DTCC
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Larry E. Thompson
Vice Chairman and General Counsel

55 Water Street
New York, NY 10041

Tel. 212 855 3240
lthompson@dtcc.com

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Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

By email: regs.comments@federalreserve.gov

Re: Notice of Proposed Rulemaking Regarding Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions

The Depository Trust & Clearing Corporation ("DTCC") appreciates this opportunity to submit comments on the Notice of Proposed Rulemaking regarding Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions (the "Proposed Rule"), published by the Board of Governors of the Federal Reserve System (the "Board") on May 11, 2016.[1] The Proposed Rule restricts the default rights that can be included in the terms of qualified financial contracts ("QFCs") entered into by any member of a U.S. headquartered global systemically important banking group ("GSIB") or the U.S. operations of a non-U.S. headquartered GSIB, in both cases, other than certain excluded entities ("Covered Entities").

The Proposed Rule is aimed at enhancing the ability of GSIBs to be resolved in an orderly manner were they to become financially distressed, a goal that DTCC fully supports. While the Proposed Rule appropriately exempts from its requirements QFC transactions to which a central counterparty is a party, it fails to exempt other QFCs that are processed through or subject to the rules of central counterparties or other financial market utilities ("FMUs"). The same rationales for excluding central counterparties from the scope of the Proposed Rule apply equally to other FMUs and FMU services that support the clearance and settlement of QFCs. And, as discussed more fully below, DTCC believes that broadening the exemption to cover FMUs more generally in this manner should serve to mitigate systemic risk when a GSIB is in distress, an explicit goal of the Board and the Financial Stability Board ("FSB"), and an underlying objective of the Proposed Rule.

We therefore respectfully request that the Board exclude from the requirements of the final rule all QFCs that are cleared, processed, or settled through the facilities of an FMU or that are entered into subject to the rules of an FMU, and any related security agreement or arrangement or other credit enhancements.

[1] 81 Fed. Reg. 29169 (May 11, 2016).

I. The DTCC Entities and their Services

DTCC is a non-public holding company that owns three SEC-registered clearing agency subsidiaries: National Securities Clearing Corporation ("NSCC"), Fixed Income Clearing Corporation ("FICC") and The Depository Trust Company ("DTC" and together with NSCC and FICC, the "DTCC Entities"), and related businesses.[2] The DTCC Entities each have been designated by the Financial Stability Oversight Council pursuant to section 804 of the Dodd-Frank Act as financial market utilities that are systemically important ("SIFMUs").[3]

Both NSCC and FICC are registered clearing agencies and central counterparties within the definition provided under the Board's Regulation Q ("CCPs").[4] NSCC provides clearing, settlement, risk management and central counterparty services for broker-to-broker trades for cash equities, corporate and municipal debt, ETFs and unit investment trusts in the United States. NSCC also provides a family of services to support mutual funds, alternative investment products and insurance products, linking fund and insurance companies with their network of distribution firms to facilitate the processing and settlement of transactions between those parties. FICC operates in two divisions. FICC's Government Securities Division provides clearing, netting, settlement and CCP services to the U.S. government securities market. FICC's Mortgage-Backed Securities Division provides such services to the U.S. mortgage-backed securities market.

DTC, a limited purpose trust company, is the world's largest central securities depository and a registered clearing agency for the book-entry settlement of securities transactions for eligible securities and other financial assets. DTC's services include asset servicing and settlement, including the settlement of issuances and presentments of money market instruments. NSCC relies on an interface with DTC for the book-entry movement of securities to settle transactions, and on DTC as its settlement agent for the consolidated settlement of end-of-day funds movements through the Federal Reserve's National Settlement Service. Collectively, the DTCC Entities provide the key infrastructure for the settlement of U.S. securities market transactions.

II. The Proposed Rule and the CCP Exemption

The Proposed Rule is divided into two key provisions—one that is intended to address the circumstance when a Covered Entity enters resolution proceedings under the Federal Deposit Insurance Act ("FDIA") or the Orderly Liquidation Authority provisions of the Dodd-Frank Act ("OLA"), and another designed to address the circumstance when the affiliate of a Covered Entity enters proceedings under other insolvency regimes, such as the U.S. Bankruptcy Code.

