

# FIA QFC Webinar

**Paul J. Pantano, Jr.**  
**Ana Alfonso**  
**Neal Kumar**  
**Michael Sorrell (FIA)**

**November 27, 2018**



# The QFC Stay Rule



# Overview Of The QFC Stay Rule

- The Qualified Financial Contract (“**QFC**”) Stay Rule applies to U.S. global systemically important banking organizations (“**GSIBs**”), the subsidiaries of U.S. GSIBs, and the U.S. operations of foreign GSIBs (including U.S. subsidiaries, U.S. branches, and U.S. agencies) (collectively, “**Covered Entities**”).
  - Federal Reserve: 82 Fed. Reg. 42882 (Sept. 12, 2017).
  - Federal Deposit Insurance Corporation: 82 Fed. Reg. 50228 (Oct. 30, 2017).
  - Office of the Comptroller of the Currency: 82 Fed. Reg. 56630 (Nov. 29, 2017).

## Overview Of The QFC Stay Rule, *cont'd*

- Clearing members / clearing brokers that are (1) subsidiaries of U.S. GSIBs, or (2) U.S. subsidiaries of foreign GSIBs, are Covered Entities and, therefore, are subject to the QFC Stay Rule.
- In addition, clearing members may have customers that are Covered Entities that are subject to the QFC Stay Rule.



# The Definition of Qualified Financial Contract

- The definition of QFC in the QFC Stay Rule is very broad. See 12 C.F.R. 252.81.
  - It is based on the definition of the same term in the Dodd-Frank Act, and includes securities contracts, commodity contracts, forward contracts, repurchase agreements, and swap agreements. See 12 U.S.C. 5390(c)(8)(D).
- The term “**commodity contract**” includes, among other contracts, futures contracts, options on futures contracts, master agreements “that provide[] for” the foregoing contracts, and security and credit enhancement agreements related to the foregoing contracts.
- The term “**forward contract**” includes, among other contracts, “a contract...for the purchase, sale, or transfer of a commodity or any similar...service...which is presently or in the future becomes the subject of dealing in the forward contract trade....”



# Definition of an In-Scope QFC and Prohibited Provisions

- An In-Scope QFC is a QFC that explicitly:
  - restricts the transfer of the QFC (or any interest or obligation in or under, or any property securing, the QFC) from a Covered Entity; or
  - provides one or more default rights that can be exercised against a Covered Entity. See 12 C.F.R. 252.82(d).
- An In-Scope QFC must be amended if it contains one or both of the following prohibited provisions that can be exercised against a Covered Entity (either a Covered Entity clearing member or a Covered Entity customer):
  - a default right related to an affiliate of the Covered Entity “becoming subject to a receivership, insolvency, liquidation, resolution or similar proceeding” (“**Prohibited Cross-Default**”); and / or
  - a prohibition against “the transfer of a covered affiliate credit enhancement” (“**Prohibited Transfer Restriction**”) (12 C.F.R. 252.84) (collectively, “**Prohibited Provisions**”).



# Express Acknowledgment Requirement for Covered QFCs Governed by Non-US Law or Non-US Counterparties

- If a covered QFC is governed by Non-U.S. Law or involves a Non-U.S. Counterparty, it must expressly acknowledge that:
  - the transfer of the QFC will be effective to the same extent as under the U.S. Special Resolution Regimes; and
  - default rights can be exercised to no greater extent than under the U.S. Special Resolution Regimes. See 12 C.F.R. 252.83.
- U.S. Counterparty (other than a Covered Entity) means:
  - an individual domiciled in the U.S.;
  - a company incorporated under the laws of, or with its principal place of business in, the U.S. or a State; or
  - a U.S. branch or U.S. Agency.



# Compliance Dates

- Covered Entities must comply with the QFC Stay Rule in three phases depending on the type of counterparty to the QFC:
  - January 1, 2019, if each party to a QFC is a Covered Entity or an excluded bank;
  - July 1, 2019, if one party is a Covered Entity and the other party is a financial counterparty (as defined in the CFTC margin rule) that is not a Covered Entity or excluded bank; and
  - January 1, 2020, if one party is a Covered Entity and the other party is a corporate entity. See 12 C.F.R. 252.82(f).
- Entering into any new QFCs (not just In-Scope QFCs) with any type of counterparty after the first compliance date (January 1, 2019) triggers a requirement to conform all pre-existing and still open QFCs with that counterparty by the applicable compliance date.





