as the context otherwise requires...,”⁷ the definition of “insured depository institution” has the same meaning as in the Federal Deposit Insurance Act. “Insured depository institution” is defined by section 3(c)(2) of the Federal Deposit Insurance Act to mean a bank or

⁵ See section 716(d) of the Dodd-Frank Act; 15 U.S.C. § 8305(d). Those identified activities are: (i) hedging and other similar risk-mitigating activities directly related to the activities of the insured depository institution, and (ii) acting as a swaps entity for swaps or security-based swaps involving rates or reference assets permissible for investment by a national bank pursuant to 12 U.S.C. 24(Seventh), other than acting as a swaps entity for non-cleared credit default swaps. Section 716(b)(2) of the Dodd-Frank Act; 15 U.S.C. § 8305(b)(2).

⁶ See Guidance on the Effective Date of Section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 77 FR 27465 (May 10, 2012).

⁷ See section 2(chapeau) and (18)(A) of the Dodd-Frank Act; 12 U.S.C. § 5301 (chapeau) and (18)(A).

savings association the deposits of which are insured by the FDIC, and, for some purposes under section 3(c)(3), an uninsured U.S. branch or agency of a foreign bank.⁸

The interim final rule resolved this ambiguity by providing that the term “insured depository institution” included uninsured U.S. branches and agencies of foreign banks for purposes of section 716.⁹ Accordingly, uninsured branches and agencies of foreign banks are provided the same exceptions and transition period relief as provided to insured depository institutions.

The Board received four comments in response to its invitation for public comment on the interim final rule. Two of these comment letters were from industry groups, one letter was from a public interest group, and one letter was from an individual. Three of the four commenters expressed strong support for the approach taken in the interim final rule. These commenters agreed that section 716 is predicated on the treatment of uninsured U.S. branches and agencies of foreign banks as insured depository institutions for purposes of qualifying for Federal assistance and that similar treatment for purposes of section 716 is consistent with Congressional intent. One of these commenters expressed the view that the treatment in the interim final rule was necessary to secure equal treatment between U.S. banks and uninsured U.S. branches and agencies of foreign banks under the provisions of section 716.

One commenter disagreed with the Board’s analysis and argued that U.S. branches and agencies of foreign banks should not be treated as “insured depository

⁸ See 12 U.S.C. § 1813(c)(2), (c)(3).

⁹ The interim final rule defined the terms branch, agency, and foreign bank by cross-reference to section 1 of the International Banking Act of 1978. 12 U.S.C. § 3101. Insured branches of foreign banks are separately included in the definition of “insured depository institution” under section 3(c)(2) of the Federal Deposit Insurance Act.

institutions” for purposes of section 716. The commenter expressed the view that the purpose of section 716 is to reduce systemic risk. The commenter argued that treating U.S. branches and agencies of foreign banks as insured depository institutions does not achieve that purpose because U.S. branches and agencies are subject to a safety and soundness regime that the commenter asserted is less rigorous than the regime applicable to insured depository institutions. The commenter also argued that U.S. branches and agencies of foreign banks have volatile liability structures and relatively weak capital requirements. For these reasons, the commenter concluded that U.S. branches and agencies of foreign banks should not be treated in the same manner as insured depository institutions and should not be allowed to continue swaps activities pursuant to the same exceptions.

As discussed in the preamble to the interim final rule, the interim final rule’s definition of “insured depository institution” is premised on the fact that, by statute, both uninsured and insured U.S. branches and agencies of foreign banks may receive Federal Reserve advances on the same terms and conditions that apply to domestic insured member banks.¹⁰ Federal Reserve advances are the only type of Federal assistance that causes uninsured U.S. branches and agencies of foreign banks to be affected by section 716.

Congress generally requires the Board to regulate foreign banking organizations in accordance with the principle of national treatment, which means that foreign banking organizations operating in the United States are generally treated no less favorably than similarly-situated U.S. banking organizations, and are generally subject to the same

¹⁰ Section 13(14) of the Federal Reserve Act; 12 U.S.C. § 347d.

restrictions and obligations in the United States that apply to the domestic operations of U.S. banking organizations.¹¹ Congress provided U.S. uninsured branches and agencies of foreign banks with access to Federal Reserve advances on the same terms as insured depository institutions, and has permitted uninsured U.S. branches and agencies to engage in the same activities as insured depository institutions, in furtherance of this principle.¹² Congress did not express an indication to deviate from this principle in the Dodd-Frank Act. Instead, the interim final rule is consistent with Congress's intent to treat U.S. branches and agencies of foreign banks like insured depository institutions for purposes of section 716.¹³

Regarding the commenter's views on the safety and soundness regime applicable to U.S. uninsured branches and agencies of foreign banks, all U.S. branches and agencies are subject to prudential supervision and regulation and must conduct swaps activities in a safe and sound manner. To the extent the safety and soundness regime applicable to uninsured branches and agencies of foreign banks differs from the regime applicable to insured depository institutions, these differences reflect the structural differences between an uninsured branch or agency and an insured depository institution.

