FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

February 28, 1994

DALLAS, TEXAS
75265-5906

Notice 94-05

TO: The Chief Executive Officer of each member bank and others concerned in the Eleventh Federal Reserve District

SUBJECT

Final Rule to Expand Definition of "Financial Institution" in Section 402 of the Federal Deposit Corporation Improvement Act

DETAILS

The Board of Governors of the Federal Reserve System has announced approval of a final rule to expand the definition of "financial institution" in Section 402 of the Federal Deposit Insurance Corporation Improvement Act (Act). The Act validates netting contracts among financial institutions.

The Act defines "financial institution" to include a securities broker or dealer, a depository institution, a futures commission merchant, or any other institution as determined by the Board. The rule establishes a category of entities considered financial institutions under the Act, while reserving the ability to expand that category further through individual determinations.

Parties to a netting contract agree that they will pay or receive the net, rather than the gross, payment due under the netting contract. The Act provides certainty that netting contracts will be enforced, even in the event of the insolvency of one of the parties.

ATTACHMENT

A copy of the Board's notice as it appears on pages 4780-85, Vol. 59, No. 22, of the Federal Register dated February 2, 1994, is attached.

MORE INFORMATION

For more information, please contact Jane Anne Schmoker at (214) 922-5101. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

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FEDERAL RESERVE SYSTEM

12 CFR Part 231

Regulation EE; Docket No. R-0801]

Netting Eligibility for Financial Institutions

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board has adopted a rule to include certain entities under the definition of "financial institution" in section 402 of the Federal Deposit Insurance Corporation Improvement Act of 1991 so that they will be covered by the Act's netting provisions. The Act authorizes the Board to expand the definition of "financial institution" to the extent consistent with the purposes of enhancing efficiency and reducing systemic risk in the financial markets.

EFFECTIVE DATE: March 7, 1994.

FOR FURTHER INFORMATION CONTACT: Oliver Ireland, Associate General Counsel (202/452-3625), or Stephanie Martin, Senior Attorney (202/452-3198), Legal Division. For the hearing impaired *only*: Telecommunications Device for the Deaf, Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

Background

The Federal Deposit Insurance Corporation Improvement Act of 1991 (Act) (Pub. L. 102-242, sections 401-407; 105 Stat. 2236, 2372-3; 12 U.S.C. 4401-4407) validates netting contracts among financial institutions. Parties to a netting contract agree that they will pay or receive the net, rather than the gross, payment due under the netting contract. The Act provides certainty that netting contracts will be enforced, even in the event of the insolvency of one of the parties. The Act's netting provisions, effective December 19, 1991, are designed to promote efficiency and reduce systemic risk within the banking system and financial markets.

The netting provisions apply to bilateral netting contracts between two financial institutions and multilateral netting contracts among members of a clearing organization. Section 402(9) of the Act defines "financial institution" to include a depository institution, a securities broker or dealer, a futures commission merchant, and any other institution as determined by the Board. In addition, the Act's definition of "broker or dealer" (section 402(1)(B)) includes any affiliate of a registered broker or dealer, to the extent consistent with the Act, as determined by the Board.

Proposed Rule

In May 1993, the Board requested comment on a proposed regulation that would expand the application of the Act's netting provisions to a broader range of financial market participants (58 FR 29149, May 19, 1993). The Board proposed that persons meeting certain tests based on market activity would qualify as "financial institutions" under the Act. The proposed tests were designed to capture institutions that are significant market participants whose coverage could enhance market liquidity and whose failure without coverage could have systemic risk implications. The Board chose the activity-based tests instead of tests based on an institution's status as a regulated entity, its affiliation with a defined financial institution, or its class of charter. As these three latter tests likely would be both over- and under-inclusive, the Board believed they were not as appropriate as an activity-based test.

The test proposed by the Board had both a qualitative and a quantitative aspect. First, to qualify as a financial institution under the proposed rule, a

person[1] would have to participate actively in a financial market for its own account and hold itself out as a counterparty that will engage in transactions both as a buyer and a seller in the financial market. Second, the person would have to meet one of two quantitative thresholds: It must have either (1) had one or more financial contracts of a total gross dollar value of $1 billion in notional principal amount outstanding on any day during the previous 15-month period with counterparties that are not its affiliates, or (2) incurred total gross mark-to-market positions of $100 million (aggregated across counterparties) in one or more financial contracts on any day during the previous 15-month period with counterparties that are not its affiliates.

