Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #768
March 1997
12 U.S.C. 194
12 U.S.C. 1821C & 3101A

October 4, 1995

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Dear [ ]:

This is in response to your request for guidance on behalf of your client, [ ] ( ), regarding the enforceability of various rights or interests of [ ] in the event that a federal branch or agency ("federal branch") that is a participating member in [ ] were to be placed in receivership. The liquidation of a federal branch of a foreign bank is governed by the International Banking Act of 1978 ("IBA"), 12 U.S.C. § 3101 et seq. As discussed below, (1) we conclude that the OCC would be required to appoint the Federal Deposit Insurance Corporation ("FDIC") as receiver of an insured federal branch or agency; (2) we agree with the conclusions of the FDIC that the described foreign exchange ("FX") transactions by [ ] would be "qualified financial contracts" ("QFCs") under the Federal Deposit Insurance Act ("FDIA"); (3) we conclude that an OCC-appointed receiver for an uninsured federal branch or agency should administer the receivership in accordance with the receivership provisions of the National Bank Act ("NBA") and the IBA; and (4) we have identified no prohibition or legal impediment to a federal branch's ability to engage in the activities described herein, subject, of course, to any particular supervisory considerations that may be present in the case of individual institutions.[1]

Background

You have represented to us that [ ] is a private limited company incorporated under the laws of [ ] and [ ] that has been organized to provide a multilateral foreign exchange contract netting and settlement service to participating commercial and investment banks. [ ] has been established under the supervision of the [A] and [B] and is regulated by the [A].

[1] In the absence of particular facts, the OCC cannot provide an opinion as to what precise actions it would take in the event of the receivership of an uninsured federal branch of a foreign bank.

We understand that, under [ ]'s rules and regulations, members are entitled to arrange FX transactions with the participating offices of other members. [ ] functions as a multilateral clearing house by interposing itself as a counterparty to FX transactions that members would otherwise engage in with other members. [ ] nets all FX transactions at times agreed upon between and among members. To protect [ ] from the default of any members on FX contracts, members agree to post security in the form of an asset pool contribution consisting of U.S. Treasury bills, in amounts to be determined by reference to the amount of a member's capital. Members also agree to post margin in U.S. dollars for transactions in excess of predesignated levels.

Discussion

For purposes of our discussion, we assume that the FX contract at issue includes, at a minimum, (1) the [ ] International FX Master Agreement (Master Agreement), (2) each FX claim arising from a transaction for the exchange of two agreed currencies in agreed amounts between a member and [ ][2], (3) [ ] Rules and Regulations[3], (4) each security interest document provided by a member in connection with the provision of margin and/or its asset pool contribution, (5) each Direct Debiting Mandate provided by a member[4], (6) The Irrevocability Agreement[5], and (7) any other document given by a member or a member grantor for the benefit of [ ]. We further assume (1) the genuineness, validity, and enforceability of the obligations of each party and of [ ] under the [ ] contracts, (2) strict identity of parties to the contracts, (3) no intent by any party to transfer assets after the commission of an act of insolvency or in contemplation of insolvency, and (4) compliance by each party with all provisions of applicable state, federal, and foreign law including all

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[2] "FX claim" means an FX credit or an FX debit. In general, an "FX credit" means the net credit balance outstanding and owed by [ ] to a particular member and an "FX debit" is the net debit balance outstanding and owed by a particular member to [ ].

[3] We express no opinion regarding the enforceability of [ ]'s Rules and Regulations. For purposes of discussion, however, we assume that [ ] Rules and Regulations are enforceable as part of the FX contract.

[4] A "Direct Debit Mandate" authorizes a member's agent to debit the member's account held with the agent, by amounts submitted by [ ] by S.W.I.F.T. message. S.W.I.F.T. is a service provided by the Society for Worldwide Interbank Financial Telecommunications S.C. and used by financial institutions and brokers to transmit messages using an international communications language.

[5] An "irrevocability agreement" is signed by member agents making payments to [ ] and provides that, once payments are confirmed, they cannot be reversed other than to comply with applicable law or regulatory requirements or by provisions of the agreements governing the use of the local currency clearing system.

requirements imposed by the [A] as supervisor of [ ]. Our analysis does not address requirements of state law or provisions of federal law other than the NBA and IBA that might be applicable.