Under the Proposed Rule, Covered Entities are required to conform the terms of QFCs they enter into with counterparties with whom they transact business to address both of these provisions. In certain cases, this will require Covered Entities to include certain provisions in their QFCs to match the requirements of the Proposed Rule. These requirements apply regardless of whether counterparties are located in the United States or abroad. Because the Proposed Rule applies to all QFCs of Covered Entities, the Proposed Rule would apply to a broad scope of contracts and agreements. "QFC," as

[2] The DTCC common shareholders include approximately 297 banks, broker dealers and other companies in the financial services industry that are participants of one or more of DTCC's clearing agency subsidiaries. For additional information regarding the structure and activities of DTC, NSCC and FICC, please see our disclosures prepared in response to the *Principles for Financial Market Infrastructures* promulgated by the Committee on Payment and Market Infrastructures and the Technical Committee of the International Organization of Securities Commissions ("CPMI-IOSCO"). DTC's Disclosure Framework is available at http://www.dtcc.com/~/media/Files/Downloads/legal/policy-and-compliance/DTC_Disclosure_Framework.pdf. NSCC's Disclosure Framework is available at http://www.dtcc.com/~/media/Files/Downloads/legal/policy-and-compliance/NSCC_Disclosure_Framework.pdf. FICC's Disclosure Framework is available at http://www.dtcc.com/~/media/Files/Downloads/legal/policy-and-compliance/FICC_Disclosure_Framework.pdf. In addition, NSCC and FICC provide certain quantitative data disclosures pursuant to CPMI-IOSCO's Public quantitative disclosure standards for central counterparties, which are also available at www.dtcc.com.

[3] 12 U.S.C. 5463. On June 18, 2012, the FSOC designated NSCC, FICC and DTC as SIFMUs.

[4] Regulation Q defines a CCP as a "counterparty (for example, a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts." 12 C.F.R. 217.2.

defined under the Proposed Rule, encompasses a wide range of financial transactions including securities contracts, as well as loans of securities or commodities repurchase transactions, swaps and other derivatives, forward transactions and any guarantees of or credit enhancements related to such transactions.[5]

The two key provisions of the Proposed Rule impose different requirements on Covered Entities. Specifically:

- The section addressing resolution proceedings requires that a Covered Entity's QFCs explicitly provide that the counterparty would only be able to exercise default rights under the QFC to the extent permitted under the FDIA or OLA, as applicable, as if the QFC was governed by U.S. law (and therefore subject to FDIA and OLA). Likewise, such counterparties would also be required to agree that any transfers of their contract, including transfers without their consent, would be enforceable to the extent provided under the FDIA and OLA as if the QFC was governed by U.S. law. As a result, the counterparty would be "opting in" to, or agreeing to be subject to the terms of, the FDIA and OLA as they relate to stays on the exercise of default rights and the transfer of QFCs. However, this section would not alter the treatment of QFCs under the FDIA or OLA, meaning the creditor protections under such regimes would still apply.

- The section addressing the insolvency under the Bankruptcy Code or similar regimes prohibits QFCs of Covered Entities from including default rights that relate, directly or indirectly, to an affiliate of the Covered Entity becoming subject to insolvency proceedings (i.e., cross-default rights). Unlike the section dealing with resolution proceedings under FDIA or OLA, counterparties must in essence agree to give up the ability to exercise certain default rights, rather than just opting in to the application of stays under an existing regime. The limitations required under this section are subject to certain protections for creditors that benefit from guarantees or other forms of credit support provided by the affiliate in such proceedings.[6]

The Proposed Rule defines "default rights" broadly to include not only acceleration, termination, setoff and related rights, but also certain contractual rights to modify margin or collateral requirements (in each case, together with "any similar rights").[7] However, the Proposed Rule exempts from its requirements QFCs to which "a CCP is party" (the "CCP Exemption").[8]

III. All FMUs Should Be Exempt from the Requirements of the Proposed Rule

The Proposed Rule appears to have been drafted largely from the perspective of bilateral, term derivative transactions, with little discussion provided as to how these requirements would be addressed with respect to securities market transactions. In particular, the Proposed Rule expands on and in many ways mirrors the framework developed by the International Swaps and Derivatives Association ("ISDA") and its members, in coordination with the FSB, to amend bilateral financial contracts between GSIBs to ensure the enforceability of stays on defaults rights that may be imposed during resolution.[9] To our knowledge, FMUs were not involved in the development of the ISDA framework. In addition, we understand that, while cleared derivatives were considered during the development of the ISDA framework, those discussions did not focus on securities market transactions or other transactions cleared or settled through FMUs.