Final Rule

The final rule adopted by the Board retains the qualitative test, in a modified form, as well as the quantitative test. Under the final rule, a person would qualify as a financial institution if it represents that it will engage in financial contracts as a counterparty on both sides of one or more financial markets and meets one of the quantitative thresholds, which are largely unchanged from the proposal.

The operation of the rule is prospective, i.e., the Act's netting provisions will apply only to those netting contracts entered into after a person qualifies as a financial institution. The final rule clarifies that a person will continue to be considered a financial institution for the purposes of any contract entered into during the period in which it qualifies, even if the person subsequently fails to qualify during the life of the contract. In addition, the Board has grandfathered those netting contracts in existence on the effective date of the final rule. If a person qualifies as a financial institution on the effective date, that person will be considered a financial institution for the purposes of any outstanding contract entered into prior to that date.

The Board also made various revisions to the proposed definitions. Those revisions are discussed in the comment summary below.

Summary of Comments

The Board received 32 comment letters (from 30 commenters) on proposed Regulation EE. The commenters were distributed as follows:

Type of institution	Number
Trade association	7
Federal Reserve Bank	4
Commercial bank	4
Government-sponsored entity	3
Clearing house	2
Financial institution holding company	2
Swaps dealer	3
Federal agency	2
Law firm	1
Financial corporation	1
International agency	l
Total	30

General Comments

Virtually all of the commenters supported the objectives of the Act's netting provisions and the Board's proposed regulation. The commenters generally agreed that broadening the Act's definition of "financial institution" would enhance efficiency and reduce risk in the financial markets. Only two commenters expressed doubts as to whether broader netting protection would decrease systemic risk.

One commenter specifically supported expansion of the definition by rule rather than by case-by-case determinations. Two commenters suggested that the Board should indicate in advance how it intends to use its discretion in case-by-case determinations. The Board, however, has set forth in the regulation the standards it believes should apply for a person to qualify as a financial institution in most circumstances. In case of unanticipated circumstances, the Board has the flexibility to make case-by-case determinations based on standards different from those in the regulation.

Qualitative Test

Fifteen commenters raised concerns about the qualitative prong of the proposed rule's test. Eleven of these commenters argued that the rule should cover major market participants that are end users, in addition to covering market intermediaries. (Four commenters suggested that the Board eliminate the test altogether, and one commenter suggested that coverage be extended to any entity that enters into a netting contract as defined by the Act.) The commenters stated that the insolvency of a major end user would raise substantial settlement, liquidity, and systemic risks and that such risks arise from the size and nature of an entity's positions, not from the character of its business. The commenters noted that although end users may not be market-makers, their arbitrage strategies may cause them to take positions on both sides of the market. The commenters observed that including end users would provide certainty of enforceability for a broader range of netting contracts. They stated that this broader range of coverage would enhance market liquidity, as dealers could do a larger volume of business with end users without raising credit limits, and would eliminate a competitive disadvantage for end users.

The Board has determined to retain the qualitative test, in a modified form. Although the Board recognizes that end users (as well as their counterparties) might benefit by the netting provisions and the failure of certain end users could create systemic risk, the Board believes it would be difficult to justify inclusion of many end users as "financial institutions." The Act defines "financial institution" to include traditional financial market intermediaries such as banks, broker-dealers, and futures commission merchants. Expanding the definition to cover end users would include many non-financial corporations and, potentially, even individuals. The Board believes it would be a stretch of the statutory definition of "financial institution" to include institutions or individuals that are not market intermediaries and are not in the financial services business.

Eleven commenters offered suggestions on how to achieve certainty that a given entity qualifies as a financial institution. The commenters argued that market participants would have no choice but to rely on the representations of their counterparties in many cases. Many commenters suggested that market participants be allowed to rely in good faith on the written representation of a counterparty, signed by an appropriate officer, stating that the tests were met. The commenters argued that this "safe harbor" would provide certainty in instances where a participant might otherwise refuse to deal with an institution solely because it cannot verify the institution's qualifications.

With regard to the qualitative test, five commenters noted that, as a practical matter, it would be difficult for counterparties to verify that an institution participates "actively" in the financial markets and holds itself out as a market intermediary. In addition, one commenter suggested that the rule should cover certain entities that do not enter into transactions for their own account, such as collective investment funds and master trust arrangements that act in a fiduciary capacity. One commenter noted that a statement from an entity that it meets the test could be

[1] "Person" is defined broadly to include any legal entity, such as a corporation, partnership, or individual.

considered the equivalent of "holding itself out" as a market intermediary. Other commenters suggested eliminating the "participates actively" clause.

