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August 5, 2016

Via Email (regs.comments@federalreserve.gov)
Robert deV. Frierson, Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Comment Letter on Proposed Rules 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

[Docket No. R–1538; RIN 7100 AE–52]

Dear Mr. deV. Frierson:

The Asset Management Group of the Securities Industry and Financial Markets Association ("SIFMA AMG" or "AMG")[1] appreciates the opportunity to comment on the notice of proposed rulemaking[2] promulgated by the Board of Governors of the Federal Reserve System (the "Board") regarding a proposed rule ("Proposed Rule") that would restrict the contractual provisions of qualified financial contracts ("QFCs") entered into by systemically important U.S. banking organizations, including their subsidiaries ("GSIBs"), and the U.S. operations of systemically important foreign banking organizations (collectively, "Covered Entities"). These restrictions extend to QFCs entered into by Covered Entities with counterparties that are not Covered Entities, which would include, among others, asset managers' clients.

AMG members manage investment needs for their clients and, in doing so, also manage liquidity needs and hedge various market risks. To achieve these objectives, AMG members often enter into QFCs on behalf of their clients with Covered Entities. Credit risk is an important factor assessed when entering into QFCs, with the financial condition of the Covered Entity among the most important considerations. The assessment of financial condition has an impact on the pricing of QFCs and is inextricably linked to important rights, including contract termination, collateral and other terms, that protect clients against deteriorating credit.

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[1] SIFMA AMG's members represent U.S. asset management firms whose combined global assets under management exceed $34 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

[2] 81 Fed. Reg. 29169 (May 11, 2016) (the "QFC Proposal").

SIFMA AMG believes that the Proposed Rule's objective of securing cross-border recognition of U.S. special resolution regimes ("U.S. SRRs")[3] should be achieved through Congressional action, not Board rulemaking. Notwithstanding this view, AMG understands the Board's intention to move forward with its cross-border recognition objective, but recommends that the scope of the resulting requirements be narrowed to those strictly necessary to achieve that objective.

SIFMA AMG also strongly believes that the Proposed Rule's separate objective of restricting cross-default rights upon an ordinary bankruptcy filing of an affiliate of a Covered Entity should not be pursued at all. However, if the Board nonetheless moves forward with restricting cross-default rights, AMG believes that the Board should provide greater balance between the contractual restrictions required and the credit protections provided. The Board should also make other improvements to tailor the final rule's requirements. AMG makes further recommendations below to clarify the scope of the Proposed Rule and to request phased-in implementation.

SIFMA AMG believes that many issues raised in our comment letter can be addressed for a number of buy side market participants through the safe harboring of an appropriate industry protocol. AMG supports the efforts of the International Swaps and Derivatives Association, Inc. ("ISDA") to develop a U.S. module to the ISDA Resolution Stay Jurisdictional Modular Protocol ("JMP") that addresses asset managers' fiduciary obligations. Such a module would need to be narrowly tailored to operate only in respect of specific U.S. resolution and insolvency regimes and, for protocol provisions that focus on cross-border recognition, would need to amend only agreements governed by non-U.S. law. AMG would further recommend that the module provide adherence mechanisms that accommodate the needs of asset managers for certainty when they amend QFCs on behalf of their clients. AMG remains ready to engage in a constructive dialogue to develop an acceptable module.

Given the importance of the contractual rights at issue for pension funds, mutual funds and other investment vehicles held by retail investors, among others, SIFMA AMG urges the Board to give full consideration to counterparties' interests and thus to promulgate a final rule whose requirements are limited to those strictly necessary to achieve the Board's goals while carefully protecting important counterparty interests.