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[5] The Proposed Rule defines "qualified financial contract" by reference to the definition provided under OLA. See 12 U.S.C. § 5390(c)(8)(D).

[6] Section 252.84 of the Proposed Rule.

[7] Section 252.81 of the Proposed Rule.

[8] Section 252.88(a) of the Proposed Rule. Note that the definition of "CCP" under the Proposed Rule is the definition provided under the Board's Regulation Q. See footnote 4 above.

[9] See, ISDA 2015 Universal Resolution Stay Protocol (the "ISDA Protocol") and related materials, available at http://www2.isda.org/functional-areas/protocol-management/protocol/22.

A. Securities Market Transactions and Conventions

Notwithstanding the significant differences between product types and market structures, the Board does not address the application of the Proposed Rule to transaction types other than derivatives, such as retail securities transactions or spot transactions, or other aspects of the primary and secondary securities markets. Transactions in these markets—including money market and fund transactions, primary issuances and secondary trading—differ significantly from derivatives transactions in their structure, operation and risk profile, and in the manner in which transactions are executed, cleared and settled. While derivatives transactions appear to be the primary focus of the Proposed Rule, the bilaterally focused ISDA framework does not apply well to or fit appropriately onto the securities markets, as the Proposed Rule would seek to do.

In particular, the Proposed Rule is focused on the effect that the exercise by counterparties of default rights could have on the orderly resolution of a GSIB group. As the Board notes, the goal of the Proposed Rule (and the override provisions of the FDIA and OLA) is to temporarily suspend the exercise of default rights "for the purpose of allowing the relevant resolution authority to take action to continue to provide for continued performance on the QFC."[10] While this concern is relevant for term transactions, where continued performance is a feature of the transaction, it is not for securities market transactions that generally settle in the short term and do not impose ongoing or continuing obligations on either party after settlement. Further, the default rights that are the focus of the Proposed Rule are not typical in these markets. By including within its scope these types of transactions, the Proposed Rule would require substantial remediation efforts, including modifying widespread market conventions and structures, with the related changes to a diverse array of documentation and arrangements. And, while such efforts would be costly and time consuming, they would not appear to be relevant to the Board's policy objectives.

In addition, as discussed in more detail below, the infrastructures for the clearing, processing and settling of securities market transactions is highly interconnected (as is the infrastructure upon which clearing by CCPs may rely) and may be affected by the requirements of the Proposed Rule. The CCP Exemption alone would not prevent disruptions to these markets that could result from such broad application. As compliance by these infrastructures and markets would not appear necessary to achieve the Board's stated policy objectives, we believe the Board should take steps to fully exempt the clearing and settlement infrastructure for securities market transactions from the scope of the Proposed Rule.

For these reasons, either securities market transactions should be excluded from the scope of the Proposed Rule or, at a minimum, the CCP Exemption should be broadened to address the manner in which such transactions are cleared, processed and settled through (or subject to the rules of) FMUs, including central securities depositories, such as DTC.

We note that doing so would be consistent with the approaches taken in other jurisdictions addressing the same issues. For example, a similar rule of the U.K. Prudential Regulation Authority has a broad exclusion for European FMUs as well as any "exchange, other trading facility, payment system, settlement system or other financial market utility or infrastructure established" in other jurisdictions.[11] Similarly, the German law addressing default rights under financial contracts exempts transactions with a wide range of financial market infrastructures.[12] We urge the Board to follow a similar approach by excluding such infrastructures from the scope of its final rule.

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[10] 81 Fed. Reg. 29172 (May 11. 2016).

[11] Prudential Regulation Authority, PRA Rulebook: CRR Firms and Non-Authorized Persons: Stay in Resolution Instrument 2015, PRA2015/82 (December 11, 2015, available at http://www.prarulebook.co.uk/rulebook/LegalInstrument/Amending/318771/22-07-2016.

[12] Section 60a, German Recovery and Resolution Act.