The Board agrees that an institution that represents that it is willing to engage in transactions on both sides of the market is, in effect, holding itself out as a market intermediary. Accordingly, the Board has revised the language of the qualitative test to provide that such a representation would suffice to meet the test. The Board has eliminated that part of the proposed rule that would have required a financial institution to participate actively in a financial market for its own account. The Board believes that the revised final rule provides counterparties with greater certainty that an institution meets the qualitative test because counterparties can rely on the institution's representation.

Three commenters made drafting suggestions, such as (1) replacing the reference to "buyer and seller," which is appropriate in a securities market, with the more generic "participates on both sides" of the market, and (2) clarifying that an institution may be active in one or more financial markets simultaneously. The Board has revised the rule to incorporate both of these suggestions. Under § 231.3(a) of the final rule, a person meets the qualitative test if it "represents that it will engage in financial contracts as a counterparty on both sides of one or more financial markets."

Quantitative Test

Fourteen commenters cited problems with the proposed quantitative test. Seven commenters noted that financial market participants will have difficulty verifying whether their counterparties meet the volume thresholds because publicly available financial statements typically do not present information in a format that would allow verification. Five commenters stated that small-volume dealers would be placed at a competitive disadvantage, resulting in concentration of trading at large dealers and barriers to entry. In addition, two commenters noted that the test would penalize business wind-downs, as financial institutions would cease to be covered as their contracts expired. Two commenters argued that counterparties could circumvent the test by engaging in reciprocal transactions to raise their outstanding principal amounts artificially.

As a solution to the problems cited above, eight commenters suggested that the Board eliminate the quantitative test. These commenters stated that the qualitative test would be sufficient to guarantee coverage of parties with a material presence in the financial markets, so a quantitative test is unnecessary.

The purpose of the rule, however, is to further the Act's objectives of increasing efficiency and decreasing systemic risk in the financial markets. The qualitative test targets institutions that are market intermediaries in order to restrict coverage to those entities that can reasonably be included in the Act's definition of "financial institution." The qualitative test alone does not necessarily focus on those institutions whose coverage would help achieve the Act's objectives. The purpose of the quantitative test is to ensure that a covered institution engages in a level of business such that its failure to meet its obligations could create systemic risk.

The Board believes that most institutions that meet the qualitative test engage in a volume of transactions substantially above the quantitative test thresholds. Although institutions entering the market may not be able to meet the quantitative test right away, the test would aid in reducing systemic risk by helping to ensure the creditworthiness of new market participants because they would have to achieve a certain level of market participation without the benefit of certainty of the validity of netting provided by the rule. In addition, the quantitative test tends to encourage active market participation by financial institutions by requiring them to meet certain volume thresholds within a set period of time. The netting contracts of institutions that are winding down their businesses would continue to be covered as long as the institution entered into the contracts while it qualified as a financial institution. (See discussion of timing issues below and § 231.3(b) of the final rule.) For these reasons, the Board has retained the proposed quantitative test in § 231.3(a) (1) and (2) of the final rule.

The commenters also suggested changes in the event the quantitative test is not eliminated. Five commenters asked that the volume thresholds be reduced from $1 billion in notional principle to $500 million and from $100 million in gross mark-to-market positions to $50 million. As the Board does not believe these thresholds would be overly limiting, it has not decreased the threshold levels. The Board may reexamine the thresholds if it finds that these levels prove to be overly limiting.

One commenter suggested that the Board establish one set of quantitative thresholds for dealers, but allow non-dealers to be covered at higher thresholds. As discussed above, the Board believes that inclusion of end users, even at higher volume thresholds, would be a stretch of the term "financial institution."

Another commenter suggested that the quantitative test measure average activity levels over a 24-month period to discourage short-run attempts to increase activity. Although using average volumes could help discourage artificial short-run increases in activity, it would also add more complexity to the determination of whether an institution meets the quantitative test. Rather than focusing on one day in a 15-month period, averaging would require surveillance of activity on a much more frequent basis. The final rule retains the proposed "one-day" test.

Several commenters suggested that the Board allow counterparties to rely on an external auditor's certificate or that the Board redesign the test so that a party could verify its counterparty's qualifications by examining publicly available information. The Board believes that institutions desiring to qualify as financial institutions under the rule will have a strong incentive to present information in publicly available documents, such as financial reports, showing that the institution meets the quantitative test. These reports could be verified by an outside auditor, if the participants so desire.