Receivership of Insured Federal Branches

First you ask whether the OCC would appoint the FDIC as receiver for an insured federal branch or, if it would not do so, whether the OCC would administer the receivership of an insured federal branch in a manner consistent with receiverships normally administered by the FDIC, including its rules and procedures on the treatment of QFCs.

The liquidation of a federal branch of a foreign bank is governed by the IBA, 12 U.S.C. § 3101 et seq. Section 4(j) of the IBA authorizes the Comptroller to appoint a receiver for federal branches and states further that the receiver shall have the same powers as receivers of national banks. 12 U.S.C. § 3102(j)(1). Section 191 of the NBA, 12 U.S.C. § 191, addresses the Comptroller's ability to appoint a receiver for a national bank and specifies that the FDIC shall be appointed receiver for insured national banks. Similarly, the FDIA in section 1821© indicates that the FDIC must be appointed receiver, and must accept such appointment, for insured financial institutions. The corresponding receivership powers available to the FDIC pursuant to its appointment as receiver under section 1821© are found in the remainder of section 1821, and include the QFC provisions. Therefore, we conclude that the OCC would appoint the FDIC as receiver for an insured federal branch of a foreign bank, and the FDIC would administer the receivership in accordance with receivership provisions of the FDIA.

Status of Transactions As QFCs

Second, you have asked whether the OCC would regard [ ]'s foreign exchange transactions as QFCs under the FDIC's rules and procedures. The FDIC, in an opinion letter to you dated July 31, 1995, from William F. Kroener, III, General Counsel, concluded that the FDIA, as well as other statutory provisions applicable to the receivership of national banks, would apply in receiverships of insured federal branches where the FDIC acts as receiver. See 12 U.S.C. § 3102(j)(1). In that letter, the FDIC also concluded that a court would determine that the foreign exchange transactions generally described in the materials [ ] provided to the FDIC would be qualified financial contracts within the statutory definition in the FDIA. See 12 U.S.C. §§ 1821(e)(8)(D)(I) and (vii). We see no reason to disagree with the FDIC's views that such foreign exchange contracts, including spot foreign exchange contracts, should be treated by the receiver as qualified financial contracts under the FDIA.

Receivership of Uninsured Federal Branches

Third, you have asked how the OCC would handle the administration of the receivership of an uninsured federal branch, including how the OCC would intend to handle [ ]'s foreign exchange transactions. In particular, you asked whether, in cases where [ ] has outstanding

foreign exchange transactions with a member, the receiver would permit [ ] to exercise its rights under its rules and regulations to (1) terminate and close out all outstanding foreign exchange transactions with the member, and (2) liquidate collateral pledged to [ ] with respect to the member's outstanding direct and indirect foreign exchange exposure. You also questioned whether the OCC would expect the receiver of an uninsured federal branch to seek invalidation of any portion of [ ]'s contractual arrangements, especially those relating to [ ]'s margin requirements and asset pool contributions, and attempt to avoid those transfers as an impermissible "preference" in reliance on 12 U.S.C. § 91.

Although the FDIC would be appointed receiver of an insured federal branch under the authority of 12 U.S.C. § 1821(c), the appointment provision of 1821© does not extend to uninsured national banks. Rather, the administration of the receivership of an uninsured federal branch or agency would be governed by the NBA and the IBA, as applicable.[6] While the FDIA receivership provisions provide special treatment for QFCs, the NBA does not contain comparably specific provisions. Therefore, our response addresses the enforceability of [ ]'s netting contracts in the context of collateral and offset arrangements under the NBA. We conclude, however, that similar results would be obtained under the NBA and the FDIA.

