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## **FEDERAL DEPOSIT INSURANCE CORPORATION**

### **12 CFR Parts 324 and 329**

#### **RIN 3064-AE30**

### **Regulatory Capital Rules, Liquidity Coverage Ratio: Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions**

**AGENCY:** Federal Deposit Insurance Corporation (FDIC).

**ACTION:** Final rule.

**SUMMARY:** The FDIC is adopting a final rule that amends the definition of “qualifying master netting agreement” under the regulatory capital rules and the liquidity coverage ratio rule. In this final rule, the FDIC also is amending the definitions of “collateral agreement,” “eligible margin loan,” and “repo-style transaction” under the regulatory capital rules. These amendments are designed to ensure that the regulatory capital and liquidity treatment of certain financial contracts generally would not be affected by implementation of special resolution regimes in non-U.S. jurisdictions that are substantially similar to the U.S. resolution framework or by changes to the International Swaps and Derivative Association (ISDA) Master Agreement that provide for contractual submission to such regimes. The Office of the Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (Federal Reserve) issued in December 2014, a joint interim final rule that is substantially identical to this final rule.

**DATES:** The final rule is effective [**Insert date of publication in the Federal Register**].

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## **SUPPLEMENTARY INFORMATION:**

### **I. Summary**

The regulatory capital rules of the Federal Reserve, the OCC, and the FDIC (collectively, the agencies) permit a banking organization to measure exposure from certain types of financial contracts on a net basis, provided that the contracts are subject to a “qualifying master netting agreement” that provides for certain rights upon a counterparty default.<sup>1</sup> The agencies, by rule, have defined a qualifying master netting agreement<sup>2</sup> as a netting agreement that, among other things, permits a banking organization to terminate, apply close-out netting, and promptly liquidate or set-off collateral upon an event of default of the counterparty (default rights), thereby reducing its counterparty exposure and market risks. On the whole, measuring the amount of exposure of these contracts on a net basis, rather than a gross basis, results in a lower measure of exposure, and thus, a lower capital requirement, under the regulatory capital rules. Similarly, the Liquidity Coverage Ratio (LCR) Rule<sup>3</sup> allows a banking organization to net the inflows and outflows associated with derivative transactions subject to a qualifying master netting agreement,

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<sup>1</sup> See 12 CFR part 3 (OCC); 12 CFR part 217 (Federal Reserve); 12 CFR part 324 (FDIC). The term “banking organization” includes national banks, state member banks, state nonmember banks, savings associations, and top-tier bank holding companies domiciled in the United States not subject to the Federal Reserve’s Small Bank Holding Company Policy Statement (12 CFR part 225, appendix C), as well as top-tier savings and loan holding companies domiciled in the United States, except for certain savings and loan holding companies that are substantially engaged in insurance underwriting or commercial activities.

<sup>2</sup> See 12 CFR 3.2 (OCC); 12 CFR 217.2 (Federal Reserve); 12 CFR 324.2 (FDIC).

<sup>3</sup> See 12 CFR part 50 (OCC); 12 CFR part 249 (Federal Reserve); 12 CFR part 329 (FDIC).

which generally results in a more accurate measure of cash outflows than if a banking organization were to calculate its derivatives inflows and outflows on a gross basis.

The agencies' current definition of "qualifying master netting agreement" recognizes that default rights may be stayed if the financial company is in receivership, conservatorship, or resolution under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),<sup>4</sup> or under the Federal Deposit Insurance Act (FDI Act).<sup>5</sup> Accordingly, transactions conducted under netting agreements where default rights may be stayed under Title II of the Dodd-Frank Act or the FDI Act may qualify for the favorable capital treatment described above. However, the FDIC's current definition of "qualifying master netting agreement" does not recognize that default rights may be stayed where a master netting agreement is subject to limited stays under non-U.S. special resolution regimes or where counterparties agree through contract that a special resolution regime would apply. When the FDIC adopted the current definition of "qualifying master netting agreement," no other jurisdiction had adopted a special resolution regime, and no banking organizations had communicated to the FDIC an intent to enter into contractual amendments to clarify that bilateral over-the-counter (OTC) derivatives transactions are subject to certain provisions of certain U.S. and foreign special resolution regimes.

Regarding non-U.S. special resolution regimes that provide a limited stay of termination rights and other remedies in financial contracts, in 2014, the European Union (EU) finalized the

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<sup>4</sup> See 12 U.S.C. 5390(c)(8)-(16).

<sup>5</sup> See 12 U.S.C. 1821(e)(8)-(13). The definition would also recognize that default rights may be stayed under any similar insolvency law applicable to government sponsored enterprises (GSEs). Generally under the agencies' regulatory capital rules, government-sponsored enterprise means an entity established or chartered by the U.S. government to serve public purposes specified by the U.S. Congress but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. government. See 12 CFR 3.2 (OCC); 12 CFR 217.2 (Federal Reserve); 12 CFR 324.2 (FDIC).

Bank Recovery and Resolution Directive (BRRD), which prescribes aspects of a special resolution regime that EU member nations should implement. For the BRRD to be fully implemented, each member nation of the EU must transpose the BRRD requirements into local law. The implementation of the BRRD by EU member nations was permitted as early as January 1, 2015, and the transposition process is largely complete.