Furthermore, the commenter's assertions referred to practices in existence before the Dodd-Frank Act. The Dodd-Frank Act directed the Board to establish enhanced

¹¹ See, e.g., International Banking Act of 1978, Pub. L. 95-369, 12 U.S.C. § 3101 *et seq.*; S. Rep. No. 95-1073 (Aug. 8, 1978) (legislative history of the International Banking Act of 1978); Gramm-Leach-Bliley Act of 1999, Pub. L. 106-102, section 141, 12 U.S.C. § 3106(c); Dodd-Frank Act, Pub. L. 111-203, section 165(b)(2), 12 U.S.C. § 5365(b)(2).

¹² 12 U.S.C. § 347d; 12 U.S.C. § 3106.

¹³ See 156 Cong. Rec. S5904 (daily ed. July 15, 2010) (statement of Sen. Lincoln, the sponsor of section 716, indicating that uninsured U.S. branches and agencies should be treated in the same manner as insured depository institutions).

prudential standards, including enhanced liquidity requirements, in order to prevent or mitigate risks to U.S. financial stability that could arise from the material financial distress or failure, or ongoing activities of foreign banking organizations with total consolidated assets of \$50 billion or more. The Board has issued a proposal to implement those requirements, which included liquidity requirements meant to address risks associated with the funding vulnerabilities the commenter cited.¹⁴ In addition, the Board notes that uninsured branches and agencies of foreign banks are not insured by, and therefore do not pose a threat to, the FDIC's deposit insurance fund.

As such, for purposes of section 716, the Board believes that treating uninsured branches and agencies of foreign banks as insured depository institutions is appropriate. The final rule adopts the interim final rule's definition of insured depository institution without change.

B. Transition period for insured depository institutions and uninsured U.S. branches and agencies of foreign banks

Section 716 provides insured depository institutions with a transition period to conform their activities.¹⁵ Under section 716(f), the appropriate Federal banking agency for an insured depository institution, in consultation with the SEC and CFTC, as appropriate, is required to establish the length of the transition period for conformance with the requirements of section 716. That transition period may be up to 24 months and may be extended for a period of up to one additional year.

¹⁴ 77 FR 76628 (December 28, 2012).

¹⁵ See 15 U.S.C. § 8305(f).

In establishing the length of the transition period for an insured depository institution, the Board is required by statute to take into account and make written findings regarding the potential impact of divestiture or cessation of swap or security-based swaps activities on the insured depository institution's: (i) mortgage lending; (ii) small business lending; (iii) job creation; (iv) capital formation versus the potential negative impact on insured depositors and the Deposit Insurance Fund of the FDIC; and (v) any other factor that the Board believes appropriate to consider.

The interim final rule provided that a state member bank and an uninsured state branch and agency of foreign bank may seek a transition period of up to 24 months from July 16, 2013 (for an entity that is a swaps entity as of July 16, 2013), or from the date on which the entity becomes a swaps entity (if that date occurs after July 16, 2013), by submitting a written request to the Board. The request must include: (i) the length of the transition period requested; (ii) a description of the quantitative and qualitative impacts of immediate divestiture or cessation of swap or security-based swaps activities on the institution, including regarding the potential impact of divestiture or cessation of swap or security-based swaps activities on the institution's mortgage lending, small business lending, job creation, capital formation versus the potential negative impact on insured depositors and the Deposit Insurance Fund of the FDIC; and (iii) a description of the insured institution's plan for conforming its activities to the requirements of section 716.

The interim final rule indicated that the Board may also request additional information that it believes is necessary in order to act on a request for a transition period. The Board will seek to act on a request for a transition period expeditiously after the receipt of a complete request. The final rule allows the Board to impose conditions on

any transition period granted if the Board determines such conditions are necessary and appropriate. Consistent with section 716(f), the final rule also permits the Board, in consultation with the SEC and CFTC, as appropriate, to extend the transition period for up to one additional year. To request an extension of the transition period, an insured depository institution must submit a written request no later than 60 days before the end of the transition period.

