DATE: December 10, 2008

MEMORANDUM TO: Board of Directors

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SUBJECT: Recordkeeping Requirements for Qualified Financial Contracts; Final Rule

Recommendation

Staff recommends that the Board of Directors (Board) authorize publication of the attached *Federal Register* document with respect to the final rule for recordkeeping requirements for qualified financial contracts (QFCs). Under section 11(e)(8) of the Federal Deposit Insurance Act (FDI Act), QFCs include such contracts as securities contracts, commodity contracts, forward contracts, repurchase agreements, and swap agreements for purposes of the FDIC's receivership operations. This final rule establishes recordkeeping requirements for QFCs held by insured depository institutions in a troubled condition as defined in this rule. The appendix to the rule requires an institution in a troubled condition, upon written notification by the FDIC, to produce immediately at the close of processing of the institution's business day, for a period provided in the notification, (1) electronic files for certain position level and counterparty level data; (2) electronic or written lists of (i) QFC counterparty and portfolio location identifiers, (ii) certain affiliates of the institution and the institution's counterparties to

QFC transactions, (iii) contact information and organizational charts for key personnel involved in QFC activities, and (iv) contact information for vendors for such activities; and (3) copies of key agreements and related documents for each QFC.

Background:

I. FDIC's Statutory Obligations with Respect to QFCs

QFCs are certain financial contracts that have been defined in the Federal Deposit Insurance Act (FDI Act) and receive special treatment by the FDIC in the event of the failure of an insured depository institution (institution). The special treatment of QFCs after the FDIC's appointment as receiver or conservator for a failed institution initially was codified in FDI Act as part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 and places certain restrictions on the FDIC as receiver for a failed institution that held QFCs.

The FDI Act identifies QFCs using the statutory definition of five specific financial contracts. This statutory list of QFCs consists of securities contracts, commodity contracts, forward contracts, repurchase agreements, and swap agreements. The FDIC also may define other similar agreements as QFCs by rule or order. In addition, a master agreement that governs any contracts in these five categories is treated as a QFC, as are security agreements that ensure the performance of a contract from the five enumerated categories.

Under the FDI Act and other U.S. insolvency statutes, a party to QFCs with the insolvent entity can exercise its contractual right to terminate QFCs and offset or net out any amounts due between the parties and apply any pledged collateral for payment. Under the Bankruptcy Code, this right is immediate upon initiation of bankruptcy

proceedings, while under the FDI Act, counterparties cannot exercise this contractual right until after 5:00 p.m. (Eastern Time) on the business day following the appointment of the FDIC as receiver. By contrast, parties to most contracts with insured institutions cannot terminate the contracts based upon the appointment of the FDIC as receiver. The special rights granted by the FDI Act to QFC counterparties are designed to protect the stability of the financial system and to reduce the potential for cascading interrelated defaults.

If QFC counterparties were unable to terminate and liquidate their positions in a timely manner after the failure of an institution, they would be exposed to market risks and uncertainty regarding the ultimate resolution of QFCs. Absent the ability to terminate a QFC in a timely manner when the counterparty becomes insolvent (which may include exercising rights to offset positions, net payments, and use collateral to cover amounts due), the potential for fluctuation in the value of the QFCs from changes in interest rates and other market factors may create market uncertainty that could lead to broader market disruptions.

After its appointment as receiver, the FDIC has three options in managing the institution's QFC portfolio: (1) transfer the QFCs to another financial institution, (2) repudiate the QFCs, or (3) retain the QFCs in the receivership. Within certain constraints, the FDIC can apply different options to QFCs with different counterparties.

First, the receiver may transfer a QFC to any other financial institution not currently in default, including but not limited to foreign banks, uninsured banks, and bridge banks or conservatorships operated by the FDIC. If the receiver transfers a QFC to another financial institution, the counterparty cannot exercise its contractual right to

terminate the QFC based solely on the transfer, the insolvency, or the appointment of the receiver.

Second, the FDIC as receiver may repudiate a QFC, within a reasonable period of time, if the receiver determines that the contract is burdensome. If the receiver repudiates the QFC, it must pay actual direct compensatory damages, which may include the normal and reasonable costs of cover or other reasonable measure of damages used in the industry for such claims, calculated as of the date of repudiation. If the receiver determines to transfer or repudiate a QFC, all other QFCs entered into between the failed institution and that counterparty, as well as those QFCs entered into with any of that counterparty's affiliates, must be transferred to the same financial institution or repudiated at the same time.