# The FIA QFC Project



# The FIA QFC Project

- FIA has assumed that some of the contracts that clearing members enter into in connection with their execution and clearing businesses are QFCs. It has analyzed whether other such contracts are QFCs.
- The contracts that FIA considered are:
  - Template electronic access agreements;
  - The 2017 FIA Standard Give-Up Agreements;
  - The 2008 LME Give-up Agreement;
  - Exchange membership agreements;
  - Clearinghouse membership agreements;



# The FIA QFC Project, *cont'd*

- Customer account-related agreements:
  - Template Customer Agreements;
  - The FIA-ISDA Cleared Derivatives Execution Agreement (2012 Ver. 1.1);
  - The FIA Professional Client Agreement (July 2011 Version);
  - The non-U.S. Terms of Business 2018; and
  - The 2017 ISDA/FIA Cleared Derivatives Execution Agreement;
- Template omnibus agreements.



# Contracts That Do Not Need To Be Amended

- A Clearing Member Contract that is:
  - not a QFC;
  - not an In-Scope QFC; or
  - excluded from the scope of the QFC Stay Rule;

does not need to be amended (“conformed” or “remediated” in the language of the rule) to eliminate Prohibited Provisions.



# Contracts That Must Be Amended

- A Clearing Member Contract that:
  - is an In-Scope QFC;
  - is not otherwise excluded; and
  - contains Prohibited Provisions that can be enforced against a Covered Entity (either a clearing member or its customer), must be amended.
- Whenever a Covered Entity is a customer of a clearing member, the Customer Agreement must be amended if it contains Prohibited Provisions that can be enforced by the clearing member against the Covered Entity customer.
- Furthermore, certain Customer Agreements that are not governed by U.S. Law or to which a non-U.S. Counterparty is a party must include an express acknowledgment provision.



## Important Questions for the QFC Analysis

**Is it an In-Scope QFC?**

**Are there prohibited provisions?**

**CCP  
counterparty?  
FMU  
counterparty?**

**US person  
counterparty?  
Contract  
governed by  
US law?**

# Electronic Access Agreements and FIA Give-Up Agreements are Not QFCs

- FIA has concluded that EAAs and give-up agreements are not QFCs.
  - EAAs (that are not part of a Customer Agreement), FIA Give-Up Agreements, and LME Give-Up Agreements *are not commodity contracts* because they are not any of the types of contracts listed in the QFC definition (e.g., futures, options on futures, master agreements or security agreements).
  - EAAs, the FIA Give-Up Agreements and the LME Give-Up Agreements are not forward contracts because they are not the subject of dealing in the forward contract trade.
    - If a clearing member elects to treat a give-up agreement as a QFC, it does not need to be amended because it does not include Prohibited Provisions.



# Exchange and Clearinghouse Membership Agreements – Contracts with Central Counterparties and Financial Market Utilities

- The QFC Stay Rule provides that a Covered Entity “is not required to conform to the requirements of this subpart a covered QFC to which:
  - (1) A CCP is a party; or
  - (2) each party (other than the covered entity) is a FMU.” See 12 C.F.R. 252.88(a).





# Exchange and Clearinghouse Membership Agreements – Contracts with CPPs and FMUs, *cont'd*

- The QFC Stay Rule defines a CCP as:
  - a counterparty (for example, a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts. See 12 C.F.R. 252.81; and 12 C.F.R. 217.2.
- CCPs should also qualify as FMUs. See 82 Fed. Reg. at 42897, fn. 134.
- CCP exclusion and European principal-to-principal model
  - For cleared swaps where the GSIB enters a swap with the CCP and enters a back-to-back client-facing transaction, the transaction with the CCP is eligible for the CCP exclusion, but the client-facing transaction is not. 82 Fed Reg. at 42897.



# Exchange and Clearinghouse Membership Agreements – Contracts with CCPs and FMUs, *cont'd*

- The QFC Stay Rule defines an FMU as “any **person**, regardless of the jurisdiction in which the person is located or organized, **that manages or operates a multilateral system** for the purpose of **transferring, clearing, or settling payments, securities, or other financial transactions** among **financial institutions** or between financial institutions and the person . . . . [with certain listed exceptions].” See 12 C.F.R. 252.81.