One commenter suggested that, for the purposes of the quantitative test, the Board should treat the aggregate risk of an affiliated group as one entity, i.e. an institution would qualify as a financial institution if it meets the qualitative test and it and/or its affiliates meet the quantitative test. If an institution fails to meet its obligations, however, those obligations are not automatically assumed by its affiliates, even though in some cases a holding company, for example, may make contributions to a troubled subsidiary. The Board believes that treating each institution separately under the rule reflects more closely the risk that institution poses for its counterparties.

Two commenters requested that the Board allow the quantitative test to be satisfied by financial contracts from several financial markets, even though the institution may not satisfy the qualitative test for each one of those financial markets. The rule would allow aggregation of financial contracts across markets for purposes of the quantitative test, but would not require an institution to meet the qualitative test for each type of its financial contracts. For example, an institution might meet the qualitative test by representing that it will engage in foreign exchange contracts on both sides of the market

and meet the quantitative test with both its foreign exchange and interest rate contracts. The institution would nevertheless qualify as a financial institution, and all of its netting contracts would be subject to the Act's protection.

Finally, in § 231.3(a)(2), the Board has changed the word "incurred" to "had" to clarify that the contracts that yield mark-to-market positions of $100 million need not be entered into on a single day. Rather, the $100 million refers to positions in outstanding contracts on a single day.

Charter Test

Six commenters suggested that the Board supplement the market activity tests with charter tests. The commenters argued that charter tests are consistent with the approach taken in the Act and are competitively neutral for each charter type. The commenters did not agree with the Board's statement that charter tests would foster inaccurate presumptions about the riskiness of covered institutions. Rather, they believed that charter tests would promote certainty without harmful results. The commenters requested coverage for a variety of charter types, including bank holding companies and their subsidiaries, insurance companies, foreign banks (rather than solely their U.S. branches and agencies), affiliates of registered broker-dealers, trust companies, Federal Reserve Banks, Federal Home Loan Banks, and certain government-sponsored entities.

The Board has determined not to expand the rule's coverage through charter tests. Charter tests would include many end user institutions that are not market intermediaries, which the Board believes would stretch beyond the meaning of "financial institution." A charter test would also cover many institutions whose business volumes do not give rise to systemic risk considerations. Although Congress used charter tests in the Act, the Board does not believe that charter tests are necessarily the most appropriate means to expand Congress' definition.

There may be certain end user institutions that reasonably can be described as financial institutions even though they are not market intermediaries. The Board has the ability to make case-by-case determinations in these instances and has done so. For example, in 1992, the Board made individual determinations in the cases of three CHIPS members. Similarly, there may be certain government-sponsored entities or international organizations that do not meet the requirements of the rule yet could reasonably be considered financial institutions due to their roles in the financial markets. The Board would consider making individual determinations in such cases.

Definitions

The commenters also made various technical suggestions concerning the definitions. One commenter suggested that, in the definition of "affiliate," the Board replace the word "dealer" with "person." The Board has revised the definition in § 231.2(b) accordingly.

Two commenters requested that the Board revise the definition of "gross mark-to-market positions" to replace the word "price" with "value" to clarify that market participants may use their normal market valuation methods rather than the method used to price each transaction at its inception. Section 231.2(e) of the final rule reflects this revision.

Six commenters requested that the definition of "person" explicitly include an entity organized outside the U.S., thereby assuring that foreign banks and other foreign market participants could qualify as financial institutions. Another commenter asked that the definition explicitly include trusts and that "similar entity" be changed to the more general "other entity." The Board intends that "person" be defined broadly to include all entities, foreign and domestic, and has revised the definition in § 231.2(f) to incorporate both of these comments.

One commenter suggested that the Board include a comprehensive description of the financial institutions defined by the Act as well as those defined by the regulation. However, to keep the rule as simple as possible, the Board has not included the Act's definitions. Section 231.1(b) of the rule specifically states that the rule does not affect the status of those financial institutions defined by the Act.

One commenter suggested that the Act's definition of netting contract also be used in the regulation, rather than the proposed "financial contract" definition, which is based on the Federal Deposit Insurance Act's (FDIA's) definition of qualified financial contract. The commenter believed that using a common definition would reduce confusion and avoid litigation. The final rule retains the concept of a financial contract based on the FDIA. The concept of a financial contract narrows the focus of the rule to participants in the financial markets and is relevant only to the determination of whether a particular institution qualifies as a financial institution under the rule. Once an institution qualifies, the Act's netting provisions would apply to all of that institution's netting contracts, as defined by the Act.