I. The Board Should Narrow the Proposed Rule's Requirements for Cross-Border Recognition of U.S. SRRs.

SIFMA AMG believes that Congress, rather than the Board, should take steps to secure cross-border recognition of the U.S. SRRs. In order to ensure the enforceability of QFCs governed by non-U.S. law entered into by a Covered Entity, Congress should work with other countries to ensure mutual recognition of all special resolution regimes, including the U.S. SRRs, irrespective of the contract's governing law. Indeed, the Financial Stability Board's ("FSB") Principles for Cross-

[3] *See* Federal Deposit Insurance Act (in respect of insured depository institutions), 12 U.S.C. 1821(e) et seq., and Title II of the Dodd-Frank Act (in respect of systemically important financial institutions), 12 U.S.C. 5384 et seq.

border Effectiveness of Resolution Actions "emphasized the importance of implementing comprehensive statutory frameworks" to achieve legal certainty for cross-border resolutions.[4]

Although the FSB recognized that "properly crafted and widely adopted [] contractual recognition approaches offer a workable solution until comprehensive statutory regimes for giving cross-border effect to resolution action are adopted,"[5] the Board's Proposed Rule is not narrowly tailored to operate as that sort of stop-gap measure. Instead, it would apply to all QFCs, including those governed by U.S. laws, and would apply irrespective of whether the QFC terms provide for default rights. The Proposed Rule's requirements regarding QFC recognition of U.S. SRRs' restrictions on default rights (the "U.S. SRR Contractual Requirements") are based on the term "QFC" as that term is broadly defined in Title II of the Dodd-Frank Act.[6] Indeed, the QFC Proposal acknowledges the breadth of that defined term.[7]

Mandating contract provisions that, in effect, restate applicable law or that limit rights not present in a contract in the first place may be viewed as a nullity. However, a final rule that nonetheless required amendments to a broad range of QFCs would be unnecessary and entail a great deal of work and expense. Moreover, it could result in ambiguity being introduced into agreements that should not have been amended at all.

Finally, the Proposed Rule is unclear as to whether the U.S. SRR Contractual Requirements must, on the one hand, limit rights at all times, as though the Covered Entity in question *were* subject to a special resolution proceeding or must, on the other hand, do so only when the Covered Entity *is actually* subject to a special resolution proceeding.[8]

For these reasons, if the Board decides to adopt a final rule that imposes U.S. SRR Contractual Requirements, AMG recommends that the Board: (1) limit QFCs subject to § 252.83 to those that both are governed by the laws of a non-U.S. jurisdiction and contain default rights; and (2) revise proposed Rule § 252.83(b) to state expressly that the default provisions required by § 252.83(b) operate only in the context of a Covered Entity actually becoming subject to resolution proceedings under one of the two U.S. SRRs.

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[4] FSB, *Principles for Crossborder Effectiveness of Resolution Actions* (November 3, 2015) at 5 ("FSB Principles"), available at: http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf.

[5] FSB Principles at 5.

[6] *See* QFC Proposal § 252.81.

[7] QFC Proposal at 29170 note 13 (acknowledging that the Proposed Rule's definition of "covered QFC" is "broader than [the] list of examples, and the default rights discussed are not common to all types of QFC").

[8] *See* Proposed Rule § 252.83(b)(2) (which requires that "Default rights with respect to the covered QFC that may be exercised against the covered entity are permitted to be exercised to no greater extent than the default rights could be exercised under the U.S. special resolution regimes *if . . . the covered entity were under the U.S. special resolution regime*" (emphasis added)).

II. The Board Should Not Impose Contractual Restrictions on Cross-Default Rights

SIFMA AMG believes that QFC counterparties transacting with Covered Entities should be permitted to seek and agree upon contractual cross-default rights (*i.e.*, rights to terminate a QFC due to an affiliate of its Covered Entity counterparty becoming subject to an insolvency proceeding). Such agreed cross-default rights bear an important relationship to guarantees that may be provided, and they relate to credit assessments that include the parent or affiliate(s) of the counterparty. If these rights must be restricted by law, such restrictions should be imposed by Congress, with due consideration of both the need for orderly resolution of GSIBs and the need for market participants to maintain adequate credit protections.