Third, the FDIC as receiver may retain a QFC in the receivership. This option would allow the counterparty to terminate the contract. If a QFC is terminated by the counterparty or repudiated by the receiver, the counterparty may exercise any contractual right to net any payment the counterparty owes to the receiver on a QFC against any payment owed by the receiver to the counterparty on a different QFC.

The FDIC as receiver has very little time to choose among these three options. Under the FDI Act, the FDIC as receiver has until 5:00 p.m. (Eastern Time) on the business day following the date of its appointment as receiver to make its decision to transfer any QFCs. During this period, counterparties are prohibited from terminating or otherwise exercising any contractual rights triggered by the appointment of the receiver under the QFC agreements. In effect, the same time limitation applies to repudiation because, after the expiration of this brief stay, counterparties are free to exercise any

contractual right to terminate the QFCs and avoid the FDIC's power to repudiate. If the FDIC as receiver decides to transfer any QFCs, it must take steps reasonably calculated to provide notice of the transfer of the QFCs of the failed institution to the relevant counterparties, who are prohibited from exercising such rights thereafter.

To make a well-informed decision on these three options, the FDIC needs access to information such as the types of QFCs, the counterparties and their affiliates, the notional amount and net position on the contracts, the purpose of the contracts, the maturity dates, and the collateral pledged for the contracts. Given the FDI Act's short time frame for such decision by the FDIC in the case of a QFC portfolio of any significant size or complexity, it may be difficult to obtain and process the large amount of information necessary for an informed decision by the FDIC as receiver unless that information is readily available to the FDIC in a format that permits the FDIC to quickly and efficiently carry out an appropriate financial and legal analysis.

In light of the large volume of information concerning QFCs that a receiver must process in the limited time frame set forth in the FDI Act, the FDIC staff recommends that the Board authorize the publication of the QFC recordkeeping requirements for institutions in a troubled condition, as described below. The absence of adequate information for decision-making by the FDIC as receiver increases the likelihood that, in a failed bank situation, QFCs will be left in the receivership or repudiated, instead of transferred to open institutions or a bridge bank. The FDIC does not believe that these QFC recordkeeping requirements are overly burdensome, but encompass information that should be maintained by institutions as part of their risk management of capital market activities. Given the business and related counterparty risks and supervisory

considerations, FDIC staff believes that these recordkeeping requirements are consistent with safe and sound banking practices by institutions holding QFCs.

II. The Proposed Rule

In 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act[1] was enacted, with section 908 of the Act authorizing the FDIC, in consultation with the other Federal banking agencies, to set recordkeeping requirements for QFCs held in institutions determined to be in a "troubled condition."[2] Consistent with this statutory authority, the FDIC issued a Notice of Proposed Rulemaking for recordkeeping requirements for QFCs (NPR), which was published in the Federal Register on July 28, 2008. See 73 FR 43635. The NPR invited comments from the public on all aspects of the proposal and in response to certain specific questions. In issuing the NPR, the FDIC stated that the QFC recordkeeping requirements in the proposed rule included position and counterparty data fields that likely were maintained by institutions as part of their risk management of capital markets activities. Given the financial exposures presented by QFCs and related counterparty risks and supervisory considerations, and after consultation with the other Federal banking agencies, the FDIC determined that the recordkeeping requirements in the proposed rule were consistent with safe and sound banking practices by insured depository institutions holding QFCs.

III. Summary of Comments

The American Bankers Association (ABA), The Clearing House Association (The Clearing House), the Independent Community Bankers of America (ICBA), and the International Swaps and Derivatives Association (ISDA) submitted comments on the

[1] Pub. L. No. 109-8, 119 Stat. 23 (April 20, 2005); H.R. Rep. No. 106-834, section 9, at 35 (2000).
[2] 12 U.S.C 1821(e)(8)(H).