B. Clearance and Settlement through FMUs

In the preamble to the Proposed Rule, the Board expresses its support for the CCP Exemption by noting that "clearing through a [CCP]. . . provides unique benefits to the financial system" and that it raises "unique issues related to the cancellation of cleared contracts."[13] Absent the CCP Exemption, Covered Entities could have been prohibited from clearing transactions with CCPs, an outcome contrary to the broader goal of increasing the proportion of financial markets transactions that are cleared. The CCP Exemption therefore provides certainty that Covered Entities would be able to continue to access the services of CCPs.

Because of the broad definition of "default rights" under the Proposed Rule, complying with the requirements of the Proposed Rule could result in CCPs being prohibited from taking the actions they would typically take to manage the risk presented by a member in distress to the CCP and its membership, including the risk to the member resulting from the default of its affiliate. CCPs have diverse rights that they exercise to manage risk, and these actions are taken not only to protect non-defaulting members but also to enable the CCP to continue to allow the member in distress access to the CCP in a manner that does not increase risk to the CCP or its other members (e.g., by requiring additional margin, or reducing credit exposures). We understand that ensuring continued access to CCPs (and other FMUs) during resolution scenarios is a key policy objective of the Board, and we believe that preserving the ability of a CCP to exercise its full range of risk-management rights is essential to enabling continued access while reducing systemic risk. Alternatively, prohibiting or impeding these actions could undermine the ability of a CCP to mitigate the risk related to the distressed member and thus prevent such risks from spreading to non-defaulting members and the broader market.

The CCP Exemption is also appropriate considering, as discussed above, that the Proposed Rule is largely intended to conform QFCs entered into by market participants on a bilateral basis and is drafted with bilateral contracts in mind.[14] As the Board notes, cleared QFCs are different than bilateral QFCs in terms of "contractual arrangements, counterparty credit risk, default management, and supervision."[15] These differences make the form of the Proposed Rule inappropriate to QFCs executed on a multilateral system and subject to common documentation rather than bilaterally negotiated agreements. Accordingly, we fully support exempting QFCs to which a CCP is a party from the requirements of the Proposed Rule.

However, the rationales that support the CCP Exemption apply equally to QFCs cleared, processed or settled through FMUs more generally, and thus support exempting a broader scope of transactions and entities from the requirements of the Proposed Rule. Specifically, the CCP Exemption should be expanded to include all entities that fall within the definition of "financial market utility" under the Dodd-Frank Act,[16] and any QFC cleared, processed, or settled through the facilities of an FMU, or entered into subject to the rules of an FMU, and any related credit enhancements.[17]

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[13] 81 Fed. Reg. at 29176 (May 11, 2016).

[14] For example, the note that the framework of the Proposed Rule is similar to that reflected in the ISDA 2015 Universal Resolution Stay Protocol (discussed further below), which amends master agreements between Adhering Parties, and in fact contemplates a different mode of compliance through the ISDA 2015 Universal Resolution Stay Protocol. CCPs and other FMUs do not enter into master agreements like other market participants, making this framework inapposite to CCPs and FMUs.

[15] Id.

[16] The term "financial market utility" is defined in section 803(6) of the Dodd-Frank Act as "any 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." 12 U.S.C. § 5462(6). To the extent this definition is interpreted as applying only to U.S. entities, we would encourage the Board to expand its scope for purposes of the final rule to include any non-U.S. entities that otherwise satisfy this definition.

[17] In this context it is also important to distinguish the risks faced by bilateral QFC counterparties from those faced by FMUs operating a multilateral system. While counterparty to a GSIB may be temporarily stayed from terminating transactions, they are under no obligation to enter into new transactions with the GSIB. This generally is not the case with FMUs—that is, so long as an FMU continues to act for a participant, it will likely be required to continue to accept and facilitate new transactions, exposing the FMU and its membership to additional and ongoing risk. The Board implicitly recognizes this, when noting the benefits provided by CCPs and the regulatory oversight to which they are subject. However, these same issues and risks arise with non-CCP FMUs as well. This unique feature of FMUs makes it imperative to preserve the ability of an FMU to exercise rights to mitigate risk to itself and its other members.