The Proposed Rule's requirements to restrict cross-default rights contractually (the "Cross-Default Restrictions") would represent, in effect, an unwarranted change to existing statutory standards. The Board acknowledges that U.S. SRR proceedings, which trigger certain limited statutory restrictions upon the exercise of cross-default rights, will be "used rarely" under "extraordinary circumstances." The Board further acknowledges that, in contrast, upon the filing of an ordinary bankruptcy, "[t]he Bankruptcy Code's automatic stay … does not prevent the exercise of cross-default rights against an affiliate of the party entering into resolution."[9] Despite the clear statutory difference intended by Congress for the different circumstances, the Proposed Rule would require Covered Entities' to contractually agree that cross-default rights under QFCs cannot be exercised in connection with the *non-extraordinary* event of a bankruptcy proceeding. The Board's stated intention is "to address . . . obstacles to orderly resolution under the Bankruptcy Code *by extending* [Dodd-Frank's Title II orderly liquidation authority] stay-and-transfer provisions to any type of resolution of a covered entity."[10]

AMG does not believe that a material alteration of the ability of counterparties to obtain and enforce cross-default rights, taking in to account the existing statutory bankruptcy regime, should be accomplished by Board rulemaking. The Board rulemaking as contemplated by the QFC Proposal is particularly concerning where the disadvantaged counterparties in question, including asset managers' clients, are not supervised by the Board. The Board's rulemaking approach to the issue, imposing restrictions on the contractual rights of market participants that are *not* subject to Board supervision, results in a lack of due consideration of those market participants' interests. While the Board's basic mission statement includes the protection of "credit rights of consumers"[11] – in other words, the Board must establish *minimum* standards of conduct related to the maintenance and protection of credit rights of individuals that deal with Board-supervised financial institutions – the Proposed Rule would materially *reduce* available rights of counterparties when they deal with Board-supervised financial institutions. The Board should not use its rulemaking power to limit creditor protections in a manner that exposes such a broad range of individuals to additional risk.

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[9] QFC Proposal at 29173.

[10] QFC Proposal at 29179 (emphasis added).

[11] Federal Reserve Board, *Mission*, available at: https://www.federalreserve.gov/aboutthefed/mission.htm (last update: November 6, 2009).

In addition, the proposed Cross-Default Restrictions could result in pro-cyclical behavior as asset managers may be forced to move funds away from Covered Entities upon the earliest signs of potential financial distress. As noted above, SIFMA AMG members have traditionally negotiated and obtained, on behalf of their clients, important rights to protect clients against deteriorating dealer credit. Those rights would be materially limited under the proposed Cross-Default Restrictions. Accordingly, AMG members may seek exits from trading relationships sooner than they would have if they had been permitted to retain a fuller set of rights on behalf of clients related to contract termination, collateral and other credit-related matters. Such trading decisions could accelerate adverse market conditions in a procyclical fashion, leaving authorities less flexibility and fewer options than anticipated.

For these reasons, we strongly recommend that the Board not adopt the proposed Cross-Default Restrictions.

III. If the Board Moves Forward with Contractual Restrictions on Cross-Default Rights, the Board Should Permit Appropriate Credit Protections, Should Not Impose Any Burden of Proof on Contracting Parties and Should Narrow Restrictions to Cover Only QFCs with Cross-Default Rights.

A. Minimum Creditor Protections Established by the Universal Protocol

The ISDA 2015 Universal Resolution Stay Protocol ("Universal Protocol"), developed by global systemically important banks in consultation with Board staff, other prudential regulators and other market participants,[12] achieved a balance of creditor protections not available under the Proposed Rule except through the application of § 252.85, which provides a safe harbor for the Universal Protocol (discussed in Part IV.A below). The QFC Proposal not only points out that the Universal Protocol offers greater creditor protections than § 252.84 of the Proposed Rule, it acknowledges that those additional protections "should meaningfully decrease [a] supported party's credit risk to its direct parties."[13]

While the Universal Protocol was not created for use by Covered Entities when they transact with non-bank counterparties and would not be appropriate for the clients of asset managers,[14] SIFMA AMG believes that the credit protections available to non-bank counterparties should not be

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[12] *See* QFC Proposal at 29181 n. 106; *see also* "FSB welcomes extension of industry initiative to promote orderly cross-boarder resolution of G-SIBS," available at: http://www.fsb.org/2015/11/fsb-welcomes-extension-of-industry-initiative-to-promote-orderly-cross-border-resolution-of-g-sibs/.