# Exchange and Clearinghouse Membership Agreements – Contracts with CCPs and FMUs, *cont'd*

- If the counterparty to a clearing member contract is:
  - a person located in or organized under the laws of any jurisdiction;
  - that operates a multilateral system (*i.e.*, with three or more members) (See Federal Reserve Policy on Payment System Risk (Sept. 15, 2017));
  - for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions;
  - among financial institutions or between financial institutions (*i.e.*, among or between Covered Entities, among other entities) and the person;then it should qualify as an FMU.
- The key factor is settling payments and transferring transactions.



# Payment, Clearing and Settlement Activities

- Section 803(7)(C) of the Dodd-Frank Act provides that, “[w]hen conducted with respect to a financial transaction, **payment, clearing, and settlement activities** may include—
  - the calculation and communication of unsettled financial transactions;
  - the netting of transactions;
  - provision and maintenance of trade, contract, or instrument information;
  - the management of risks and activities associated with continuing financial transactions;
  - transmittal and storage of payment instructions;
  - the movement of funds;
  - the final settlement of financial transactions; and
  - other similar functions that the [FSOC] may determine.”



# Exchange (DCM) vs. CCP

- An exchange may not qualify as an FMU.
  - There is a **limited exclusion of designated contract markets** (“DCMs”) from the FMU definition “*solely* by reason of [the DCM] *providing facilities for comparison of data* respecting the terms of settlement of [] futures transactions effected on such exchange or by means of any electronic system operated or controlled by [the DCM], provided that the exclusions in this clause apply only with respect to the activities that require the entity to be so registered.”
- The importance of the distinction between an Exchange and CCP.
  - CME Group Rule 800: right or liability of the clearinghouse shall be enforced by or against the Exchange.
  - ICE Futures US: no comparable rule to CME Group Rule 800.
- Unclear whether this exclusion applies to non-CFTC designated exchanges.



# Contracts Assumed to be QFCs – Customer

- FIA's QFC Working Group elected to assume that certain Customer Agreements are QFCs.
- For this reason, FIA has not analyzed whether each of these types of agreements, in fact, falls within the broad definition of QFC.
- The variables that affect whether a clearing member is required to amend Customer Agreements include:
  - whether the Customer Agreement is an In-Scope QFC;
  - whether it contains Prohibited Provisions;
  - the type of customer; and
  - the governing law.



# Contracts Assumed to be QFCs, *cont'd*

- **Transfer Restrictions:**
  - U.S. Counterparties that are not Covered Entities
    - ✓ Clearing members should review their Customer Agreements to determine whether they have a Prohibited Transfer Restriction. If yes, they must be amended.
    - ✓ Clearing members should review their Customer Agreements to confirm that they are governed by U.S. Law, do not exclude the U.S. special resolution regimes, and involve only a U.S. Counterparty. If the Customer Agreement satisfies each of these three requirements, it does not need an express acknowledgment.



# Contracts Assumed to be QFCs, *cont'd*

- U.S. Counterparties that are Covered Entities
  - ✓ Clearing members should amend any Customer Agreement with a U.S. Counterparty that includes a Prohibited Transfer Restriction
- If a Customer Agreement with a non-U.S. Counterparty contains a Prohibited Transfer Restriction that is enforceable against the clearing member, it should be amended to conform to the QFC Stay Rule.
- A Customer Agreement with a non-U.S. Counterparty should be amended to include an express acknowledgment.





# Customer Agreements, *cont'd*

- **Default Rights:**
- U.S. Counterparties that are not Covered Entities:
  - Clearing members should review their Customer Agreements to confirm that they do not contain Prohibited Cross-Default provisions.
  - If not, a Customer Agreement with a non-Covered Entity U.S. Counterparty is not subject to this prong of the In-Scope QFC definition.
  - Any Customer Agreement that contains a Prohibited Cross-Default provision that can be exercised against a clearing member must be amended to conform with the QFC Stay Rule.
  - Clearing members should review their Customer Agreements to confirm that they are governed by U.S. Law, do not exclude the U.S. special resolution regimes, and involve only a U.S. Counterparty. If the Customer Agreement satisfies each of these three requirements, it does not need an express acknowledgment.