NPR. These comments focused on issues regarding the (1) the institutions covered by the rule, (2) the requirement that QFC "position level" data be reported under the data fields in Table A1 of Appendix A, (3) the requirement that QFC counterparty level data be reported under the data fields in Table A2 of Appendix A, (4) the requirement of a standardized reporting format for the reporting of both position level and counterparty-specific data, (5) the proposed time frame for compliance, and (6) the differences between the QFC reporting requirements for purposes of the Basel II Advanced Approaches final rule and the QFC reporting requirements under Tables A1 and A2 of the proposed rule.

A. Institutions Covered under the Rule. Certain comment letters on the proposed rule suggested that the FDIC exclude from the definition of "troubled condition" institutions with a composite supervisory rating of 3 under the Uniform Financial Institution Rating System, because complying with the requirements of the rule could signal to employees, other institutions, and eventually the public that the institution is in financial distress. It was suggested by one commenter that "3" rated institutions not be required to comply with the rule unless the institution either holds more than $10 billion in assets or its primary federal regulator agrees that the institution should be required to comply. Another comment letter suggested that the rule apply only to institutions that have been found to have poor QFC risk management practices in place for their portfolios, or unsustainable QFC concentrations. Another comment letter suggested that because the use of QFCs by smaller community banks is limited, the rule should not apply to institutions with less than $5 billion in assets, or with fewer than ten open QFC positions on the balance sheet at any one time.

Under section 370.1(c) of the proposed rule, consistent with the Congressional directive, the FDIC provided that only institutions that were in a "troubled condition" would be covered by the rule. The FDIC based its definition of that term in the proposed rule on its current definition of "troubled condition" in 12 CFR 303.101(c), which was promulgated to implement 12 U.S.C. 1831i, regarding the Federal banking agencies' approval of the appointment of directors and senior executive officers of institutions. The proposed rule added one new criterion to that definition and expanded another criterion in the current definition to reflect the FDIC's data needs in its role as receiver under the FDI Act. The new criterion was that, notwithstanding the composite rating of the institution by that agency in its most recent report of examination, the institution is determined by the appropriate Federal banking agency, or the FDIC in consultation with the appropriate Federal banking agency, to be experiencing a significant deterioration of capital or significant funding difficulties or liquidity stress.

FDIC staff has determined that it is appropriate to include institutions with a 3 composite rating and total consolidated assets of $10 billion or greater, because these institutions are likely to pose risks to the deposit insurance fund arising from QFC activities. The FDIC has similar concerns regarding risks to the deposit insurance fund arising from any insured depository institution with QFCs that is experiencing a significant deterioration of capital or significant funding difficulties or liquidity stress, irrespective of the institution's supervisory rating. Based on its experience in its receivership capacity, the FDIC believes it is prudent to give institutions facing deteriorating conditions sufficient time to comply with this rule. Accordingly, the FDIC believes it is imperative that institutions with a supervisory rating of 3 and total assets of

$10 billion or greater and/or experiencing a significant deterioration of capital or significant funding difficulties or liquidity stress develop and maintain the QFC position level and counterparty-specific data fields shown in Tables A1 and A2 of the Appendix to this rule.

We believe that the "signaling" problem expressed in certain comment letters does not justify the exemption of certain institutions in a troubled condition from maintaining QFC information consistent with safe and sound practices as required by this rule. The FDIC's request for information would be non-public, as are many other supervisory directives. Also, the recordkeeping requirements in this final rule do not impose any restrictions on the business operations of institutions covered by this rule.

B. <u>QFC Position Level-Specific Data Fields (Table A1 of Appendix A)</u>. The ISDA and The Clearing House comment letters indicated that institutions usually do not maintain and aggregate the position-level information requested in Table A1 of Appendix A of the proposed rule, but instead aggregate information by counterparty. As noted in these comment letters, the FDIC's receivership authority under section 11(e)(9) of the FDI Act, 12 U.S.C. §1821(e)(9), requires that the FDIC treat all QFC contracts with a single counterparty and its affiliates similarly when deciding whether to transfer, repudiate or retain the QFC portfolio of a failed institution. Accordingly, in their view, transaction-level QFC position information should be unnecessary for the FDIC's decision-making process. These comment letters also indicated that the "purpose of the position" field be eliminated from Table A1 because institutions typically do not record this information for specific QFC positions and the purpose of a QFC position can change in dynamic markets. The Clearing House also indicated that providing a full transaction-

level understanding of the broad range of QFCs would entail different recordkeeping requirements for specific QFCs, thereby resulting in increased implementation complexity and associated costs.