[13] QFC Proposal at 29182 ("As compared to the creditor protections provided in the proposal, the [Universal] Protocol's additional creditor protections appear to meaningfully increase a supported party's assurance that material payment and delivery obligations under its covered QFCs will continue to be performed and should meaningfully decrease the supported party's credit risk to its direct parties.").

[14] *See* Part IV.A below; *see also* SIFMA Asset Management Group Statement on the ISDA 2015 Universal Resolution Stay Protocol, available at: http://www.sifma.org/newsroom/2015/sifma_asset_management_group_statement_on_the_isda_2015_universal_resolution_stay_protocol/.

below the minimum established for Covered Entities when they enter into interbank QFCs. The protections in the Universal Protocol that should be provided in Proposed Rule § 252.84 include the following (as contrasted with the analogous protections currently reflected in § 252.84):

Universal Protocol	**Proposed Rule § 252.84**[15]
Requires that the affiliate support provider or transferee remain obligated to the "same extent" for the stay to remain effective, and that the direct party remain duly registered and licensed by relevant regulatory bodies.	Requires that the covered affiliate support provider or transferee remains obligated to the same *or substantially similar extent* as the covered affiliate support provider was immediately prior to entering the resolution proceeding.
Provides for the specific form and timing of assurances that the affiliate support provider's assets (or net proceeds therefrom) would be transferred to the transferee, as confirmed by bankruptcy court order. Provides additional protections for situations in which credit enhancements are transferred: ▪ the transferee satisfying all material payment and delivery obligations to each of its creditors during the stay period; ▪ the transferee, in certain circumstances, continuing to satisfy all financial covenants and other terms applicable to the credit enhancement provider under the agreement after the stay period; and ▪ the transferee continuing to satisfy all provisions and covenants regarding the attachment, enforceability, perfection, or priority of property securing the obligations of the credit enhancement after the stay period.	Provides for a general "reasonable assurance" requirement regarding the transfer of the covered affiliate support provider's assets (or net proceeds therefrom).
Provides for additional protections for situations in which the affiliate credit support provider remains obligated after the resolution proceeding, including the bankruptcy court's issuance of an order by the end of the stay	None.

[15]Assumes no reliance on the safe harbor provision in § 252.85(b).

period providing supported parties with increased creditor priority in bankruptcy.	
Restricts the exercise of cross defaults only in the context of proceedings under Chapter 7 and Chapter 11 of the Bankruptcy Code and under certain provisions of the FDIA and SIPA.	Restricts the exercise of cross defaults in the context any "receivership, insolvency, liquidation, resolution, or similar proceeding," whether U.S. or foreign, whether U.S. state or federal, whether under an insolvency regime of general or of specific nature. [16]
Does not condition creditor protections on a affiliate credit support provider being itself a covered entity.	Does not permit a range of creditor protections if the affiliate credit support provider is not a covered entity, but effectively overrides cross-defaults in those circumstances in the same manner as it overrides unsupported cross-defaults.[17]
Does not prohibit a non-defaulting counterparty from exercising its default rights related to a direct party's affiliate entering into resolution proceedings (other than U.S. federal insolvency proceedings) if the top-tier U.S. parent of the direct party remains outside of U.S. federal insolvency proceedings.	None.

SIFMA AMG believes that the Board should not propose a balance of regulatory goals and creditor protections that is entirely different from that reflected in the Universal Protocol and fundamentally skewed against creditor interests. Thus, the final rule, at a minimum, should provide for creditor protections that meet the minimum standards set forth by the Universal Protocol.

B. Burden of Proof

The Proposed Rule's Cross-Default Restrictions require that parties seeking to exercise certain QFC default rights bear the burden of proof that the exercise is permitted under the QFC, and that such burden is supported by clear and convincing evidence or a similar or higher burden of

[16] Thus, the Proposed Rule would appear to extend, for example, to a state law conservatorship of an insurance company, though it is unclear how such a proceeding might involve systemic risk.