The sections of the NBA that would be relevant to the treatment of netting contracts and related collateral arrangements within a national bank receivership are found in 12 U.S.C. §§ 91 and 194. Section 194 of the NBA requires the Comptroller to make a ratable dividend of the money paid to him by the receiver on all claims proved[7] to his satisfaction or adjudicated in a court of competent jurisdiction. First Empire Bank v. FDIC, 572 F.2d 1361 (9th Cir.), cert denied, 439 U.S. 919 (1978). Courts have recognized two concepts with respect to the ratability requirement that are pertinent to the analysis of netting arrangements and collateral held as security for debts owed. First, courts have found that the offsetting of amounts owed to a creditor with amounts due to the insolvent by that creditor does not violate the ratability requirement because amounts subject to offset are not assets of the receivership. See Scott v. Armstrong, 146 U.S. 499 (1892); InterFirst Bank Abilene, N.A. v. FDIC, 777 F.2d 1092 (5th Cir. 1985). See also Yardley v. Philler, 167 U.S. 192 (l897). The ability to offset is conditioned on the existence of mutuality of obligations. Id. Second, courts have found that legally enforceable security interests or collateral pledges are not subject to ratable distribution. See Scott v. Armstrong, supra. This concept indicates that a perfected security interest would be recognized outside the confines of pro rata sharing of all assets of the insolvent bank. See Merrill v. National Bank of Jacksonville, 173 U.S. 131 (1899); Bank

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[6] The provisions of the IBA appear to be consistent with the requirements of the NBA discussed herein.

[7] For purposes of this discussion, the OCC assumes that any [ ] claim under its contract is provable.

One, Texas, N.A. v. Prudential Ins. Co. of America, 878 F. Supp. 943, 961 n.3 (N.D.Tex. 1995). In order to be legally enforceable, any agreement creating a security interest must satisfy applicable state and foreign law, as well as the NBA.

Section 91, however, permits the receiver of a national bank to void those transfers of assets made in connection with claims that are made after the commission of an act of insolvency, or in contemplation of insolvency, or with a view to create a preference. 12 U.S.C. § 91. Therefore, security interests, pledges, liens, and other rights created by an uninsured federal branch or agency upon the event of insolvency, or in contemplation of insolvency, with the intent to avoid the pro rata application of the assets as required under the NBA, or to prefer one creditor over another would be invalidated. Consistent with the assumptions stated above, we would not view [ ]'s contractual arrangements, including [ ]'s margin requirements and asset pool contributions, as being created "in contemplation of insolvency," and therefore transactions pursuant to those arrangements should not be voidable under Section 91.

Therefore, assuming that mutuality of obligation exists between [ ] and the defaulting institution, a right to offset arising from express agreements or implied from the nature of the dealings between parties, or by operation of law, prior to insolvency and not in contemplation of insolvency should not be prohibited by the statutes governing national bank insolvencies. See Scott v. Armstrong, supra. Further, assuming that [ ] has a valid and perfected first priority security interest in the designated cash and United States government securities pledged to it under the relevant applicable law, in our opinion, the security interest should be enforceable by [ ] in a receivership of an uninsured federal branch or agency of a foreign bank. Thus, we conclude that to the extent that [ ] has FX transactions outstanding with an insolvent uninsured bank or branch counterparty, it should be able to perform the netting of those contracts and, to the extent that the netting results in an amount owed to [ ], the margin and asset pool collateral should be available to satisfy that obligation.

Participation in [ ]

Fourth, you have asked whether the OCC would object should a foreign bank with an uninsured federal branch seek to join [ ]. This presents both legal and supervisory issues. As a legal matter, national banks and federal branches are permitted to engage in foreign exchange activities, as they are permitted to "buy[] and sell[] exchange, coin, and bullion." See 12 U.S.C. §§ 24 (Seventh) and 3102(b). We have identified no specific prohibition on a federal branch's ability to engage in such activity and no legal impediment to an uninsured federal branch entering into foreign exchange contracts with [ ], where the branch's counterparty has the legal capacity to enter into those contracts. We also have identified no legal prohibition against an uninsured federal branch entering into an agreement that provides for netting among the various parties to the agreement. We cannot, of course, address supervisory issues that may pertain to an individual bank or federal branch that would be relevant to whether it was appropriate, as a safety and soundness matter, for that entity to

participate in a particular activity or transaction.

I hope this is responsive to your inquiry. If you have any further questions, please do not hesitate to contact our staff.

Very truly yours,

/s/

Julie L. Williams
Chief Counsel