The position-level QFC data fields in Table A1 of the Appendix to this final rule provide information necessary to enable the FDIC to meet its obligations under the least cost test for closed bank resolutions under section 13(c)(4) of the FDI Act, 12 U.S.C. § 1823(c)(4). The information required in Table A1 (e.g., the current market value of the QFC position, the type and purpose of the position, and the notional or principal amount of the position) are important to the evaluation of the costs associated with the FDIC as receiver's decision to (1) transfer the QFCs to another financial institution, (2) repudiate the QFCs, or (3) retain the QFCs in the receivership. As an example of the importance of position-level QFC data to the FDIC's least-cost resolution decisions in its receivership capacity, if one of the counterparty's QFC positions is a forward sale contract (a contract that allows the institution to sell assets at a set price in the future), and the institution has amassed a $50 million "pipeline" of assets for future delivery under the contract, the FDIC as receiver may realize significant financial benefits by transferring the forward contract together with the mortgage loan pipeline that it hedges. These financial benefits may, on the whole, exceed the savings that the receivership might realize if all of that counterparty's QFCs remained with the receivership and the loan pipeline were sold without the hedge. In another example, information identifying the "booking location" of individual QFCs would enable the FDIC to classify QFCs by foreign branch location and thereby allow the FDIC to evaluate the potential effect of "ring-fencing" whereby

foreign governments use foreign assets held by a failed U.S. institution to satisfy claims of depositors and creditors in that same jurisdiction. .

Identifying the type and purpose of QFCs on both an individual transaction level and on an aggregate basis will permit the FDIC to assess the impact that QFC determinations may have on a counterparty's other banking relationships with a failed institution. For example, knowledge of how particular QFCs fit into a counterparty's business with the institution might lead the FDIC to transfer the QFCs to a bridge bank in order to maintain the value of a customer relationship that otherwise would be destroyed if QFC determinations were made without regard to a QFC's purpose. As a specific illustration, a QFC might include an interest rate swap between an institution and a borrower, which is designed to tailor the interest payment due on the loan. Position-level QFC data would permit the FDIC to make an informed judgment concerning the least-cost disposition of the customer relationship. Also, position-level data would enable the FDIC to consider clearinghouse arrangements used for settling trades, which may influence the disposition of other QFCs settled through the same clearinghouse.

Information provided in Table A1 also may be needed by the FDIC as receiver to determine how to react to the termination of contracts by a counterparty in the event that such contracts are not transferred. A counterparty is under no obligation to terminate all of its contracts with the FDIC as receiver. Accordingly, in this situation, counterparty level data will be of little value, and the FDIC as receiver must obtain position-level data to satisfy the termination provisions of the contract.

As discussed below, concerns have been addressed as related to the position-specific data fields in Table A1 through a more flexible approach for

institutions' formats for reporting the QFC position-specific data fields in Table A1. The introduction to Table A1 in the Appendix has been revised to state that not later than three business days after the institution's receipt of the written notification from the FDIC under section 371.1(c) of this part, the institution must provide the FDIC with (i) a directory of the electronic files that will be used by the institution to maintain the position level data found in Table A1 and (ii) a point of contact at the institution should the FDIC have follow-up questions concerning this information.

In response to certain comment letters regarding whether the FDIC needs the data field in Table A1 that covers the "purpose of the position" for QFCs (e.g., whether the QFC position is being used for hedging or trading purposes), FDIC staff has determined that this data field is necessary for it to quickly ascertain the potential impact of its receivership options regarding certain QFC positions.[3]

C. QFC Counterparty-Specific Data Fields (Table A2 of Appendix A). The Clearing House and ISDA comment letters acknowledged the significance of the counterparty-specific data fields in Table A2 of Appendix A of the proposed rule.

D. Reporting Format for Data Fields Required in the Rule. The ABA commented that since banking organizations currently maintain QFC position-specific data in various formats and across various databases, the requirements in Table A1 and A2 of the Appendix of the proposed rule would require costly system upgrades and

[3] The information required for the "purpose of position" field is similar to information required under Financial Accounting Standards Board (FASB) Statements No. 133 and 161. Under these Statements, disclosures must be made as to whether derivatives are held for speculative purposes or risk mitigation, the types of risk mitigation strategies implemented, and how the use of derivatives affects the institutions financial position and performance. As this information is required under FASB Statements No. 133 and 161, prudently managed financial institutions should currently be recording the purpose of their entering into derivative contracts.

potential contract renegotiations with service providers. The ABA recommended instead that covered institutions be allowed to provide the FDIC the information in its existing format and include a "roadmap" of where the required information can be found.