# Customer Agreements, *cont'd*

- **U.S. Counterparties that are Covered Entities:**
  - Any Customer Agreement with a Covered Entity customer that includes Prohibited Cross-Default provisions must be amended.
  - U.S. Law governed Customer Agreements with U.S. Counterparties do not require an express acknowledgment.



# Customer Agreements, *cont'd*

- **Non-U.S. Counterparties:**
  - If a Customer Agreement with a non-U.S. Counterparty contains a Prohibited Cross-Default right that can be exercised against the clearing member, it should be amended to conform to the QFC Stay Rule.
  - A Customer Agreement with a non-U.S. Counterparty must be amended to include an express acknowledgment.

# The FIA Professional Client Agreement (July 2011) and Default Module (With and Without the Clearing Module)

- **Transfer Restrictions:**
  - Under English law, counterparty consent to transfer is required for novation, or assignment without residual liability of the assignor, of the PCA.
  - In addition, the PCA prohibits assignment by the Firm's counterparty without the Firm's prior written consent.
  - Thus, assuming that the PCA is a QFC, it is an In-Scope QFC.
  - If the transfer restriction applies to the transfer of a credit enhancement provided by an affiliate of a Covered Entity (either the Firm or the client), it is a Prohibited Transfer Restriction and must be amended.



# The FIA Professional Client Agreement (July 2011) and Default Module (With and Without the Clearing Module), *cont'd*

- **Default Rights:**
  - Firms should review their forms of PCA to determine whether they contain any Prohibited Cross-Default rights that can be exercised against the Firm.
    - If they do, they must be amended.
- **Covered Entity Clients:**
  - PCAs with Covered Entity clients must be amended to comply with the QFC Stay Rule.
- **U.S. Counterparties:**
  - In addition, PCAs with U.S. Counterparties must include an express acknowledgment provision.



# The FIA Terms of Business 2018

- **Transfer Restrictions:**
  - If the transfer restriction in the Terms of Business applies to a credit enhancement provided by an affiliate of a Covered Entity counterparty, it is a Prohibited Transfer Restriction and must be amended.
- **Default Rights:**
  - Firms should review their forms of the Terms of Business to determine whether they contain any Prohibited Cross-Default rights that can be exercised against the Firm. If they do, they must be amended.
  - Any Terms of Business with a Covered Entity Client must be amended to comply with the QFC Stay Rule.
- **U.S. Counterparties:**
  - Terms of Business with a U.S. Counterparty must include an express acknowledgment provision.



# The Cleared Derivatives Execution Agreements (2012 and 2017)

- FIA and ISDA have published N.Y. law and English law CDEAs.
- Both prohibit transfer of the agreement without counterparty consent and, thus, assuming that they are QFCs, they are In-Scope QFCs.
- Only Prohibited Transfer Restrictions (those that limit transfer of credit support for Covered Entity transactions) require amendment.
- The English law version requires an express acknowledgment.



# Processes for Amending Customer Agreements With Prohibited Provisions

- **The ISDA 2018 U.S. Resolution Stay Protocol**
  - The simplest way to modify a Customer Agreement that includes Prohibited Provisions or that requires an express acknowledgment is for both parties to adhere to the ISDA Resolution Stay Protocol.
  - The Protocol is “universal” meaning that when an entity adheres, all of its QFCs with all Covered Entities that have adhered are amended.
  - Each separate legal entity in a corporate group must adhere.



# Processes for Amending Customer Agreements With Prohibited Provisions, *cont'd*

- **Bilateral Amendments**

- If a counterparty / client / customer will not adhere to the ISDA Resolution Stay Protocol, the parties should execute a bilateral agreement amending any Customer Agreement that includes Prohibited Provisions or that requires an express acknowledgment.
- It is not possible to comply with the QFC Stay Rule by incorporating by reference the terms of the Protocol in a bilateral agreement (unless all parties previously have adhered).
- Counterparties that choose to amend their QFCs bilaterally do not receive the benefit of “enhanced customer protections” provided under the Protocol:
  - ISDA has published a table comparing the creditor protections provided in the Protocol to the provisions permitted in bilateral amendments pursuant to the QFC Stay Rule.



