Client Alert

June 6, 2013

Fed Comes to the Rescue: *Interim Final Rule for Foreign Banks under Lincoln Amendment*

In a move that will be welcomed by the U.S. foreign bank community and its clients, the Federal Reserve Board yesterday issued an interim final rule that accords foreign banks' uninsured U.S. branches and agencies parity with U.S. insured depository institutions ("IDIs") for purposes of the swaps push-out rule in Section 716 of the Dodd-Frank Act (the "Lincoln Amendment").[1] In the absence of the interim final rule, uninsured U.S. branches and agencies of foreign banks that are "swaps entities" would have been required to "push out" their swaps activities to an affiliate or otherwise cease their swaps activity by July 16, 2013 in order to be eligible for access to the discount window. Such branches and agencies, if they are state-licensed branches and agencies, now may apply to the Federal Reserve Board for a transition period of up to 24 months (with the possibility of an additional year) in which to conform their swaps activities to those permitted to IDIs under Section 716. State-licensed branches and agencies subject to the Lincoln Amendment will want to submit their requests to the Federal Reserve Board as soon as possible.

The interim rule is effective immediately.

The foreign bank community has been quite concerned about the treatment of uninsured branches and agencies under Title VII, and the Lincoln Amendment in particular. A number of foreign bank swaps entities have undertaken reorganizations of their U.S. operations at significant cost to address the possibility that they would no longer be permitted to engage in hedging and customer-driven swaps business through their U.S. branches and agencies. Uninsured branches and agencies also have continued to express concerns about the potential risks and costs associated with termination and/or transfer of their swaps activities. The interim rule will alleviate some of the competitive inequality created for foreign banks under Title VII.

Section 716 generally prohibits the provision of "Federal assistance" to any swaps entity with regard to any swap, security-based swap, or other activity of the swaps entity. The term "Federal assistance" is defined by Section 716 to include, in relevant part, "the use of any advances from any Federal Reserve credit facility or discount window that is not part of a program or facility with broad-based eligibility under Section 13(3)(A) of the Federal Reserve Act."[2] "Swaps entity" means any swap dealer, security-based swap dealer, major swap participant, or major security-based swap participant that is registered under the Commodity Exchange Act or the Securities Exchange Act of 1934.[3]

Expressly excluded from the prohibitions of Section 716, however, are IDIs that are major swap participants and major security-based swap participants. IDIs are also permitted by the terms of Section 716 to limit their swaps

[1] 15 U.S.C. § 8305(a).
[2] 15 U.S.C. § 8305(b)(1).
[3] 15 U.S.C. § 8305(b)(2).

activities to certain specified swaps activities, such as hedging, without being subject to the prohibition on obtaining Federal assistance.[4] Finally, IDIs are entitled to a transition period in which to conform their activities to Section 716.[5] In what has been regarded as a drafting oversight—as acknowledged even by the Lincoln Amendment's sponsors—Section 716 does not extend the benefit of these exclusions and the transition period to uninsured U.S. branches and agencies of foreign banks.

Up until the Federal Reserve Board's action yesterday, the foreign bank community had been looking to Congress to enact a technical amendment to Section 716 that would address the drafting issue, but congressional action on this matter has stalled for a variety of reasons, and a legislative solution prior to the July 16 date did not appear likely. The Federal Reserve Board effectively took matters into its own hands in addressing this issue. Notwithstanding the express statutory language of the push-out rule, in issuing this interim final rule the Federal Reserve Board found that the legislative purposes and intent behind Section 716 are consistent with U.S. uninsured branches and agencies being treated as IDIs for all purposes under Section 716. The Federal Reserve Board pointed out that branches and agencies have access to Federal assistance through the discount window in the same manner as IDIs, and that permitting branches and agencies to wind down and conform their activities to those permitted for IDIs is consistent with the intent of Title VII to reduce systemic risks from derivatives. As support for its position, the Federal Reserve Board also referred to a colloquy between Senator Lincoln, sponsor of Section 716, and Senator Dodd, during the Senate's review of the Dodd-Frank Act Conference Report, in which the senators agreed that uninsured U.S. branches and agencies of foreign banks should be treated as IDIs.[6]

The Federal Reserve Board's rule establishes a procedure for it to approve, in consultation with the Securities and Exchange Commission or the Commodity Futures Trading Commission, as appropriate, an application by an uninsured state branch or agency of a foreign bank, or state member bank, for a transition period of up to 24 months from the effective date of the Lincoln Amendment to bring itself into compliance with Section 716, with the possibility of a one-year extension. The Federal Reserve Board's transition period process does not apply to uninsured federally-licensed branches; the Office of the Comptroller of the Currency would need to implement a transition period approval process for those branches and agencies, as it previously did for national banks.[7] The OCC's rulemaking with respect to national banks was noticeably silent regarding federally-licensed branches and agencies, and the interim final rule should spur the OCC to issue a similar rule for federally-licensed branches and agencies.

The interim final rule poses three questions for public comment, the most critical of which is whether it is appropriate and consistent with Section 716 to define an IDI to include an uninsured U.S. branch or agency. Assuming that question is answered in the affirmative, the Federal Reserve Board also is seeking comment on what factors are appropriate for consideration in evaluating a request for a transition period and whether and what limitations and conditions should be placed on institutions during the transition period either in general or on a tailored or case-by-case basis. It may well be that the factors that should be considered for foreign banks' U.S. banking offices should differ from those generally applicable to IDIs.

[4] 15 U.S.C. § 8305(d).
[5] 15 U.S.C. § 8305(f).
[6] See Statement of Sen. Lincoln, 156 Cong. Rec. S5904 (daily ed. July 15, 2010).
[7] OCC Notice of Guidance regarding "Transition Period Under Section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act," 78 Fed. Reg. 1,306 (January 8, 2013).

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