October 2, 2017

The Honorable Michael Crapo
Chairman
The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Jeb Hensarling
Chairman
The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
House of Representatives

Subject: Federal Reserve System: 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

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Board of Governors of the Federal Reserve System (the Board) entitled “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” (RIN: 7100-AE52). We received the rule on September 20, 2017. It was published in the Federal Register as a final rule on September 12, 2017, and both the Senate and House of Representatives reported receiving it on September 11, 2017. 82 Fed. Reg. 42,882.

The final rule imposes restrictions on U.S. top-tier bank holding companies identified by the Board as a global systemically important banking organization (GSIB), the subsidiaries of U.S. GSIB (other than national banks, federal savings associations, state nonmember banks, and state savings associations), and the U.S. operations of foreign GSIBs (other than national banks, federal savings associations, state nonmember banks, and state savings associations) with regard to the terms of their non-cleared qualified financial contracts (QFCs).

First, under this rule, a covered entity generally is required to ensure that QFCs to which it is party provide that any default rights and restrictions on the transfer of the QFCs are limited to the same extent as they would be under the Dodd-Frank Act and the Federal Deposit Insurance Act. Second, a covered entity generally is prohibited from being party to QFCs that would allow a QFC counterparty to exercise default rights against the covered entity, directly or indirectly, based on the entry into a resolution proceeding under the Dodd-Frank Act or Federal Deposit Insurance Act, or any other resolution proceeding, of an affiliate of the covered entity. The final
rule also amends certain definitions in the Board's capital and liquidity rules; the Board intends these amendments ensure that the regulatory capital and liquidity treatment of QFCs to which a covered entity is party is not affected by the final rule's restrictions on such QFCs. This final rule is effective on November 13, 2017.

Enclosed is our assessment of the Board's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. Our review of the procedural steps taken indicates that the Board complied with the applicable requirements.

If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shirley A. Jones, Assistant General Counsel, at (202) 512-8156.

signed

Robert J. Cramer
Managing Associate General Counsel

Enclosure

cc: Linda Robertson
Assistant to the Board of Governors
of the Federal Reserve System
REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON A MAJOR RULE
ISSUED BY THE
FEDERAL RESERVE SYSTEM
ENTITLED
“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”
(RIN: 7100-AE52)

(i) Cost-benefit analysis

The Board of Governors of the Federal Reserve System (the Board) analyzed the costs and benefits of this final rule. The Board intends this rule to yield substantial net benefits for the financial stability of the United States by reducing the potential that resolution of a global systemically important banking organization (GSIB), particularly a resolution in bankruptcy, will be disorderly and disruptive to financial stability. The Board expects these benefits to substantially outweigh the costs associated with the final rule.

As identified by the Board, the costs of the final rule to covered entities and their qualified financial contracts (QFCs) counterparties would generally be of three types. The first cost would be the cost to QFC counterparties arising from the relinquishment of certain rights, such as cross-default rights, that would have been permitted prior to the rule. However, the Board expects the costs of restricting such rights to be low as the nature of the rights that are restricted is narrow, the likelihood of exercising such rights is low, and other forms of protection are available that are not prohibited by the rule. The second cost associated with the rule is the cost of lost revenue for covered entities that might result if non-covered entity counterparties refuse to engage in QFCs with covered entities as a result of the reduction in rights required by the rule. The Board concluded that this cost only accrues in the aggregate to the financial system to the extent that non-covered entity counterparties refuse to engage in QFCs with any counterparty. Third and finally, this rule imposes costs on covered entities and non-covered entities to the extent that they are required to bear legal and administrative costs associated with drafting and negotiating compliant contracts. The Board expects these costs to be small relative to the costs of doing business in the financial sector generally. The Board notes that the final rule explicitly allows for the use of standardized industry protocols in lieu of complying with the terms of the rule, which it expects will reduce the legal and administrative costs associated with complying with the rule.

(ii) Agency actions relevant to the Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 603-605, 607, and 609

The Board determined that this final rule will not have a significant economic impact on a substantial number of small entities.
(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory agency, the Board is not subject to the Act.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 et seq.

On May 11, 2016, the Board published a notice of proposed rulemaking. 81 Fed. Reg. 29,169. The Board received approximately 30 comments on the proposed rule from banking organizations, trade associations, public interest advocacy groups, and private individuals. Board staff also met with some commenters at their request to discuss their comments on the proposal. The Board responded to comments in the final rule.

Paperwork Reduction Act (PRA), 44 U.S.C. §§ 3501-3520

The Board determined that this final rule contains information collection requirements under the Act. The Board reviewed these requirements under the authority delegated to it by the Office of Management and Budget (OMB). The information collection is entitled “Reporting, Recordkeeping, and Disclosure Requirements Associated with Enhanced Prudential Standards,” is assigned OMB Control Number 7100-0350, and has a total estimated annual burden of 119,264 hours.

Statutory authorization for the rule

The Board promulgated this final rule under the authority of sections 321–338a, 481–486, 1467a, 1818, 1828, 1831n, 1831o, 1831p-l, 1831w, 1835, 1844(b), 1844(c), 3101–3110, 3101 note, 3904, 3906-3909, 4808, 5361, 5362, 5365, 5366, 5367, 5368, and 5371 of title 12, United States Code.

Executive Order No. 12,866 (Regulatory Planning and Review)

As an independent regulatory agency, the Board is not subject to the Order.

Executive Order No. 13,132 (Federalism)

As an independent regulatory agency, the Board is not subject to the Order.