



FEDERAL RESERVE BANK
OF DALLAS

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

DALLAS, TEXAS
75265-5906

February 12, 1996

Notice 96-16

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

SUBJECT

**Final Amendment to Regulation EE
(Netting Eligibility for Financial Institutions)**

DETAILS

The Board of Governors of the Federal Reserve System has amended Regulation EE (Netting Eligibility for Financial Institutions). The final rule clarifies that, for purposes of qualifying as a financial institution under Regulation EE, a person may represent that it is a financial market intermediary either orally or in writing. The amendment is intended to remove uncertainty in the financial markets as to the form of such representations.

The final rule becomes effective February 20, 1996.

ATTACHMENT

A copy of the Board's notice as it appears on pages 1273-74, Vol. 61, No. 13, of the *Federal Register* dated January 19, 1996, 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,

Rules and Regulations

Federal Register

Vol. 61, No. 13

Friday, January 19, 1996

FEDERAL RESERVE SYSTEM

12 CFR Part 231

[Regulation EE; Docket No. R-0912]

Netting Eligibility for Financial Institutions

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board has amended Regulation EE to clarify that, for purposes of qualifying as a financial institution under Regulation EE, a person may represent that it is a financial market intermediary either orally or in writing. This amendment is intended to remove uncertainty in the financial markets as to the form of such representations.

EFFECTIVE DATE: February 20, 1996.

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

SUPPLEMENTARY INFORMATION:

Background

The Federal Deposit Insurance Corporation Improvement Act of 1991 (Act) (Pub. L. 102-242, §§ 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 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.

In 1994, the Board adopted Regulation EE (12 CFR part 231) to expand the application of the Act's netting provisions to a broader range of financial market participants (59 FR 4780, February 2, 1994). Under Regulation EE, persons meeting certain tests based on market activity will qualify as "financial institutions" under the Act. The 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 Regulation EE tests have both a qualitative and a quantitative aspect. First, to qualify as a financial institution under the rule, a person¹ must represent that it will engage in financial contracts as a counterparty on both sides of one or more financial markets. Second, the person must meet one of two quantitative thresholds: It must have 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

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

with counterparties that are not its affiliates.

Form of Representation

Regulation EE does not require a person to make the "market intermediary" representation in any particular form. Some market participants, however, have requested that the Board clarify that the representation can be made orally or in writing. The Board has amended § 231.3(a) of Regulation EE accordingly. The regulation does not require written representations (either as part of a financial contract or outside of the contract). Representations can be made orally and need not be made to a particular counterparty. This amendment should remove any lingering uncertainty in the financial markets as to the form of the representation as well as reduce the burden on any institutions that assumed the representation had to be in writing.

Regulatory Flexibility Act Certification

In accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), the Board certifies that this rule will not have a significant economic impact on a substantial number of small entities. The rule applies only to entities with a large volume of financial contracts and, in any case, does not impose any additional requirements on entities affected by the regulation.

Paperwork Reduction Act

In accordance with section 3506 of the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 35; 5 CFR 1320 Appendix A.1), the Board reviewed the rule under the authority delegated to the Board by the Office of Management and Budget. No collections of information pursuant to the Paperwork Reduction Act are contained in the rule.

Administrative Procedure Act

The Administrative Procedure Act generally requires agencies to publish a notice of proposed rule making before adopting a final rule (5 U.S.C. 553(b)). In certain circumstances, however, the Act allows an agency to forego to the notice-and-comment process. These circumstances include when the agency for good cause finds that notice and comment are unnecessary or contrary to the public interest (5 U.S.C. 553(b)(B)). The amendment to Regulation EE does not make a substantive change to the rule but rather clarifies that by not specifying a form of representation in the original rule, the Board intended that the representations could be made orally or in writing. The amendment clarifies a market uncertainty and may

reduce burden for any institutions that assumed the representation had to be in writing. For these reasons, the Board finds that public comment is unnecessary and contrary to the public interest. Therefore, the Board finds that this amendment fits within the Act's exceptions from the notice-and-comment procedure.

List of Subjects in 12 CFR Part 231

Banks, banking, Federal Reserve System.

For the reasons set out in the preamble, 12 CFR Part 231 is amended as set forth below:

PART 231—NETTING ELIGIBILITY FOR FINANCIAL INSTITUTIONS (REGULATION EE)

1. The authority citation for Part 231 continues to read as follows:

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

2. In § 231.3, the introductory text of paragraph (a) is revised to read as follows:

§ 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, orally or in writing, that it will engage in financial contracts as a counterparty on both sides of one or more financial markets and either—

* * * * *

By order of the Board of Governors of the Federal Reserve System, January 11, 1996.

William W. Wiles,
Secretary of the Board.

[FR Doc. 96–506 Filed 1–18–96; 8:45 am]

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