Regarding contractual amendments between counterparties to OTC derivatives, various U.S. banking organizations have adhered to the 2015 Universal ISDA Resolution Stay Protocol (ISDA Protocol),<sup>6</sup> which is a multilateral amendment mechanism that provides for cross-border application of temporary stays under special resolution regimes (including Title II of the Dodd-Frank Act and the FDI Act). The ISDA Protocol would apply the provisions of Title II of the Dodd-Frank Act or the FDI Act, as appropriate, concerning stays of termination rights and other remedies in qualified financial contracts entered into by U.S. financial companies, including insured banks, if counterparties to such transactions are not subject to U.S. law. It would also apply similar provisions of the laws and regulations of certain EU member countries that have implemented the BRRD to counterparties of financial companies in those countries. Thus, the ISDA Protocol would limit the rights of counterparties to exercise termination rights and other remedies in financial contracts to the same extent that those rights would be limited under the sovereign resolution regime applicable to their counterparties or, in certain circumstances, their counterparties' affiliates.

In addition, the ISDA Protocol provides for limited stays of termination rights and other remedies for cross-defaults resulting from affiliate insolvency proceedings under a limited

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<sup>6</sup> See ISDA Protocol at <http://assets.isda.org/media/f253b540-25/958e4aed.pdf/>.

number of U.S. insolvency regimes. ISDA Master Agreements<sup>7</sup> and securities financing transactions (documented under industry standard documentation for such transactions)<sup>8</sup> between counterparties that adhere to the ISDA Protocol are automatically amended to stay certain default rights and other remedies provided under the agreement. The effective date of certain provisions of the ISDA Protocol was January 1, 2016.

A master netting agreement under which default rights may be stayed under the BRRD or that incorporates the ISDA Protocol would no longer qualify as a qualifying master netting agreement under the FDIC's current regulatory capital and liquidity rules. This would result in considerably higher capital and liquidity requirements.

The FDIC issued in the Federal Register of January 30, 2015, proposed amendments to the definition of qualifying master netting agreement in the regulatory capital and liquidity rules and certain related definitions in the regulatory capital rules (January 2015 NPR).<sup>9</sup> This final rule adopts those revised definitions in the proposed rule issued in the January 2015 NPR, as amended to better conform with the interim final rule jointly issued by the Federal Reserve and the OCC in December 2014.<sup>10</sup>

Under this final rule, the FDIC permits an otherwise qualifying master netting agreement to qualify for favored netting treatment under the FDIC's regulatory capital and liquidity rules if

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<sup>7</sup> The ISDA Master Agreement is a form of agreement that governs OTC derivatives transactions and is used by a significant portion of the parties to bilateral OTC derivatives transactions, including large, internationally active banking organizations. Furthermore, the ISDA Master Agreement generally creates a single legal obligation that provides for the netting of all individual transactions covered by the agreement.

<sup>8</sup> The ISDA Protocol is an expansion of the ISDA 2014 Resolution Stay Protocol and covers securities financing transactions in addition to over-the-counter derivatives documented under ISDA Master Agreements. As between adhering parties, the ISDA Protocol replaces the ISDA 2014 Resolution Stay Protocol (which does not cover securities financing transactions). Securities financing transactions (which generally include repurchase agreements and securities lending transactions) are documented under non-ISDA master agreements. The ISDA Protocol addresses financial contracts under these master agreements in the "Securities Financing Transaction Annex."

<sup>9</sup> 80 FR 5063 (January 30, 2015).

<sup>10</sup> 79 FR 78287 (December 30, 2014).

(i) default rights under the agreement may be stayed under a qualifying non-U.S. special resolution regime or (ii) the agreement incorporates a qualifying special resolution regime by contract. Through these revisions, the final rule maintains the existing treatment for these contracts for purposes of the regulatory capital and liquidity rules, while recognizing the recent changes instituted by the BRRD and the ISDA Protocol.

The final rule also revises certain other definitions of the regulatory capital rules to make various conforming changes designed to ensure that a banking organization may continue to recognize the risk mitigating effects of financial collateral<sup>11</sup> received in a secured lending transaction, repo-style transaction, or eligible margin loan for purposes of the regulatory capital and liquidity rules. Specifically, the final rule revises the definition of “collateral agreement,” “eligible margin loan,”<sup>12</sup> and repo-style transaction<sup>13</sup> to provide that a counterparty’s default

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<sup>11</sup> Generally, under the agencies’ regulatory capital rules, financial collateral means collateral in the form of: (i) cash on deposit with the banking organization (including cash held for the banking organization by a third-party custodian or trustee); (ii) gold bullion; (iii) long-term debt securities that are not resecuritization exposures and that are investment grade; (iv) short-term debt instruments that are not resecuritization exposures and that are investment grade; (v) equity securities that are publicly traded; (vi) convertible bonds that are publicly traded; or (vii) money market fund shares and other mutual fund shares if a price for the shares is publicly quoted daily. In addition, the regulatory capital rules also require that the banking organization have a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit and notwithstanding the prior security interest of any custodial agent). See 12 CFR 3.2 (OCC); 12 CFR 217.2 (Federal Reserve); 12 CFR 324.2 (FDIC).

<sup>12</sup> Generally under the agencies’ regulatory capital rules, eligible margin loan means an extension of credit where: (i) the extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, or gold; (ii) the collateral is marked-to-fair value daily, and the transaction is subject to daily margin maintenance requirements; and (iii) the extension of credit is conducted under an agreement that provides the banking organization with default rights, provided that any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs. In addition, in order to recognize an exposure as an eligible margin loan a banking organization must comply with the requirements of section 3(b) of the regulatory capital rules with respect to that exposure.