The proposed rule did not mandate a specific format for the reporting by institutions in a troubled condition of the position level specific data fields in Table A1; instead, the FDIC provided a functional criterion that the data fields must be accessible for FDIC's monitoring purposes. In conjunction with the appropriate Federal banking agency, the FDIC will discuss with such institutions whether the existing electronic data files maintained by the respective institutions are in a suitable format to produce information required under the data fields in Table A1. Similarly, for purposes of the counterparty-level data fields in Table A2, the final rule requires that such data fields must be maintained in an electronic file in a format acceptable to the FDIC.

The data maintenance requirements for QFCs in this final rule are consistent with recommendations that have been developed by industry participants to measure and safeguard risks to financial institutions arising from the OTC derivatives market. The recent report from the Counterparty Risk Management Policy Group III (CRMPG III) recommends various measures to safeguard risks to financial institutions arising from counterparty credit risk, including that:

> . . . large integrated financial intermediaries ensure that their credit systems are adequate to compile detailed exposures to each of their institutional counterparties on an end-of-day basis by the opening of business the subsequent morning. In addition, the Policy Group recommends that large integrated financial intermediaries ensure their credit systems are capable of compiling, on an *ad hoc* basis and within a matter of hours, detailed and accurate estimates of market and credit risk exposure data across all counterparties and the risk parameters set out below. Within a slightly longer time frame this information should be expandable to include: (1) the directionality of the portfolio and of

> individual trades; (2) the incorporation of additional risk types, including contingent exposures and second and third order exposures (for example, SIVs, ABS, *etc*.); and (3) such other information as would be required to optimally manage risk exposures to a troubled counterparty.[4]

For purposes of minimizing the recordkeeping burdens for community banks under this final rule, the Appendix of the final rule provides that for institutions in a troubled condition with less than twenty open QFC positions upon receipt of the written notification from the FDIC under part 371 and the Appendix, the data required in Tables A1 and A2 may be recorded and maintained in a written format so long as the data are capable of being updated on a daily basis.

E. Time Period for Compliance. Three of the four comment letters stated that the proposed 30-day time period to comply after being notified of being in a troubled condition would be too short, especially if institutions had to change their systems or renegotiate contracts with third party service providers. One suggestion was to allow a "roadmap" compliance system, as discussed above, in which an institution would provide the FDIC a roadmap as to how the information could be collected when needed rather than actually assembling and providing the information on a regular basis. A second suggestion was to permit an institution to formally request an extension of time for compliance. In addition, the ABA comment letter recommended that the QFC data be updated only weekly because many of the large broker dealers operate global, around-the-clock operations and would have difficulty updating their files daily.

In response to these comments, in order to meet the statutory deadlines for decisions on QFCs upon the appointment of the FDIC as receiver for an institution in a troubled condition under section 11(e)(10) of the FDI Act, FDIC staff has determined that

[4] CRMPG III, Containing Systemic Risk: The Road to Reform 81.(August 6, 2008).

an initial 60 day compliance deadline. However, the FDIC will permit institutions to request additional extensions of this deadline, which the FDIC may grant after review on a case-by-case basis. Institutions should submit a request for an extension to the FDIC at least 15 days prior to the deadline for its compliance with the requirements of this rule, and the institution's request should contain the reasons why the extension is needed.

F. Conflict with Basel II implementation. The ABA comment letter suggested that implementing the QFC recordkeeping rule and the Basel II Advanced Approaches final rule at the same time would be overly burdensome and ineffective; therefore, either the QFC rules should "piggyback" the Basel II rules or institutions should be able to use the same information systems for both.