[17] *See* Proposed Rule § 252.84(g) (providing for protections after the "stay period" but only where the credit support provider is a "covered affiliate support provider"); *see also* QFC Proposal at 29180 note 92 ("Note that the exception in § 252.84(g) . . . would not apply with respect to credit enhancements that are not covered affiliate credit enhancements. In particular, it would not apply with respect to a credit enhancement provided by a non-U.S. entity of a foreign GSIB, which would not be a covered entity under the proposal.").

proof.[18] Those burden of proof requirements, which are more stringent than the burden of proof requirements for typical contractual disputes adjudicated in court, unduly hamper the credit protections of counterparties and interject uncertainty into straightforward contractual terms.

SIFMA AMG believes that it is fundamentally inappropriate for the Board, through rulemaking, to alter long-standing law regarding judicial resolution of contractual disputes. If a dispute exists under a covered QFC, that dispute should be adjudicated by judicial application of substantive applicable law under long established rules governing the burden of proof, without preemptions that operate through Board-mandated provisions.

C. QFCs with Cross-Default Rights

As discussed in Part I above, the Proposed Rule relies on the broad definition of QFC contained in Title II of the Dodd-Frank Act. As a result of that definition, Proposed Rule's Cross-Default Restrictions would apply to a much broader category of transactions than is warranted. The Cross-Default Restrictions have application to QFCs containing cross-default rights, and, as a consequence, there should be no requirement for QFCs *not* containing such rights to be subject to the restrictions. Any other approach would raise difficult practical considerations and potentially costly and unnecessary action. To take just one example: as proposed, the Cross-Default Restrictions would seem to require Covered Entities and counterparties that trade spot foreign exchange to subject their foreign exchange transactions to specific terms related to cross-default rights despite the fact that the transactions are not typically documented under master agreements or other agreements that contain the kinds of cross-default rights that must be addressed; as a result, it's not clear how the requirements as proposed would be satisfied. The Board should thus narrow the Cross-Default Restrictions to cover only QFCs with cross-default rights.

IV. Compliance Alternatives Under the Final Rule Should Include a JMP Module Suitable for Use by Fiduciaries and a Less Burdensome and More Flexible General Approval Process.

A. Compliance with the Final Rule Through Protocol Adherence

The availability of safe harbored compliance alternatives should not be limited to adherence to the Universal Protocol or to a "jurisdictional module for the United States that is substantially identical to the [Universal] Protocol in all respects aside from [covering QFCs between non-Covered Entities]."[19] SIFMA AMG members act pursuant to fiduciary obligations in agreeing to or amending transactional terms for their clients. Any decision to amend a QFC on behalf of a client (in response to final rule or otherwise) must be considered in light of those fiduciary duties. As the Board staff has heard at length during discussions concerning the Universal Protocol, SIFMA AMG members, as well as other buy side representatives, believe that the breadth of the Universal Protocol makes it difficult if not impossible for asset managers to use Universal Protocol for their

[18] Proposed Rule § 252.84(j) ("Prohibited Terminations").

[19] *See* QFC Proposal at 29181 n. 106.

clients.[20] As a result, the Universal Protocol and its 2014 predecessor were developed without any expectation of their use by asset managers on behalf of their clients.[21] Instead, asset managers were expected to utilize narrowly tailored modules to which parties would adhere, on a jurisdiction-by-jurisdiction basis, through the JMP. This approach has already been taken in connection with requirements adopted by UK and German authorities, neither of which required, nor suggested the alternative necessity for, universal adherence in connection with regulatory initiatives that are analogous to those of the Proposed Rule.[22]

AMG recommends that the Board expand § 252.85(a) ("Protocol compliance") to provide a safe harbor, applicable to requirements under the final rule generally, for a module to the JMP that would be based on, but more narrowly-tailored than, the Universal Protocol. The cross-border requirements of the module would operate only in respect of the two U.S. SRRs.[23] In addition, the module would provide adherence mechanisms that accommodate the needs for certainty of asset managers amending QFCs on behalf of their clients.