<sup>13</sup> Generally, under the agencies’ regulatory capital rules, repo-style transaction means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the banking organization acts as agent for a customer and indemnifies the customer against loss, provided that: (1) the transaction is based solely on liquid and readily marketable securities, cash, or gold; (2) the transaction is marked-to-fair value daily and subject to daily margin maintenance requirements; (3) the transaction provides certain default rights. In addition, in order to recognize an exposure as a repo-style transaction for purposes of this

rights may be stayed under a non-U.S. special resolution regime or, if applicable, that are made subject to a special resolution regime by contract.<sup>14</sup>

## **II. Background**

### **A. U.S. Resolution Regime**

It is common market practice for bilateral derivatives and certain other types of financial contracts entered into by large banking organizations to permit a non-defaulting counterparty to exercise early termination rights and other contractual remedies upon a counterparty (or a related entity) experiencing an event of default. These contractual provisions are generally recognized as a credit risk mitigant because the provisions allow a non-defaulting party the uninterrupted right to close-out, net, and liquidate any collateral securing its claim under the contract upon a counterparty's default.

However, as the failure of Lehman Brothers demonstrated, the uninterrupted exercise of such rights by counterparties of a globally active financial company with a significant derivatives portfolio could impede the orderly resolution of the financial company and pose risks to financial stability. The United States has enacted laws that impose a limited stay on the exercise of early termination rights and other remedies with regard to qualified financial contracts (such as OTC derivatives, securities financing transactions, and margin loans) with insured depository institutions in resolution under the FDI Act and, in 2010, with financial companies in resolution under Title II of the Dodd-Frank Act.

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subpart, a banking organization must comply with the requirements of section 3(b) of the regulatory capital rules. See 12 CFR 3.2 (OCC); 12 CFR 217.2 (Federal Reserve); 12 CFR 324.2 (FDIC).

<sup>14</sup> See 12 CFR part 32.

## **B. Foreign Special Resolution Procedures and the ISDA Protocol**

In recognition of the issues faced in the financial crisis concerning resolution of globally-active financial companies, the EU issued the BRRD on April 15, 2014, which requires EU member states to implement a resolution mechanism by December 31, 2014, in order to increase the likelihood for successful national or cross-border resolutions of a financial company organized in the EU.<sup>15</sup> The BRRD contains special resolution powers, including a limited stay on certain financial contracts that is similar to the stays provided under Title II of the Dodd-Frank Act and the FDI Act. Therefore, the operations of U.S. banking organizations located in jurisdictions that have implemented the BRRD could become subject to an orderly resolution under the BRRD, including the application of a limited statutory stay of a counterparty's right to exercise early termination rights and other remedies with respect to certain financial contracts. The BRRD is generally designed to be consistent with the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes),<sup>16</sup> which were published by the Financial Stability Board (FSB)<sup>17</sup> of the G-20<sup>18</sup> member nations in October 2011, and is designed to

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<sup>15</sup> On January 1, 2015, most of the provisions of the BRRD were in effect in a number of the EU member states.

<sup>16</sup> The Key Attributes area available at [www.financialstabilityboard.org/publications/r\\_111104cc.pdf](http://www.financialstabilityboard.org/publications/r_111104cc.pdf). See specifically Key Attributes 4.1-4.4 regarding set-off, netting, collateralization and segregation of client assets and Appendix I Annex 5 regarding temporary stays on early termination rights.

<sup>17</sup> The FSB is an international body that monitors and makes recommendations about the global financial system. The FSB coordinates the regulatory, supervisory, and other financial sector policies of national financial authorities and international standard-setting bodies.

<sup>18</sup> The G-20 membership comprises a mix of the world's largest advanced and emerging economies. The G-20 members are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States, and the European Union. Following the most recent financial crisis, leaders of the G-20 member nations recognized that the orderly cross-border resolution of a globally active financial company requires all countries to have effective national resolution regimes to resolve failing financial companies in an orderly manner and that national resolution regimes should be consistent with one another. Subjecting the same financial company to conflicting legal rules, procedures, and mechanisms across jurisdictions can create uncertainty, instability, possible systemic contagion, and higher costs of resolution. The Key Attributes were adopted by the G-20 leaders and are now international-agreed-upon standards that set forth the responsibilities and powers that national resolution regimes should have to resolve a failing systemically important financial institution.

increase the likelihood for successful national or cross-border resolutions of a financial company organized in the EU.

ISDA launched the ISDA Protocol on November 12, 2015, which provides a mechanism for parties to transactions under ISDA Master Agreements (and securities financing transactions documented under industry standard documentation for such transactions) to amend those agreements to stay certain early termination rights and other remedies provided under the agreement. As of July 14, 2016, 217 parties, including several of the largest U.S. banking organizations,<sup>19</sup> have adhered to the ISDA Protocol and have thereby modified their ISDA Master Agreements. Like other qualified financial contracts, OTC derivatives transactions executed under standard ISDA Master Agreements allow a party to terminate the agreement immediately upon an event of default of its counterparty, including if its counterparty (or a related entity)<sup>20</sup> enters insolvency or similar proceedings.