Two commenters expressed support regarding the Board's expeditious action on transition period requests submitted in advance of section 716's July 16, 2013, effective date. The commenter indicated that factors governing transition period request determinations prescribed in Regulation KK are appropriate and provide the Board sufficient flexibility to address the particular circumstances presented by individual requests.

The Board is finalizing these transition period procedures as proposed.

II. Administrative Law Matters

A. Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act required the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Board sought to present the interim final rule in a simple and straightforward manner and did not receive any comments on the use of plain language.

B. Paperwork Reduction Act Analysis

In accordance with section 3512 of the Paperwork Reduction Act of 1995 (44 U.S.C. § 3501-3521) (PRA), the Board may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid

Office of Management and Budget (OMB) control number. The OMB control number for this information collection will be assigned. The Board reviewed the final rule under the authority delegated to the Board by OMB. The Board received no comments on the PRA.

The final rule contains requirements subject to the PRA. The reporting requirements are found in sections 237.22(a)(1) and 237.22(e). This information collection requirement would implement section 716 of the Dodd-Frank Act.

Proposed Information Collection

Title of Information Collection: Reporting Requirements Associated with Regulation KK.

Frequency of Response: On occasion.

Affected Public: Businesses or other for-profit.

Respondents: Uninsured U.S. branches or agencies of a foreign bank and state member banks.

Abstract: The final rule would treat an uninsured U.S. branch or agency of a foreign bank as an insured depository institution and establish a process by which a state member bank and uninsured branch or agency of a foreign bank may request a transition period to conform its swaps activities to the requirements of section 716 of the Dodd-Frank Act (15 U.S.C. § 8305).

Section 237.22(a)(1) provides that an insured depository institution for which the Board is the appropriate Federal banking agency may request a transition period of up to 24 months from the later of July 16, 2013, or the date on which it becomes a swaps entity, to conform its swaps activities to the requirements of section 716 of the Dodd-Frank Act by submitting a request in writing to the Board. Any request submitted must,

at a minimum, include the following information: (1) the length of the transition period requested; (2) a description of the quantitative and qualitative impacts of divestiture or cessation of swap or security-based swaps activities on the insured depository institution, including information that addresses the factors in section 237.22(c); and (3) a detailed explanation of the insured depository institution's plan for conforming its activities to the requirements of section 716 of the Dodd-Frank Act.

Section 237.22(e) would allow the Board to extend a transition period for a period of up to one additional year. To request an extension of the transition period, an insured depository institution must submit a written request containing the information set forth in section 237.22(a) no later than 60 days before the end of the transition period.

Estimated Paperwork Burden

Number of Respondents: 2 (12 initial submissions for transition period relief).

Estimated Average Hours per Response: 7 hours.

Total Estimated Annual Burden: 14 hours (84 hours for initial submissions for transition period relief).

The Board has a continuing interest in the public's opinions of collections of information. At any time, comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project, Washington, DC 20503.

List of Subjects in 12 CFR Part 237

Administrative practice and procedure, Banks and banking, Capital, Foreign banking, Holding companies, Margin requirements, Reporting and recordkeeping requirements, Risk, Derivatives.

Authority and Issuance

For the reasons stated in the Supplementary Information, the interim rule adding part 237 to 12 CFR Chapter II and published at 78 FR 34545 on June 10, 2013, is adopted as final with the following changes:

Part 237 – Margin and Capital Requirements for Covered Swaps Entities

(Regulation KK)

1. The authority citation for part 237 shall read as follows:

Authority: 15 U.S.C. § 8305, 12 U.S.C. § 343–350, 12 U.S.C. §1818, 12 U.S.C. § 3101 *et seq.*

2. Subpart B is revised to read as follows:

Subpart B-- Prohibition Against Federal Assistance to Swaps Entities

Sec.

237.20 Definitions.

237.21 Definition of Insured Depository Institution for Purposes of Section 716 of the Dodd-Frank Act (15 U.S.C. § 8305).

237.22 Transition Period for Insured Depository Institutions.

Subpart B-- Prohibition Against Federal Assistance to Swaps Entities

§ 237.20 Definitions.

Unless otherwise specified, for purposes of this subpart:

(a) *Board* means the Board of Governors of the Federal Reserve System.

(b) *Dodd-Frank Act* means the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(c) *Foreign bank* has the same meaning as in section 211.21(n) of the Board's Regulation K (12 CFR 211.21(n)).

(d) *Major security-based swap participant* has the same meaning as in section 3(a)(67) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(67)) and as implemented in rules and orders issued by the Securities and Exchange Commission.