To that end, AMG supports the efforts of ISDA to develop a JMP module that would take into consideration the needs of buy side clients to amend their existing contracts. SIFMA AMG and other industry representatives remain ready to engage in a constructive dialogue to develop an acceptable module.

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[20] The same would apply to a JMP module that was "substantially identical" to the Universal Protocol (as described above).

[21] *See* ISDA, 2015 Universal Resolution Stay Protocol FAQs ("Buy-side institutions are not expected by regulators to adhere to the ISDA 2015 Universal Protocol."), available at: http://www2.isda.org/functional-areas/protocol-management/faq/22; SIFMA Asset Management Group Statement on the ISDA 2015 Universal Resolution Stay Protocol ("SIFMA's Asset Management Group has been actively engaged with ISDA, the Prudential Regulators and banks in developing an ISDA Resolution Stay Protocol for non-bank counterparties, including SIFMA AMG members, projected for 2016 that will have a modular approach tailored on a jurisdictional basis for implementing new and expected prudential regulations that impact non-bank counterparties to cross-border contracts. SIFMA AMG has and will continue to advocate buy side perspectives to Prudential Regulators and banks on the development of this next phase of the protocol to promote the interests of asset managers' clients."), available at: http://www.sifma.org/newsroom/2015/sifma_asset_management_group_statement_on_the_isda_2015_universal_resolution_stay_protocol/.

[22] The final requirements in both the United Kingdom and Germany permit buy side adherents choices (i) as to jurisdictions in which they wish to continue to trade, and (ii) as to which banks in each respective jurisdiction the buy side adherents would amend contracts. The two JMP modules developed by ISDA in response to those requirements operate accordingly. Neither the UK nor the German module requires recognition of any non-UK or non-German special resolution regime, respectively.

[23] By virtue of a narrowed definition of "covered QFC" (as discussed elsewhere in this letter), adherence to the module would be relevant only in respect of: (i) in the case of the final rule's cross-border requirements, QFCs that provide for default rights and are governed by non-U.S. law; and (ii) in the case of the final rule's cross-default restrictions, QFCs that provide for cross-default rights.

B. Compliance with the Final Rule Through Alternative Proposals for Board Approval

The approval process for alternative means of compliance with the final rule should be made less burdensome and more flexible. Thus, irrespective of the availability of a safe harbor or other approval mechanisms for a JMP module as discussed above, Proposed Rule § 252.85(b) ("Proposal of enhanced creditor protection conditions") should be modified.

Paragraph (b)(1) permits a Covered Entity to make a request to the Board related to enhanced creditor protection conditions for QFCs. That provision should be broadened to permit counterparties to make such requests inasmuch as counterparties will have a significant stake in proposed enhanced creditor protection conditions. Moreover, the provision should clearly provide that an appropriate trade association, representing Covered Entities or counterparties (or both), may make such a request. Such a change would be consistent with the Board's statement that "[o]nce approved by the Board, enhanced creditor protections could be used by other covered entities (in addition to the covered entity that submitted the request for Board approval) as appropriate."[24]

Paragraph (b)(3)(ii) requires that a requesting Covered Entity must provide a "written legal opinion verifying that proposed provisions or amendments would be valid and enforceable under applicable law of the relevant jurisdictions, including, in the case of proposed amendments, the validity and enforceability of the proposal to amend the covered QFCs." This requirement should be eliminated. It is overbroad and vague in its terms, and it is unnecessary given the separate requirements that the Covered Entity provide an "analysis of the proposal that addresses each consideration in paragraph (d) of this section" and provide "[a]ny other relevant information that the Board requests."[25] At a minimum, the requirement should apply only in the event that a proposal includes enhanced creditor protection conditions that are qualitatively and materially different from conditions that are permitted by the final rule (either by its direct terms or through its safe harbor provisions).