The contractual amendments effectuated pursuant to the ISDA Protocol would apply the provisions of Title II of the Dodd-Frank Act and the FDI Act concerning limited stays of termination rights and other remedies in qualified financial contracts to ISDA Master Agreements between adhering counterparties, including adhering counterparties that are not otherwise subject to U.S. law. The amendments also would apply substantially similar provisions of certain non-U.S. laws, to ISDA Master Agreements between adhering

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<sup>19</sup> The U.S. banking organizations that have adhered to the ISDA Protocol include Bank of America Corporation, The Bank of New York Mellon, Citigroup Inc., The Goldman Sachs Group, Inc., JPMorgan Chase & Co., Wells Fargo & Co., Morgan Stanley, and certain subsidiaries thereof. See current list of adhering parties to the ISDA Protocol at <http://www2.isda.org/functional-areas/protocol-management/protocol-data-csv/22>.

<sup>20</sup> Under the ISDA Protocol, a related entity is defined to include (i) each parent or (ii) an affiliate that is (a) a creditor support provider or (b) a specified entity.

counterparties that are not otherwise subject to such laws.<sup>21</sup> Thus, the contractual amendments effectuated pursuant to the ISDA Protocol would permit a party that has agreed to adhere to the ISDA Protocol to exercise early termination rights and other remedies only to the extent that it would be entitled to do so under the special resolution regime applicable to its adhering counterparties (or related entities, as applicable).<sup>22</sup>

### **C. Description of Relevant Provisions of the Regulatory Capital and the Liquidity Coverage Ratio Rules**

As noted above, the agencies' regulatory capital rules permit a banking organization to measure exposure from certain types of financial contracts on a net basis, provided that the contracts are subject to a qualifying master netting agreement or other agreement that contains specific provisions. Specifically, under the current regulatory capital rules, a banking organization with multiple OTC derivatives that are subject to a qualifying master netting agreement would be able to calculate a net exposure amount by netting the sum of all positive and negative fair values of the individual OTC derivative contracts subject to the qualifying master netting agreement and calculating a risk-weighted asset amount based on the net exposure amount. For purposes of the current supplementary leverage ratio (as applied only to advanced approaches banking organizations), a banking organization that has one or more OTC derivatives with the same counterparty that are subject to a qualifying master netting agreement would be permitted to not include in total leverage exposure cash variation margin received from such counterparty that has offset the mark-to-fair value of the derivative asset, or cash collateral that is

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<sup>21</sup> The provisions of the ISDA Protocol relating to the special resolution regimes in these jurisdictions became effective on January 1, 2016, for ISDA Master Agreements between the adherents. The ISDA Protocol also provides a mechanism for adhering parties to opt-in to special resolution regimes in other FSB member jurisdictions so long as the regimes meet conditions specified in the ISDA Protocol relating to creditor safeguards, which are consistent with the Key Attributes.

<sup>22</sup> Parties adhering to the ISDA Protocol initially were contractually subject to the statutory special resolution regimes of France, Germany, Japan, Switzerland, the United Kingdom and the United States.

posted to such counterparty that has reduced the banking organization's on-balance sheet assets.<sup>23</sup>

In addition, for risk-based capital purposes, a banking organization with a securities financing transaction that meets the definition of a repo-style transaction with financial collateral, a margin loan that meets the definition of an eligible margin loan with financial collateral, or an OTC derivative contract collateralized with financial collateral may determine a net exposure amount to its counterparty according to section 37 or section 132 of the regulatory capital rules. A banking organization with multiple repo-style transactions or eligible margin loans with a counterparty that are subject to a qualifying master netting agreement may net the exposure amounts of the individual transactions under that agreement. In addition, for purposes of the supplementary leverage ratio, an advanced approaches banking organization with multiple repo-style transactions with the same counterparty that are subject to a qualifying master netting agreement would be permitted to net for purposes of calculating the counterparty credit risk component of its total leverage exposure. In general, recognition of netting results in a lower measure of risk-weighted assets and total leverage exposure than if a banking organization were

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<sup>23</sup> Under the agencies' regulatory capital rules, the general framework consists of two approaches: (1) the standardized approach, which, beginning on January 1, 2015, applies to all banking organizations regardless of total asset size, and (2) the advanced approaches, which currently apply to large internationally active banking organizations (defined as those banking organizations with \$250 billion or more in total consolidated assets or \$10 billion or more in total on-balance sheet foreign exposure, depository institution subsidiaries of those banking organizations that use the advanced approaches rule, and banking organizations that elect to use the advanced approaches). As a general matter, the standardized approach sets forth standardized risk weights for different asset types for regulatory capital calculations, whereas, for certain assets, the advanced approaches make use of risk assessments provided by banking organizations' internal systems as inputs for regulatory capital calculations. Consistent with section 171 of the Dodd-Frank Act (codified at 12 U.S.C. 5371), a banking organization that is required to calculate its risk-based capital requirements under the advanced approaches (*i.e.*, an advanced approaches banking organization) also must determine its risk-based capital requirements under the generally applicable risk-based capital rules, which is the standardized approach as of January 1, 2015). The lower – or more binding – ratio for each risk-based capital requirement is the ratio that the advanced approaches banking organization must use to determine its compliance with minimum regulatory capital requirements.

to calculate its OTC derivatives, repo-style transactions, and eligible margin loans on a gross basis.