The FDIC and the other Federal banking agencies have developed reporting schedules for purposes of implementing the Basel II Advanced Approaches final rule. The FDIC has determined that the relevant schedules that have been developed for Basel II implementation do not contain counterparty-level data that Table A2 would require nor the specific data fields presented in Table A1 of Appendix A. Instead, these schedules report information aggregated across multiple transactions and counterparties. Accordingly, the interagency Basel II schedules for derivative contract exposures are neither duplicative nor appropriate for the FDIC's data needs in its receivership capacity under the FDI Act. In addition, several of the QFC categories under the FDI Act are not covered explicitly under the Basel II reporting schedules. It also is likely that fewer than twenty banks in the United States will implement the Basel II Advanced Approaches final rule for purposes of their risk-based capital requirements. Accordingly, the FDIC has determined not to change the proposed rule in this respect.

IV. The Final Rule

The final rule differs from the proposal by providing in section 371.1(c) that the institutions subject to this rule must comply within 60 days after they receive written notification from their appropriate Federal banking agency or the FDIC. The FDIC may, at its discretion, grant one or more extensions of time for compliance with this rule. No single extension may be for a period of more than 30 days. Such institutions may request an extension of time by submitting a written request to the FDIC at least 15 days prior to the deadline for its compliance with the requirements of this part. In addition, the final rule provides that not later than three business days after the institution's receipt of the written notification from the FDIC under section 371.1(c) of this part, the institution must provide the FDIC with (i) a directory of the electronic files that will be used by the institution to maintain the position level data found in Table A1 and (ii) a point of contact at the institution should the FDIC have follow-up questions concerning this information. Section 371.5 has been added to clarify that violating the terms or requirements of part 371 and Appendix A constitutes a violation of a regulation and may subject the institution to enforcement actions under Section 8 of the FDI Act (12 U.S.C. 1818).

Furthermore, a "de minimus" provision has been included to provide that for institutions in a troubled condition with less than twenty open QFC positions upon receipt of the written notification from the FDIC or the institution's appropriate Federal banking agency under part 371 and this Appendix, the data required in Tables A1 and A2 is not required to be recorded and maintained in electronic form as would otherwise be required by this part, so long as all required information is capable of being updated on a daily basis. If at any time after receiving such notification an institution has twenty or more

open QFC positions, it must within 60 days after that first occurs, comply with all provisions of part 371.

Other changes to the proposed rule are: (1) the change of the designated part of the FDIC's codified regulations for this rule from part 370 for the proposed to part 371 for the final rule; (2) as recommended in ISDA's comment letter, the penultimate data field in Table A2 will read: "Counterparty's collateral excess or deficiency with respect to all of the institution's positions with each counterparty, as determined under each applicable agreement including thresholds and haircuts where applicable;" and (3) also as recommended in ISDA's comment letter, the second bullet item under section B.1 will read: "A list of the affiliates of the counterparties that are also counterparties to QFC transactions with the institution or its affiliates, and the specific master netting agreements, if any, under which they are counterparties."

Section 371.1 provides that this part applies to insured depository institutions that are in a troubled condition, as defined in section 371.2(f), and that such institutions shall comply with this part (1) within 60 days after written notification by the institution's appropriate Federal banking agency or the FDIC that it is in a troubled condition, or (2) within a period requested by the institution and approved by the FDIC for an extension of this compliance deadline at least 15 days prior to the deadline.

Section 371.2 provides definitions for purposes of this part. In particular, "troubled condition" means any insured depository institution that (1) has a composite rating, as determined by its appropriate Federal banking agency in its most recent report of examination, of 3 (only for insured depository institutions with total consolidated assets of ten billion dollars or greater), 4, or 5 under the Uniform Financial Institution

Rating System, or in the case of an insured branch of a foreign bank, an equivalent rating; (2) is subject to a proceeding initiated by the FDIC for termination or suspension of deposit insurance; (3) is subject to a cease-and-desist order or written agreement issued by the appropriate Federal banking agency, as defined in 12 U.S.C. 1813(q), that requires action to improve the financial condition of the insured depository institution or is subject to a proceeding initiated by the appropriate Federal banking agency which contemplates the issuance of an order that requires action to improve the financial condition of the insured depository institution, unless otherwise informed in writing by the appropriate Federal banking agency; (4) is informed in writing by the insured depository institution's appropriate Federal banking agency that it is in troubled condition for purposes of 12 U.S.C. 1831i on the basis of the institution's most recent report of condition or report of examination, or other information available to the institution's appropriate Federal banking agency; or (5) is determined by the appropriate Federal banking agency or the FDIC in consultation with the appropriate Federal banking agency to be experiencing a significant deterioration of capital or significant funding difficulties or liquidity stress, notwithstanding the composite rating of the institution by its appropriate Federal banking agency in its most recent report of examination.