Finally, the approval process under § 252.85(b) should not be limited to "enhanced creditor protection conditions" in the manner contemplated. Instead, the final rule should anticipate requests for Board approval that may, technically speaking, propose variations of more than the creditor protections referenced by § 252.85(b). In that regard, we note that some of the differences between the Proposed Rule and the Universal Protocol may not fall squarely within the rubric of creditor protections.[26] Thus, § 252.85(b) should not be as narrow as it is and should permit the Board to consider any appropriate alternative to compliance with the final rule.

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[24] *See* QFC Proposal at 29184. In addition, the text of § 252.85 should be revised to directly reflect the Board's statement regarding Covered Entity reliance.

[25] *See* Proposed Rule § 252.85(b)(3)(i) and (iii).

[26] For example, Proposed Rule § 252.85(b) covers a broad range of insolvency regime proceedings ("a receivership, insolvency, liquidation, resolution, or similar proceeding") whereas the analogous provisions of the Universal Protocol narrowly target specific U.S. insolvency statutory provisions (e.g., Chapter 11 under the Bankruptcy Code).

V. The Board Should Make Additional Changes to Narrow and Clarify the Proposed Rule.

A. The Final Rule Should Clearly State that a Covered Entity's Failure to Comply with Its Requirements in Connection with One or More Covered QFCs Will Not Affect the Enforceability of Covered QFCs.

SIFMA AMG's members, particularly when they act as agents for clients, believe that it is essential that no doubt concerning the enforceability of QFCs is introduced when the Board adopts its final rule. Accordingly, the final rule should clearly state that any failure by a Covered Entity to comply with the final rule in any respect in connection with any QFC will not affect the enforceability of any QFC.

B. The Proposed Rule's Requirements Should Only Be Triggered by QFC Transactions Between a Covered Entity and a Counterparty, not Transactions with an Affiliate of the Counterparty.

The Proposed Rule defines "covered QFC" in respect of a Covered Entity to include any QFC that the Covered Entity:

> Entered, executed, or otherwise became a party to before [the Proposed Rule] first becomes effective, if the covered entity or any affiliate that is a covered entity or a covered bank also enters, executes, or otherwise becomes a party to a QFC with the same person *or affiliate of the same person* on or after the date this subpart first becomes effective.[27]

Inclusion of the non-Covered Entity's affiliates would require counterparties to engage in an extensive and burdensome exercise to determine and track affiliations, and to disclose them to Covered Entities. Narrowing the scope of the definition so that it ties only to transactions directly with a counterparty itself would still result in amendments for all existing QFCs of the counterparty with all affiliated members of a Covered Entity if the counterparty traded a new QFC with any such member. In addition, any trading of new QFCs by an affiliate of that counterparty would result in that affiliate amending all of its existing QFCs with Covered Entity and its affiliates. Thus, even without the counterparty affiliate element of the definition of "covered QFC," the definition would result in the amendment of an extensive range of agreements for any counterparty and its affiliates that continue to transact QFCs after the final rule becomes effective.

The limited additional regulatory benefit of including affiliates of the non-Covered Entity is not warranted by the burden that would result. That burden would be particularly great if affiliation were determined in accordance with bank holding company "control" principles (as would appear to

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[27] Proposed Rule § 252.83(a)(2) (emphasis added) (defining the term for the U.S. SRR Requirements); *see also* Proposed Rule § 252.84(a)(2) (incorporating the definition for purposes of the Insolvency Requirements).

be intended[28]). However, even if affiliation were determined under generally acceptable accounting principles, the exercise would likely be unduly burdensome. For example, when an SIFMA AMG member acts as agent on behalf of a client, it may or may not have information regarding the client's affiliations. If the definition of "covered QFC" is not narrowed by removal of the phrase "*or affiliate of the same person,*" the final rule will impose extensive new burdens on SIFMA AMG members and their clients, which may risk significant difficulties and delay in connection with compliance efforts.

Thus, SIFMA AMG urges the Board to modify the definition of "covered QFC" so that, in respect of a Covered Entity and a given counterparty, the definition does not depend on any affiliation of the counterparty.