The agencies also use the concept of a qualifying master netting agreement in the LCR rule.<sup>24</sup> The LCR rule requires a banking organization to maintain an amount of high-quality liquid assets (the numerator) to match at least 100 percent of its total net cash outflows over a prospective 30 calendar-day period (the denominator). For derivative transactions subject to a qualifying master netting agreement, a banking organization would be able to calculate the net derivative outflow or inflow amount by netting the contractual payments and collateral that it would provide to, or receive from, the counterparty over a prospective 30 calendar-day period.<sup>25</sup> If the derivative transactions are not subject to a qualifying master netting agreement, then the derivative cash outflows for that counterparty would be included in the net derivative cash outflow amount and the derivative cash inflows for that counterparty would be included in the net derivative cash inflow amount, without any netting and subject to the LCR rule's cap on total inflows. Recognition of netting generally results in a more accurate measure of outflows than if a banking organization were to calculate its inflows and outflows on its derivatives transactions on a gross basis.

### **III. The Final Rule**

The final rule amends the definitions of “collateral agreement,” “eligible margin loan,” “qualifying master netting agreement,” and “repo-style transaction” in the FDIC’s regulatory capital rules and “qualifying master netting agreement” in the FDIC’s LCR rules to ensure that

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<sup>24</sup> The agencies’ LCR rule may be found at 12 CFR part 50 (OCC); 12 CFR part 249 (Federal Reserve); and 12 CFR part 329 (FDIC).

<sup>25</sup> The LCR rule provides that foreign currency transactions that meet certain criteria can be netted regardless of whether those transactions are covered by a qualified master netting agreement. See 12 CFR 50.32(c)(2) (OCC); 12 CFR 249.32(c)(2) (Federal Reserve); 12 CFR 329.32(c)(2) (FDIC).

the regulatory capital and liquidity treatment of OTC derivatives, repo-style transactions, eligible margin loans, and other collateralized transactions would be unaffected by the adoption of various foreign special resolution regimes and the ISDA Protocol. In particular, the final rule amends these definitions to provide that a relevant netting agreement or collateral agreement may provide for a limited stay or avoidance of rights where the agreement is subject by its terms to, or incorporates, certain resolution regimes applicable to financial companies, including Title II of the Dodd-Frank Act, the FDI Act, or any similar foreign resolution regime that are jointly determined by the agencies to be substantially similar to Title II of the Dodd-Frank Act or the FDI Act.

In determining whether the laws of foreign jurisdictions are “similar” to the FDI Act and Title II of the Dodd-Frank Act, the FDIC, jointly with the OCC and FRB, intends to consider all aspects of U.S. law, including all aspects of stays provided thereunder.<sup>26</sup> Relevant factors include, for instance, creditor safeguards or protections provided under a foreign resolution regime as well as the length of stay.<sup>27</sup>

This final rule allows for the continuation of the existing netting treatment for these contracts for purposes of the regulatory capital and liquidity rules. Implementation of consistent, national resolution regimes on a global basis furthers the orderly resolution of internationally active financial companies, and enhances financial stability. In addition, the development of the

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<sup>26</sup> See 12 U.S.C. 1821(e)(8)-(13) and 5390(c)(8)-(16). As noted above, the ISDA Protocol covers only resolution regimes that are considered to be consistent with the principles of the Key Attributes. Therefore, it is also expected that any limited statutory stay under foreign law determined for purposes of this final rule to be similar to the FDI Act and Title II of the Dodd-Frank Act would also be consistent with the relevant principles of the Key Attributes.

<sup>27</sup> Under Title II of the Dodd-Frank Act, counterparties are stayed until 5:00 p.m. on the business day following the date of appointment of a receiver from exercising termination, liquidation, or netting rights under the qualified financial contract. 12 U.S.C. 5390(c)(10)(B)(i)(I). If the qualified financial contracts are transferred to a solvent third party before the stay expires, the counterparty is permanently enjoined from exercising such rights based upon the appointment of the receiver, but is not stayed from exercising such rights based upon other events of default. See 12 U.S.C. 5390(c)(10)(B)(i)(II).

ISDA Protocol furthers the principles of Title II of the Dodd-Frank Act and the FDI Act (in instances where a counterparty is a U.S. entity or its subsidiary) to counterparties who are not otherwise subject to U.S. law.

In addition to giving contractual effect to limited stays of termination rights under special resolution regimes on a cross-border basis, the ISDA Protocol also provides for limited stay of termination rights for cross-defaults resulting from affiliate insolvency proceedings under a limited number of U.S. general insolvency regimes, including the U.S. bankruptcy code. This provision takes effect upon the effective date of implementing regulations in the United States. To the extent the agencies implement regulations to give effect to these provisions of the ISDA Protocol, the FDIC will consider further amending the definition of “qualifying master netting agreement” in the regulatory capital and liquidity rules and the definition of “collateral agreement”, “repo-style transaction” and “eligible margin loan” in the regulatory capital rules.

The qualified master netting agreement definition in the FDIC’s capital and liquidity rules also relates to the eligible master netting agreement definition in the swap margin rules issued by the adopting agencies in November 2015.<sup>28</sup> The swap margin rule establishes margin requirements for non-cleared swaps entered into by an entity supervised by one of the adopting agencies that is also registered with the Commodity Futures Trading Commission or the Securities and Exchange Commission as a dealer or major participants in non-cleared swaps (such entities are referred to in the swap margin rule as “covered swap entities.”) The swap margin rule allows a covered swap entity to net variation margin and initial margin requirements for non-cleared swaps subject to the rule when such swaps are subject to an “eligible master netting agreement” between the covered swap entity and its counterparty.