As required by the statutory authority for the FDIC's promulgation of this final rule for QFC recordkeeping by insured depository institutions in a "troubled condition," we have determined that the definition of "troubled condition" in this final rule is consistent with the current definition of "troubled condition" in 12 CFR § 303.101(c), and supplements the criteria in that definition with certain additional criteria that reflect the FDIC's concern that institutions in a troubled condition need to produce necessary

QFC data for purposes of the FDIC meeting its statutory obligations under section 11(e) of the FDI Act, in the event of the failure of any such institution. The third and fourth criteria of the term "troubled condition" as defined in final rule are similar to criteria for the definition of that term in other FDIC rules and the rules of the other Federal banking agencies (which generally implement 12 U.S.C. 1831i, regarding the Federal banking agencies' approval of appointment of directors and senior executive officers of institutions).[5] However, the first, second, and fifth criteria for the definition of "troubled condition" in the proposed rule differ from the other agencies' rules that implement 12 U.S.C. 1831i.

Consistent with the FDIC's and the other Federal banking agencies' definition of "troubled condition" for purposes of 12 U.S.C. 1831i, the first criterion of the definition of "troubled condition" in this proposed rule includes institutions with a composite rating, as determined by its appropriate Federal banking agency in its most recent examination, of 4 or 5 under the Uniform Financial Institution Rating System, or in the case of an insured branch of a foreign bank, an equivalent rating. However, for purposes of this first criterion for "troubled condition" in this proposed rule, the FDIC has included any insured depository institution with total consolidated assets of ten billion dollars or greater and a composite rating, as determined by its appropriate Federal banking agency in its most recent examination, of 3 under the Uniform Financial Institution Rating System. The inclusion of institutions of such asset size with a composite rating of 3 reflects the risks to the deposit insurance fund arising from large institutions with QFC

[5] See 12 CFR 303.101(c) (FDIC), 12 CFR. 5.51(c)(6) (OCC), 12 CFR 225.71(d) (FRB); and 12 CFR 563.555 (OTS).

portfolios for which the appropriate Federal banking agency has assigned a composite rating of 3.

The second criterion of the definition of "troubled condition" in this proposed rule reflects the FDIC's responsibility to terminate the deposit insurance of institutions that pose unreasonable risk to the deposit insurance fund. Similarly, the fifth criterion of this definition is based on circumstances that create a significant risk that an institution may require the appointment of the FDIC as receiver.

Section 371.3 provides that the records required to be maintained by an insured depository institution for QFCs under this part (except for records that must be maintained through electronic files under Appendix A of this part) may be maintained in any form, including in an electronic file, provided that the records are updated at least daily. Records not maintained in written form must be capable of being reproduced or printed in written form. Records must be made available upon written request by the institution's appropriate Federal banking agency or the FDIC immediately at the close of processing of the institution's business day, for a period provided in that written request. The report will contain information as of the close of business on the report day. Insured depository institutions that are in a troubled condition as defined in section 371.2(f) shall continue to maintain records required to comply with this part for a period of one year after the date that the appropriate Federal banking agency notifies the institution that it is no longer in a troubled condition as defined in section 371.2(f). If an insured depository institution that has been determined by the appropriate Federal banking agency to be in a troubled condition ceases to exist as an insured depository institution as a result of a merger or a similar transaction into an insured depository

institution that is not in a troubled condition immediately following the acquisition, the obligation to comply with this part will terminate when the institution in a troubled condition ceases to exist as an insured depository institution.

Section 371.4 provides that for each QFC for which an insured depository institution is a party or is subject to a master netting agreement involving the QFC, that institution must maintain records as listed under Appendix A of this part.

Section 371.5 was added to the final rule to clarify that violating the terms or requirements of part 371 and Appendix A constitutes a violation of a regulation and subjects the participating entity to enforcement actions under Section 8 of the FDI Act (12 U.S.C. 1818).