(e) *Major swap participant* has the same meaning as in section 1a(33) of the Commodity Exchange Act (7 U.S.C. § 1a(33)) and as implemented in rules and orders issued by the Commodity Futures Trading Commission.

(f) *Security-based swap* has the same meaning as in section 3(a)(68) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(68)) and as implemented in rules and orders issued by the Securities and Exchange Commission.

(g) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(71)) and as implemented in rules and orders issued by the Securities and Exchange Commission.

(h) *Swap dealer* has the same meaning as in section 1a(49) of the Commodity Exchange Act (7 U.S.C. § 1a(49)) and as implemented in rules and orders issued by the Commodity Futures Trading Commission.

(i) *Swaps entity* means a person that is registered as a swap dealer, security-based swap dealer, major swap participant, or major security-based swap participant under the Commodity Exchange Act or Securities Exchange Act of 1934, other than an insured depository institution that is registered as a major swap participant or major security-based swap participant.

§ 237.21 Definition of Insured Depository Institution for Purposes of Section 716 of the Dodd-Frank Act (15 U.S.C. § 8305).

For purposes of section 716 of the Dodd-Frank Act (15 U.S.C. § 8305) and this rule, the term “insured depository institution” includes any insured depository institution as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. § 1813) and any uninsured U.S. branch or agency of a foreign bank. The terms branch, agency, and foreign bank are defined in section 1 of the International Banking Act of 1978 (12 U.S.C. § 3101).

§ 237.22 Transition Period for Insured Depository Institutions.

(a) *Approval of transition period.* (1) To the extent an insured depository institution for which the Board is the appropriate Federal banking agency qualifies as a “swaps entity” and would be subject to the Federal assistance prohibition in section 716(a) of the Dodd-Frank Act (15 U.S.C. § 8305(a)), the insured depository institution may request a transition period of up to 24 months from the later of July 16, 2013, or the date on which it becomes a swaps entity, during which to conform its swaps activities to the requirements of section 716 of the Dodd-Frank Act (15 U.S.C. § 8305) by submitting a request in writing to the Board.

(2) Any request submitted pursuant to this paragraph (a) of this section shall, at a minimum, include the following information:

- (i) The length of the transition period requested;
- (ii) A description of the quantitative and qualitative impacts of divestiture or cessation of swap or security-based swaps activities on the insured depository institution, including information that addresses the factors in paragraph (c) of this section; and
- (iii) A detailed explanation of the insured depository institution’s plan for conforming its activities to the requirements of section 716 of the Dodd-Frank Act (15 U.S.C. § 8305) and this part.

(3) The Board may, at any time, request additional information that it believes is necessary for its decision.

(b) *Transition period for insured depository institutions.* Following review of a written request submitted under paragraph (a), the Board shall permit an insured depository institution for which it is the appropriate Federal banking agency up to 24 months after the later of July 16, 2013, or the date on which the insured depository institution becomes a swaps entity, to comply with the requirements of section 716 of the Dodd-Frank Act (15 U.S.C. § 8305) and this subpart based on its consideration of the factors in paragraph (c).

(c) *Factors governing Board determinations.* In establishing an appropriate transition period pursuant to any request under this section, the Board will take into account and make written findings regarding:

(1) The potential impact of divestiture or cessation of swap or security-based swaps activities on the insured depository institution's:

(i) Mortgage lending;

(ii) Small business lending;

(iii) Job creation; and

(iv) Capital formation versus the potential negative impact on insured depositors and the Deposit Insurance Fund of the Federal Deposit Insurance Corporation; and

(2) Any other factor that the Board believes appropriate.

(d) *Timing of Board review.* The Board will seek to act on a request under paragraph (a) of this section expeditiously after the receipt of a complete request.

(e) *Extension of transition period.* The Board may extend a transition period provided under this section for a period of up to one additional year. To request an extension of the transition period, an insured depository institution must submit a written request containing the information set forth in paragraph (a) of this section no later than 60 days before the end of the transition period.

(f) *Authority to impose restrictions during any transition period.* The Board may impose such conditions on any transition period granted under this section as the Board determines are necessary or appropriate.

(g) *Consultation.* The Board shall consult with the Commodity Futures Trading Commission or the Securities and Exchange Commission, as appropriate, prior to the approval of a request by an insured depository institution for a transition period under this section.

By order of the Board of Governors of the Federal Reserve System, December 24, 2013.

Margaret McCloskey Shanks (signed)

Margaret McCloskey Shanks,
Deputy Secretary of the Board.