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<sup>28</sup> See 80 FR. 74840 (November 30, 2015).

The swap margin rule's definition of "eligible master netting agreement" is substantively the same as the definition of "qualified master netting agreement" as amended by this final rule.

#### **IV. Summary of Comments on the January 2015 NPR**

The FDIC received three comments on the January 2015 NPR. One comment was generally supportive of the proposed rule in the January 2015 NPR as a necessary technical amendment that would promote the objective of establishing effective resolution regimes for globally active financial companies. That commenter also recommended that the FDIC revisit in the near term the broader policy questions surrounding the impact of close-out netting on systemic risk mitigation, and evaluate how well the regulatory capital and liquidity coverage ratio rules reflect the risks associated with netted financial contracts.<sup>29</sup>

Two of the commenters<sup>30</sup> noted the absence of reference to any stays authorized by state insurance law in the proposed definition of "qualifying master netting agreement." Some States may be considering amending laws applicable to the conservation, rehabilitation, liquidation and insolvency of insurance companies to provide authority for close-outs of derivative and similar financial contracts to be stayed for twenty-four hours, similar to stays under the FDI Act and the Dodd-Frank Act. The commenters maintained that failure to include stays under state insurance resolution proceedings within the definition of "qualifying master netting agreement" might adversely affect derivative and similar financial transactions between state-regulated insurance companies and their counterparties, including FDIC-supervised institutions. As such stays may be analogous to similar stays under the other resolution authorities referenced in the rule's definition, the commenters recommend that state law should also be referenced.

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<sup>29</sup> Systemic Risk Council.

<sup>30</sup> American Council of Life Insurers; Northwestern Mutual.

The narrow purpose of amending the definition of “qualifying master netting agreement” in the proposed rule and this final rule is to maintain the regulatory capital and liquidity treatment of certain financial contracts as unaffected by the ISDA Master Agreement and stays by non-U.S. resolution authorities. The FDIC has considered the comments for purposes of the final rule, and has determined that the commenters raise an issue that is beyond that limited purpose.<sup>31</sup>

## **V. Effective Date**

This final rule is effective upon publication in the Federal Register. The final rule imposes no new requirements, and will benefit FDIC-supervised institutions that adhere to the ISDA Protocol by allowing for the continuation of the existing netting treatment for certain financial contracts for purposes of the regulatory capital and liquidity rules.

Section 302 of the Riegle Community Development and Regulatory Improvement Act<sup>32</sup> (RCDRIA) generally requires that each Federal banking agency, in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, consider, consistent with principles of safety and soundness and the public interest, any administrative burdens that such regulations would place on depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. In addition, new regulations that impose additional reporting, disclosures, or other new

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<sup>31</sup> Although the issue is currently outside the scope of this rulemaking, staff may consider the treatment of derivatives and other similar financial contracts subject to stays in state insurance resolution proceedings in the context of further rulemaking, in consultation with the other agencies and with State insurance regulatory authorities.

<sup>32</sup> 12 U.S.C. 4802.

requirements on an insured depository institution generally must take effect on the first day of a calendar quarter which begins on or after the date on which the regulations are published in final form. The FDIC has determined that this final rule does not impose any additional reporting, disclosure, or other new requirements on insured depository institutions and thus section 302 of RCDRIA does not apply.

The Administrative Procedure Act (“APA”) requires that a final rule be published in the *Federal Register* no less than 30 days before its effective date unless good cause is found and published with the final rule.<sup>33</sup> The FDIC finds good cause for the final rule to take effect on the date it is published in the *Federal Register*. Having the final rule take effect on the date of publication in the *Federal Register* will allow affected FDIC-supervised institutions to use the definition of qualified master netting agreement as amended by the final rule when they file their respective Call Report for the third quarter period ending on September 30, 2016.

## **VI. Expected Effects**

The final rule is intended to prevent any change in the treatment of QFCs under capital and liquidity rules that may result from the establishment of non-U.S. special resolution regimes or by contract. As stated above, the final rule maintains the existing treatment for these contracts for purposes of the regulatory capital and liquidity rules, while recognizing the recent changes instituted by the BRRD and the ISDA Protocol. Implementation of consistent, national resolution regimes on a global basis furthers the orderly resolution of internationally active financial companies, and enhances financial stability. In addition, the development of the ISDA Protocol furthers the principles of Title II of the Dodd-Frank Act and the FDI Act (in instances

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<sup>33</sup> See 5 U.S.C. 553(d).

where a counterparty is a U.S. entity or its subsidiary) to counterparties who are not otherwise subject to U.S. law.

This final rule will benefit FDIC-supervised institutions that adhere to the ISDA Protocol by allowing for the continuation of the existing netting treatment for these contracts for purposes of the regulatory capital and liquidity rules. Absent the final rule, such FDIC-supervised institutions would be unable to include a master netting agreement under which default rights may be stayed under the BRRD or that incorporates the ISDA Protocol as a qualifying master netting agreement under the FDIC's current regulatory capital and liquidity regulations, and would be required to hold more capital and liquid assets as a result.

The final rule may result in administrative costs associated with changing the legal language that govern QFCs for a small number of entities. These costs are likely to be very small relative to the increase in capital and liquidity requirements likely to result if capital and liquidity requirements for QFCs had to be calculated on a gross basis. Any administrative costs associated with the proposed rule are likely to be very low given that similar legal structures already exist in the ISDA Protocol. The FDIC estimates that six FDIC-supervised institutions will be directly affected by this rule. Therefore, any administrative costs for FDIC-supervised institutions is likely to be low and the volume of costs for all FDIC-supervised institutions is likely to have no significant impact on financial institutions or the economy.