Like CCPs, other FMUs are highly regulated, and like the cleared transactions that are the current focus of the CCP Exemption, the transactions processed and settled by or through other FMUs are subject to a common—and public—rulebook applicable to the FMUs' membership as a whole, and not bilaterally negotiated agreements like the QFCs with which the Proposed Rule is concerned. The common rulebook provides transparency to the market and all members of the FMU. Consistency of rights of members, and the FMU vis-à-vis its members, is an important feature of the FMU structure—all parties are aware of the risks that participants of the FMU would be exposed to as well as their rights and the rights of the FMU itself.

From the perspective of an FMU, it is impractical—and potentially disruptive—to have one set of rights apply with respect to GSIB participants and another set of rights apply with respect to the FMU's other participants. Moreover, FMUs must be able to exercise their rights and apply their risk mitigation tools appropriately across *all* the services they provide to a member in order to effectively manage risk and satisfy their regulatory mandate. Further, the services provided by CCPs and other FMUs are often tightly integrated and subjecting only certain transactions or certain aspects of transactions facilitated by FMUs to restrictions could lead to uncertainty and disruption in markets during a resolution event. This could occur because the process of clearing and settling a transaction involves multiple steps and multiple FMUs. If there is an asymmetry between the rights of these different FMUs with respect to the same transaction, it could lead to unexpected disruptions in the clearing infrastructure.

In addition to FMUs that become a party to QFCs, FMUs also clear, process or settle QFCs to which they are not a party. These underlying QFCs are nonetheless subject to the rules of the CCP. Similarly, parties to QFCs cleared or settled through FMUs may enter into other agreements related to such QFCs that may or may not be subject to the rules of the FMU. This would include, for example, certain credit support arrangements between the parties to a QFC entered into in connection with the cleared or settled transactions. Even if not subject to the rules of the FMU, these related agreements form an integrated whole with the QFCs that are cleared or settled through the FMU and should therefore also be exempted from the requirements of the Proposed Rule. In addition to being relevant to existing clearing and settlement practices, including these related agreements within the scope of the exemption would facilitate the continued expansion of the clearing and settlement framework and the market-stabilizing benefits it provides.

<u>Proposed Changes to the CCP Exemption</u>

For the reasons described above, we urge the Board to expand the CCP Exemption to apply to all FMUs, the QFC transactions they facilitate, and certain related agreements. In particular, we respectfully request that the Board exclude from the requirements of the final rule all QFCs that are cleared, processed, or settled through the facilities of an FMU or that are entered into subject to the rules of an FMU, together with any related security agreements or arrangements or other credit enhancements, including guarantees or reimbursement obligations, in respect of such QFCs. For this purpose, "FMU" should be defined by reference to the definition provided in section 803(6) of the Dodd-Frank Act and include any non-U.S. entity that satisfies this definition.[18] If expanded as proposed, the CCP Exemption would apply not only to other FMUs, but also to the full range of QFC transactions that are facilitated by these entities, and the credit enhancements that support these entities and transactions. As described above, this approach would align the Proposed Rule with the approach taken in other jurisdictions, including Germany and the United Kingdom.

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[18] 12 U.S.C. § 5462(6).

We recognize that the Proposed Rule is part of a broader effort by the Board and other regulators to improve the resolvability of GSIBs and avoid the systemic effects that could result from their failure. These are efforts that we have supported and continue to support.[19] Broadening the CCP Exemption is consistent with these efforts as it preserves the flexibility that FMUs need to, where appropriate, continue to act for a GSIB in resolution or, when necessary, take actions to protect the FMU, its members and the broader financial system from related risks.

We appreciate the opportunity to comment on the Proposed Rule. Should you wish to discuss these comments further, please contact me at 212-855-3240.

Sincerely yours,

Larry E. Thompson

Larry E. Thompson

Vice Chairman and General Counsel

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[19] Specifically, we have provided greater detail on the types of interactions members would have with DTCC Entities during stress scenarios and what would be required for members to continue to maintain access to services provided by the DTCC Entities in a wide range of adverse circumstances, including a member's resolution. DTCC White Paper, Understanding Interconnectedness Risks to Build a More Resilient Financial System, (October 12, 2015), available at http://www.dtcc.com/news/2015/october/12/understanding-interconnectedness-risks-article. DTCC Entities have also established clear membership requirements, which provide fair and open access for applicants, while maintaining prudent risk management standards that enable DTCC Entities to manage the material risks resulting from membership activities.