V. Appendix A of the Final Rule: QFC Recordkeeping Requirements

Appendix A to Part 371 sets forth the specific QFC recordkeeping requirements proposed in this NPR. These QFC recordkeeping requirements are organized into three categories as provided in Appendix A: (1) position level data (Table A1), (2) counterparty level data (Table A2), and (3) certain contracts and lists of counterparty affiliates and identifiers, affiliates of the institution that are counterparties to QFC transactions, organizational charts involving the institution and its affiliates, and supporting vendors (Section B). An institution in a troubled condition is required to maintain the position level data and counterparty data listed under Tables A1 and A2 in electronic files in a format acceptable to the FDIC, and such institutions are required to demonstrate the ability to produce this information immediately at the close of processing of the institution's business day, for a period provided in a written notification by the FDIC. The files required under Section B are less quantitative and may be maintained in

electronic format, in written format, or in a combination of those two formats. Nonetheless, the nature of this information requires that it be updated and available upon request on a daily basis. For institutions in a troubled condition with less than twenty open QFC positions upon receipt of the written notification from the FDIC or the institution's appropriate Federal banking agency under part 371 and this Appendix, the data required in Tables A1 and A2 are not required to be recorded in electronic form as otherwise would be required by this part, so long as all required information is maintained and is capable of being updated on a daily basis.

The final rule and Appendix A are intended to facilitate the ability of the receiver to gather relevant information on QFCs in order to make business decisions within the short time frame between when a failure occurs and when the FDIC as receiver must act under 12 U.S.C. 1821(e)(9) and (10). Also, the data fields and related information required in Appendix A are important for the due diligence by institutions of their QFC agreements in conjunction with their risk management policies and procedures.

For purposes of the final rule and Appendix A, "position" is defined in the final rule to mean the rights and obligations of a person or entity as party to an individual transaction. For example, "position" would include the rights and obligations of an institution under a "Transaction" (as such term is defined in the 2002 Master Agreement of the International Swaps and Derivatives Association (ISDA)), such as an interest rate swap.

Table A1. Not later than three business days after the institution's receipt of the written notification from the FDIC under section 371.1(c) of this part, the institution must provide the FDIC with (i) a directory of the electronic files that will be used by the

institution to maintain the position level data found in Table A1 and (ii) a point of contact at the institution should the FDIC have follow-up questions concerning this information. Table A1 requires data that must be maintained regarding open QFC positions entered into by that institution.[6] For such data, the institution must produce at the close of processing of the institution's business day a report that aggregates the current market value and the amount of QFCs by each of the delineated fields. The institution must produce the report within 60 days of a written notification by the FDIC for the period specified in the notification. In addition, the FDIC also may require a certain combination of recordkeeping fields from Table A1 where significant for purposes of its evaluation of risks associated with the institution's positions.

Table A2. Table A2 requires data that must be maintained at the counterparty[7] level for all QFCs entered into by an institution. For such data, the institution must demonstrate the ability to produce immediately at the close of processing of the institution's business day, for a period provided in a written notification by the FDIC, a report that (i) itemizes, by each counterparty and its affiliates with QFCs with the institution, the data required in each field delineated in Table A2; and (ii) aggregates by field, for each counterparty and its affiliates, the data required in each field.

Data files and contract information required under Section B: Section B of Appendix A requires that other data files be maintained in either written or electronic format for QFCs and upon a written request by the FDIC, be produced immediately at the close of processing of the institution's business day, for the period provided in that

[6] These positions include QFCs entered into by affiliates of the insured institution that are covered by the master agreements to which the institution is a party.

[7] The use of the term "counterparty" in Appendix A generally includes all entities (including all affiliates) that are effectively treated as a single counterparty under a master agreement.

written request. Each institution must maintain lists of: counterparty identifiers with the associated counterparty and contact information; affiliates of the counterparties that are also counterparties to QFC transactions; affiliates of the institution that are counterparties to QFC transactions, specifically indicating which affiliates are direct or indirect subsidiaries of the institution; and portfolio location identifiers with the associated booking locations.

For each QFC, the institution must maintain copies in a central location or data base in the United States of certain agreements, including active master netting agreements, and other QFC agreements between the institution and its counterparties that govern the QFC; active or "open" confirmations, if the position has been confirmed; credit support documents; and assignment documents, if applicable. The institution also must maintain a legal entity organizational chart; an organizational chart of all personnel involved in QFC-related activities at the institution, parent and affiliates; and a list of vendors supporting the QFC-related activities.