## **VII. Regulatory Analysis**

### **A. Small Business Regulatory Enforcement Fairness Act**

The Office of Management and Budget has determined that the final rule is not a "major rule" within the meaning of the Small Business Regulatory Enforcement Fairness Act of 1996 (Title II, Pub. L. 104-121).

### **B. Regulatory Flexibility Act Analysis**

The Regulatory Flexibility Act, 5 U.S.C. 601 et seq. (RFA), requires an agency, in connection with a final rule, to prepare an Initial Regulatory Flexibility Act analysis describing the impact of the final rule on small entities (defined by the Small Business Administration for purposes of the RFA to include banking entities with total assets of \$550 million or less) or to certify that the final rule would not have a significant economic impact on a substantial number of small entities. The FDIC believes that the final rule would not have a significant economic impact on a substantial number of small entities.

Under regulations issued by the Small Business Administration, a small entity includes a depository institution, bank holding company, or savings and loan holding company with total assets of \$550 million or less (a small banking organization).<sup>34</sup> As of March 31, 2016, there were approximately 2,942 small state nonmember banks and 275 small state savings associations under the FDIC's supervisory jurisdiction.

The final rule is expected only to apply to banking organizations that adhere to the ISDA Protocol or engage in a substantial amount of cross-border derivatives transactions. Small entities generally would not fall into this category. Accordingly, the FDIC believes that this final rule would not have a significant economic impact on small banking organizations supervised by the FDIC and therefore believes that there are no significant alternatives to the issuance of this final rule that would reduce the economic impact on small banking organizations supervised by the FDIC. Pursuant to section 605(b) of the RFA, the FDIC certifies that the Final Rule will not have a significant economic impact on a substantial number of small entities.

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<sup>34</sup> See 13 CFR 121.201. Effective July 14, 2014, the Small Business Administration revised the size standards for banking organizations to \$550 million in assets from \$500 million in assets. 79 FR 33647 (June 12, 2014).

### **C. Paperwork Reduction Act**

In accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3521) (PRA), the FDIC may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (“OMB”) control number. The FDIC has reviewed this final rule and determined that it does not create any new, or revise any existing, collection of information pursuant to the PRA. Consequently, no information has been submitted to the Office on Management and Budget for review.

### **D. The Treasury and General Government Appropriations Act, 1999— Assessment of Federal Regulations and Policies on Families**

The FDIC has determined that the final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, enacted as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (Public Law 105-277, 112 Stat. 2681).

### **E. Solicitation of Comments on Use of Plain Language**

Section 722 of the Gramm-Leach-Bliley Act, Public Law 106-102, 113 Stat. 1338, 1471 (Nov. 12, 1999), requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The FDIC invited comments on how to make this rule easier to understand. No comments addressing this issue were received.

## **List of Subjects**

### **12 CFR Part 324**

Administrative practice and procedure; Banks, banking; Capital adequacy; Reporting and recordkeeping requirements; Savings associations; State non-member banks.

## **12 CFR Part 329**

Administrative practice and procedure; Banks, banking; Federal Deposit Insurance Corporation, FDIC; Liquidity; Reporting and recordkeeping requirements.

For the reasons set forth in the supplementary information, the Federal Deposit Insurance Corporation amends 12 CFR Chapter III, parts 324 and 329 to read as follows:

### **PART 324—CAPITAL ADEQUACY OF FDIC-SUPERVISED INSTITUTIONS**

1. The authority citation for part 324 continues to read as follows:

**Authority:** 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; 5371; 5412; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 2355, as amended by Pub. L. 103-325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102-242, 105 Stat. 2236, 2386, as amended by Pub. L. 102-550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note); Pub. L. 111-203, 124 Stat. 1376, 1887 (15 U.S.C. 78o-7 note).

#### **§ 324.210 [Amended]**

2. In § 324.210, redesignate footnote 29 as footnote 33.

#### **§ 324.202 [Amended]**

3. In § 324.202, redesignate footnotes 27 and 28 as footnotes 31 and 32.

**§ 324.134 [Amended]**

4. In § 324.134, redesignate footnote 26 as footnote 30.

**§ 324.101 [Amended]**

5. In § 324.101, redesignate footnote 25 as footnote 29.

**§ 324.22 [Amended]**

6. In § 324.22, redesignate footnotes 18 through 24 as footnotes 22 through 28.

**§ 324.20 [Amended]**

7. In § 324.20, redesignate footnotes 8 through 17 as footnotes 12 through 21.

**§ 324.11 [Amended]**

8. In § 324.11, redesignate footnote 7 as footnote 11.

**§ 324.4 [Amended]**

9. In § 324.4, redesignate footnote 6 as footnote 10.

10. Section 324.2 is amended by redesignating footnote 5 as footnote 9, and by revising the definitions of “Collateral agreement,” “Eligible margin loan,” “Qualifying master netting agreement,” and “Repo-style transaction” to read as follows:

**§324.2 Definitions.**

\* \* \* \* \*

*Collateral agreement* means a legal contract that specifies the time when, and circumstances under which, a counterparty is required to pledge collateral to an FDIC-supervised institution for a single financial contract or for all financial contracts in a netting set and confers upon the FDIC-supervised institution a perfected, first-priority security interest (notwithstanding the prior security interest of any custodial agent), or the legal equivalent thereof, in the collateral posted by the counterparty under the agreement. This security interest must provide the FDIC-supervised institution with a right to close out the financial positions and liquidate the collateral upon an event of default of, or failure to perform by, the counterparty under the collateral agreement. A contract would not satisfy this requirement if the FDIC-supervised institution's exercise of rights under the agreement may be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(1) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar<sup>4</sup> to the U.S. laws referenced in this paragraph (1) in order to facilitate the orderly resolution of the defaulting counterparty; or

(2) Where the agreement is subject by its terms to any of the laws referenced in paragraph (1) of this definition.