# Processes for Amending Customer Agreements With Prohibited Provisions, *cont'd*

- **No Trade Lists**
  - If a counterparty / client / customer will not adhere to the ISDA Stay Protocol or execute a bilateral agreement amending Prohibited Provisions and, where necessary, adding an express acknowledgment by the relevant compliance date, clearing members should not execute and clear new trades for that party until after the required amendments are made and / or acknowledgment is added to the Customer Agreement.

# FIA Clearing Member Contract / QFC Table<sup>1</sup>

Type of Agreement <sup>2</sup>	QFC?	In-Scope QFC?	Amendment Required?	Express Acknowledgement Required?		ISDA Stay Protocol	Bilateral Amendment	Automatic Amendment
				U.S. Law and U.S. CPs	Non-U.S. Law or non-U.S. CPs			
Give-Up	No <sup>3</sup>							
Electronic Access	No							
DCM Membership	Yes	Yes	No, excluded <sup>4</sup>					
DCO Membership	Yes	Yes	No, excluded					
Customer Agreement ("CA") <sup>5</sup>	Yes	Yes <sup>6</sup>	Yes <sup>7</sup>	No	Yes	Yes	Yes	Yes <sup>8</sup>
Omnibus Agreement	Yes	See CA	See CA	No	Yes	See CA	See CA	See CA
CDEA 2012	Yes	Yes <sup>9</sup>	No <sup>10</sup>	No	Yes	Yes, but only for EA <sup>11</sup>	Yes, but only for EA	Yes, but only for EA
PCA (with and without Default Module and Clearing Module)	Yes	Yes <sup>12</sup>	Yes <sup>13</sup>		Yes	Yes	Yes	Yes <sup>14</sup>
FIA Terms of Business 2018	Yes	Yes <sup>15</sup>	Yes <sup>16</sup>		Yes	Yes	Yes	Yes <sup>17</sup>
2017 CDEA	Yes	Yes <sup>18</sup>	No <sup>19</sup>		Yes	Yes, but only for EA	Yes, but only for EA	Yes, but only for EA



# Endnotes to FIA Clearing Member Contract / QFC Table

1. This table is provided for convenience only. It should only be used in conjunction with Willkie Farr & Gallagher LLP's October 23, 2018 Memorandum titled: QFC Analysis of Clearing Member Contracts (the "WFG Memorandum"). Capitalized terms used, but not defined in this table are defined in the WFG Memorandum. Table cells that are not applicable are shaded gray.
2. As explained in the WFG Memorandum, at the direction of FIA and members of the FIA QFC working group WFG has assumed, solely for purposes of this analysis, that DCM and DCO membership agreements, customer agreements, the FIA-ISDA Cleared Derivatives Execution Agreement (2012), omnibus agreements, the PCA (with and without the Default and Clearing Modules), the non-U.S. Terms of Business (with and without two-way default provisions and OTC clearing provisions) and the 2017 ISDA/FIA Cleared Derivatives Execution Agreement, are QFCs.
3. We understand that some clearing members may elect to treat give-up agreements as QFCs for other purposes. They do not contain Prohibited Provisions so need not be amended.
4. This conclusion does not apply to the IFUS membership application and agreement.
5. This row applies solely to customer clearing agreements, not to the broader category of Customer Agreements as defined in the WFG Memorandum.
6. If it includes a transfer restriction or default rights.
7. For Covered Entity customers or if it includes Prohibited Provisions exercisable against Firm.
8. If authorized by the agreement.
9. Restricts transfer without consent.
10. Does not include Prohibited Provisions.
11. "EA" means the required express acknowledgment for contracts with non-U.S. Counterparties.
12. Transfer restricted and includes default rights that can be exercised against a Covered Entity client.
13. For Covered Entity counterparties and if it includes the Default Module.
14. Can be used to amend the PCA, which is the subject of FIA's QFC analysis. Amendment is effective on date specified in notice. Sec. 15.1.
15. Transfer restricted and includes default rights that can be exercised against a Covered Entity client.
16. For Covered Entity counterparties and if it includes full two-way default provisions.
17. Can be used to amend the Terms of Business. Amendment is effective on date specified in notice. Sec. 27.1.
18. Restricts transfer without consent.
19. Does not include Prohibited Provisions.