C. The Compliance Deadline for the Final Rule Should Be Extended by Addition of a Phase-in Schedule that Distinguishes Among Counterparties.

The QFC Proposal states that the final rule "would take effect on the first day of the first calendar quarter that begins at least one year after the issuance of the final rule."[29] Because of the extent of the effort that will be required by Covered Entities and counterparties to identify and amend QFCs and otherwise to take steps to comply with the final rule, the final rule should included an extended compliance period that distinguishes among types of counterparties. SIFMA AMG would recommend that QFCs with banks, broker-dealers and swap dealers (and perhaps other sell side financial firms) should be subject to the initial compliance date for the final rule (i.e., the first day of the first calendar quarter that begins at least one year after the issuance of the final rule). Compliance for QFCs with mutual funds, private funds and commodity pools (and perhaps other collective investment vehicles and financial trading firms) should be subject to a compliance date six months later, with QFCs with other counterparties subject to compliance another six months after than (i.e., one year after the initial compliance date).

VI. Summary of SIFMA AMG's Recommendations

For the reasons described above, the Board should make the following changes to improve the Proposed Rule:

- ***Narrow the Proposed Rule's Requirements for Cross-Border Recognition of U.S. SRRs.*** The Board should limit QFCs that are subject to its cross-border recognition requirements to those that both are governed by the laws of a non-U.S. jurisdiction and contain default rights. It should also revise those provisions to state expressly that the required default provisions must operate only in the context of a Covered Entity actually becoming subject to resolution proceedings under one of the two U.S. SRRs.

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[28] The Proposed Rule does not include a definition of "affiliate"; however, the rule would be codified as part of Regulation YY, which defines "affiliate" by reference "control" as defined under the Bank Holding Company Act of 1956.

[29] QFC Proposal at 29184 (citing the Riegle Community Development and Regulatory Improvement Act of 1994 and its requirements with respect to certain Board regulations).

- ***Not Impose Contractual Restrictions on Cross-Default Rights or, Alternatively, Permit Appropriate Creditor Protections, Not Impose Any Burden of Proof on Contracting Parties, and Limit Restrictions to QFCs with Cross-Default Rights.*** The Board should not adopt the proposed Cross-Default Restrictions in any form. However, if the Board moves forward with the Cross-Default Restrictions, it should ensure that the final rule includes at least those minimum creditor protections established by the Universal Protocol for interbank transactions. It should not require Covered QFCs to include provisions addressing burden of proof in respect of the exercise of default rights. And it should limit the Cross-Default Restrictions to QFCs providing for relevant cross-default rights.

- ***Provide for Compliance Alternatives that Include a JMP Module Suitable for Use by Fiduciaries and a Less Burdensome and More Flexible General Approval Process.*** The Board should expand § 252.85(a) to provide a safe harbor, applicable to requirements under the final rule generally, for a module to the JMP that would be based on, but more narrowly-tailored than, the Universal Protocol. In addition, § 252.85(b) should be modified to permit counterparties of Covered Entities, and appropriate trade associations, to make requests for enhanced creditor protection conditions. The requirement for a legal opinion should be eliminated. And the approval process should not be limited to "enhanced creditor protection conditions," but should permit the Board to consider any appropriate alternative to compliance with the final rule.

- ***The Board Should Make Additional Changes to Narrow and Clarify the Proposed Rule.*** The final rule should clearly state that a Covered Entity's failure to comply with its requirements in connection with one or more Covered QFCs will not affect the enforceability of Covered QFCs. The Proposed Rule's requirements should be triggered only by QFC transactions between a Covered Entity and a counterparty, not transactions with an affiliate of the counterparty. The compliance deadline for the final rule should be extended by addition of a phase-in schedule that distinguishes among counterparties.

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Should you have any questions or wish to discuss these matters further, please do not hesitate to contact Tim Cameron at 202-962-7447 or tcameron@sifma.org, Laura Martin at 212-313-1176 or lmartin@sifma.org, Michele Navazio at 212-839-5310 or mnavazio@sidley.com, or William Shirley at 212-839-5965 or wshirley@sidley.com.

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