\* \* \* \* \*

*Eligible margin loan* means:

(1) An extension of credit where:

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<sup>4</sup> The FDIC expects to evaluate jointly with the Federal Reserve and the OCC whether foreign special resolution regimes meet the requirements of this paragraph.

(i) The extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, or gold;

(ii) The collateral is marked to fair value daily, and the transaction is subject to daily margin maintenance requirements; and

(iii) The extension of credit is conducted under an agreement that provides the FDIC-supervised institution the right to accelerate and terminate the extension of credit and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, conservatorship, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs,<sup>5</sup> or laws of foreign jurisdictions that are substantially similar<sup>6</sup> to the U.S. laws referenced in this paragraph in order to facilitate the orderly resolution of the defaulting counterparty.

(2) In order to recognize an exposure as an eligible margin loan for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of §324.3(b) with respect to that exposure.

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<sup>5</sup> This requirement is met where all transactions under the agreement are (i) executed under U.S. law and (ii) constitute “securities contracts” under section 555 of the Bankruptcy Code (11 U.S.C. 555), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act, or netting contracts between or among financial institutions under sections 401--407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board's Regulation EE (12 CFR part 231).

<sup>6</sup> The FDIC expects to evaluate jointly with the Federal Reserve and the OCC whether foreign special resolution regimes meet the requirements of this paragraph.

*Qualifying master netting agreement* means a written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this definition, including upon an event of receivership, insolvency, conservatorship, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the FDIC-supervised institution the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar<sup>7</sup> to the U.S. laws referenced in this paragraph (2)(i) in order to facilitate the orderly resolution of the defaulting counterparty; or

(ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (2)(i) of this definition;

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the

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<sup>7</sup> The FDIC expects to evaluate jointly with the Federal Reserve and the OCC whether foreign special resolution regimes meet the requirements of this paragraph.

agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of §324.3(d) of this chapter with respect to that agreement.

\* \* \* \* \*

*Repo-style transaction* means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the FDIC-supervised institution acts as agent for a customer and indemnifies the customer against loss, provided that:

(1) The transaction is based solely on liquid and readily marketable securities, cash, or gold;

(2) The transaction is marked-to-fair value daily and subject to daily margin maintenance requirements;

(3)(i) The transaction is a “securities contract” or “repurchase agreement” under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act, or a netting contract between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve's Regulation EE (12 CFR part 231); or

(ii) If the transaction does not meet the criteria set forth in paragraph (3)(i) of this definition, then either:

(A) The transaction is executed under an agreement that provides the FDIC-supervised institution the right to accelerate, terminate, and close-out the transaction on a net basis and to

liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar<sup>8</sup> to the U.S. laws referenced in this paragraph (3)(ii)(A) in order to facilitate the orderly resolution of the defaulting counterparty; or

(B) The transaction is:

(1) Either overnight or unconditionally cancelable at any time by the FDIC-supervised institution; and

(2) Executed under an agreement that provides the FDIC-supervised institution the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set off collateral promptly upon an event of counterparty default; and

(4) In order to recognize an exposure as a repo-style transaction for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of §324.3(e) with respect to that exposure.

\* \* \* \* \*

## **PART 329—LIQUIDITY RISK MEASUREMENT STANDARDS**

11. The authority citation for part 329 continues to read as follows:

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<sup>8</sup> The FDIC expects to evaluate jointly with the Federal Reserve and the OCC whether foreign special resolution regimes meet the requirements of this paragraph.

**Authority:** 12 U.S.C. 1815, 1816, 1818, 1819, 1828, 1831p-1, 5412.

12. Amend § 329.3 as follows:

a. Redesignate footnote 1 as footnote 2.; and

b. Revise the definition of “Qualifying master netting agreement” to read as follows:

**§329.3 Definitions.**

\* \* \* \* \*

*Qualifying master netting agreement* means a written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this definition, including upon an event of receivership, insolvency, conservatorship, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the FDIC-supervised institution the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or

laws of foreign jurisdictions that are substantially similar<sup>1</sup> to the U.S. laws referenced in this paragraph (2)(i) in order to facilitate the orderly resolution of the defaulting counterparty; or

(ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (2)(i) of this definition;

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this subpart, an FDIC-supervised institution must comply with the requirements of §329.4(a) with respect to that agreement.

\* \* \* \* \*

By order of the Board of directors of the Federal Deposit Insurance Corporation.

Date: September 20, 2016.

Valerie J. Best

Assistant Executive Secretary

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<sup>1</sup> The FDIC expects to evaluate jointly with the Federal Reserve and the OCC whether foreign special resolution regimes meet the requirements of this paragraph.

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