The Board has expanded upon the FDIA to include spot forward contracts (contracts with maturities of two days or less) as financial contracts for purposes of the qualitative and quantitative tests. Arguably, the FDIA definition of swap agreement already includes spot forward contracts, however, for purposes of clarity, the Board has included spot contracts expressly in the forward contract definition.

Timing Issues

Many commenters raised timing-related issues regarding the rule's coverage. Eight commenters requested that the Board clarify that the Act's netting provisions will apply for the life of a contract as long as the parties qualify as financial institutions at the time they enter into the contract. The Board has revised the rule to clarify that a person will continue to be considered a financial institution for the purposes of any contract entered into during the period it qualifies, even if the person subsequently fails to qualify. (See § 231.3(b).)

Four commenters suggested that the Board clarify that an institution's status as a financial institution will be determined at the time it enters into a netting contract because that is when the counterparty will evaluate the institution's creditworthiness. On the other hand, two commenters suggested that the netting provisions should be applied retroactively to an institution's existing contracts once it qualifies as a financial institution. One commenter requested clarification as to whether existing contracts will be grandfathered when the rule takes effect. Under the final rule, the Act's netting provisions will apply only to those netting contracts entered into after a person qualifies as a financial institution. However, the Board has revised the rule to grandfather those contracts in existence on the effective date of the final rule for entities qualifying under the rule at that time. (See § 231.3(c).)

One commenter requested that the Board define the 15-month rolling period in the quantitative test with reference to the time parties enter into a master agreement, not the time of the first transaction under that agreement. In the absence of a master agreement, the commenter suggested that the period be measured with reference to a particular netting transaction. In practice, to determine whether a party meets the quantitative test, the 15-month period will date back from the day a party enters into a netting

contract, whether or not that netting contract is a master agreement. Thus, on a particular day ("Day X"), a party meets the quantitative test if its financial contracts, as defined in the rule, met one of the rule's threshold levels on any day during the previous 15 months. Assuming the party qualifies as a financial institution and enters into a netting contract, as defined in the Act, on Day X, § 231.3(b) of the rule provides that the netting contract will be covered by the Act's provisions regardless of whether the party ceases to qualify as a financial institution on a subsequent day. If the netting contract that the party enters into on Day X is a master agreement, e.g., an agreement to net specified types of underlying transactions that the counterparties may enter into in the future, § 231.3(b) would provide that netting under that master agreement would continue to be protected under the Act even though the party enters into individual underlying transactions after it ceases to qualify as a financial institution. The Act's provisions would not extend to netting under any new master agreement entered into after the party ceases to qualify as a financial institution.

Board List.

Two commenters requested that the Board keep a list of entities that have declared themselves to be financial institutions. The Board believes that the commenters' concerns about lack of certainty are largely addressed by allowing counterparties to rely on an institution's representation that it will act as a market intermediary and creating an incentive for institutions to publish volume threshold information to establish that they meet the quantitative test. Thus, the Board does not believe an "official" list is necessary.

Automatic Stays.

Section 405 of the Act provides that no injunction or similar order issued by a court or agency will interfere with the application of netting. One commenter believed that section 405 could be interpreted so as *not* to override provisions for automatic stays in bankruptcy under federal or state law. The commenter asked that the Board indicate its view on this matter. Although the Board cannot authoritatively interpret the provisions of the Act, the Board believes the intent of the Act is to override the automatic statutory bankruptcy stays for valid netting contracts. Sections 403 and 404 of the Act explicitly provide that netting is effective "notwithstanding any other provision of law." The Board believes that section 405 was included to clarify that the netting provisions override court or agency actions in addition to overriding statutory law.

CFTC Comment.

The Commodity Futures Trading Commission (CFTC) noted that it can exempt certain contracts between "appropriate persons" from the Commodity Exchange Act's (CEA's) exchange-trading requirement and has done so for certain swaps, hybrid instruments, and energy contracts. The CFTC may also exempt appropriate multilateral netting arrangements, in which case the arrangement may not meet the Act's definition of clearing organization, which refers to an organization that "performs clearing functions for a contract market designated pursuant to the CEA." The CFTC stated that it would like to work with the Board to ensure that a clearing organization exempted by the CFTC would be covered by the Act's netting provisions. The Board is willing to work with the CFTC in this area.

Final Regulatory Flexibility Analysis

Two of the three requirements of a final regulatory flexibility analysis (5 U.S.C. 604), (1) a succinct statement of the need for and the objectives of the rule and (2) a summary of the issues raised by the public comments, the agency's assessment of the issues, and a statement of the changes made in the final rule in response to the comments, are discussed above. The third requirement of a final regulatory flexibility analysis is a description of significant alternatives to the rule that would minimize the rule's economic impact on small entities and reasons why the alternatives were rejected.

The rule, however, should not have an economic impact on small entities. The rule will apply only to entities with financial contracts of $1 billion in gross notional principal amount or gross mark-to-market positions of $100 million over a period of 15 months. Entities with a smaller level of market activity would not be covered by the Board's expanded definition of "financial institution." Many small market participants are included in the Act's definition of "financial institution" and thus are already covered by the netting provisions. The Board limited its expansion of the Act's definition to entities with a relatively large volume of activity because the lack of netting coverage for small entities is unlikely to affect overall market efficiency or systemic risk.

List of Subjects in 12 CFR Part 231

Banks, banking, Financial institutions, Netting.

For the reasons set out in the preamble, the Board adds a new part 231 to Title 12, Chapter II of the Code of Federal Regulations to read as follows:

PART 231—NETTING ELIGIBILITY FOR FINANCIAL INSTITUTIONS REGULATION EE

Sec.
231.1 Authority, purpose, and scope.
231.2 Definitions.
231.3 Qualification as a financial institution.

Authority: 12 U.S.C. 4402(1)(B) and 4402(9).

§ 231.1 Authority, purpose, and scope.

(a) *Authority.* This part (Regulation EE; 12 CFR part 231) is issued by the Board of Governors of the Federal Reserve System under the authority of sections 402(1)(B) and 402(9) of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4402(1)(B) and 4402(9)).

(b) *Purpose and scope.* The purpose of the Act and this part is to enhance efficiency and reduce systemic risk in the financial markets. This part expands the Act's definition of "financial institution" to allow more financial market participants to avail themselves of the netting provisions set forth in sections 401–407 of the Act (12 U.S.C. 4401–4407). This part does not affect the status of those financial institutions specifically defined in the Act.

§ 231.2 Definitions.

As used in this part, unless the context requires otherwise:

(a) *Act* means the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102–242, 105 Stat. 2236), as amended.

(b) *Affiliate,* with respect to a person, means any other person that controls, is controlled by, or is under common control with the person.

(c) *Financial contract* means a qualified financial contract as defined in section 11(e)(8)(D) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)(D)), as amended, except that a forward contract includes a contract with a maturity date two days or less after the date the contract is entered into (i.e., a "spot" contract).

(d) *Financial market* means a market for a financial contract.

(e) *Gross mark-to-market positions* in one or more financial contracts means the sum of the absolute values of positions in those contracts, adjusted to

reflect the market values of those positions in accordance with the methods used by the parties to each contract to value the contract.

(f) *Person* means any legal entity, foreign or domestic, including a corporation, unincorporated company, partnership, government unit or instrumentality, trust, natural person, or any other entity or organization.

§ 231.3 Qualification as a financial institution.

(a) A person qualifies as a financial institution for purposes of sections 401–407 of the Act if it represents that it will engage in financial contracts as a counterparty on both sides of one or more financial markets and either—

(1) Had one or more financial contracts of a total gross dollar value of at least $1 billion in notional principal amount outstanding on any day during the previous 15-month period with counterparties that are not its affiliates; or

(2) Had total gross mark-to-market positions of at least $100 million (aggregated across counterparties) in one or more financial contracts on any day during the previous 15-month period with counterparties that are not its affiliates.

(b) If a person qualifies as a financial institution under paragraph (a) of this section, that person will be considered a financial institution for the purposes of any contract entered into during the period it qualifies, even if the person subsequently fails to qualify.

(c) If a person qualifies as a financial institution under paragraph (a) of this section on March 7, 1994, that person will be considered a financial institution for the purposes of any outstanding contract entered into prior to March 7, 1994.

By order of the Board of Governors of the Federal Reserve System, January 27, 1994.

William W. Wiles,

Secretary of the Board.

[FR Doc. 94–2324 Filed 2–1–94; 8:45 am]

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