

103<sup>D</sup> CONGRESS  
2<sup>D</sup> SESSION

# H. R. 3748

To provide an enhanced framework for Federal financial institution regulation of derivatives activities.

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IN THE HOUSE OF REPRESENTATIVES

JANUARY 26, 1994

Mr. LEACH introduced the following bill; which was referred jointly to the Committees on Banking, Finance and Urban Affairs, Energy and Commerce, and Agriculture

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## A BILL

To provide an enhanced framework for Federal financial institution regulation of derivatives activities.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act shall be cited as the “Derivatives Super-  
5 vision Act of 1994.”

6 **TITLE I—FEDERAL DERIVATIVES**

7 **COMMISSION**

8 **SEC. 101. DECLARATION OF PURPOSE.**

9 It is the purpose of this title to establish a Federal  
10 Derivatives Commission which shall establish principles

1 and standards for the supervision by Federal financial in-  
2 stitution regulators of financial institutions engaged in de-  
3 rivatives activities and make recommendations to promote  
4 uniformity in the supervision of these financial institu-  
5 tions. The Commission’s actions shall be designed to pro-  
6 mote consistency in regulatory practices and to insure pro-  
7 gressive and vigilant supervision.

8 **SEC. 102. DEFINITIONS.**

9 As used in this title—

10 (1) the term “Federal financial institutions reg-  
11 ulatory agencies” means the Office of the Comptrol-  
12 ler of the Currency, the Board of Governors of the  
13 Federal Reserve System, the Federal Deposit Insur-  
14 ance Corporation, the Office of Thrift Supervision,  
15 the Securities and Exchange Commission, and the  
16 Commodity Futures Trading Commission;

17 (2) the term “Commission” means the Federal  
18 Derivatives Commission;

19 (3) the term “Federal banking agency” has the  
20 same meaning as in section 3 of the Federal Deposit  
21 Insurance Act (12 U.S.C. 1813);

22 (4) the term “financial institution” means any  
23 institution described in section 402(9) of the Federal  
24 Deposit Insurance Corporation Improvement Act of  
25 1991, any Government sponsored enterprise, or any

1 other institution (including any type of end user) as  
2 determined by the Commission;

3 (5) the term “Government sponsored enter-  
4 prise” has the same meaning as in section 1404(e)  
5 of the Financial Institutions Reform, Recovery, and  
6 Enforcement Act of 1989;

7 (6) the term “qualified financial contract” has  
8 the same meaning as in section 11(e)(8)(D) of the  
9 Federal Deposit Insurance Act (12 U.S.C.  
10 1821(e)(8)(D)), except that the Commission may de-  
11 termine any similar agreement to be a qualified fi-  
12 nancial contract for purposes of this title; and

13 (7) the term “derivatives activities” means ac-  
14 tivities by a financial institution involving qualified  
15 financial contracts or any similar agreements that  
16 the Commission determines are qualified financial  
17 contracts for purposes of this title.

18 **SEC. 103. FEDERAL DERIVATIVES COMMISSION.**

19 (a) ESTABLISHMENT; COMPOSITION.—There is es-  
20 tablished the Federal Derivatives Commission which shall  
21 consist of—

22 (1) the Chairman of the Board of Governors of  
23 the Federal Reserve System,

24 (2) the Comptroller of the Currency,

1           (3) the Chairperson of the Board of Directors  
2 of the Federal Deposit Insurance Corporation,

3           (4) the Director of the Office of Thrift Super-  
4 vision,

5           (5) the Chairman of the Securities and Ex-  
6 change Commission,

7           (6) the Chairman of the Commodity Futures  
8 Trading Commission, and

9           (7) the Secretary of Treasury.

10          (b) CHAIRMANSHIP.—The Chairman of the Commis-  
11 sion shall be the Chairman of the Board of Governors of  
12 the Federal Reserve System.

13          (c) DESIGNATION OF OFFICERS AND EMPLOYEES.—  
14 The members of the Commission may, from time to time,  
15 designate other officers or employees of their respective  
16 agencies to carry out their duties on the Commission.

17          (d) COMPENSATION AND EXPENSES.—Each member  
18 of the Commission shall serve without additional com-  
19 pensation but shall be entitled to reasonable expenses in-  
20 curred in carrying out his official duties as such a mem-  
21 ber.

22 **SEC. 104. COSTS AND EXPENSES OF COMMISSION.**

23          One-sixth of the costs and expenses of the Commis-  
24 sion, including the salaries of its employees, shall be paid  
25 by each of the Federal financial institutions regulatory

1 agencies. Annual assessments for such share shall be lev-  
2 ied by the Commission based upon its projected budget  
3 for the year, and additional assessments may be made dur-  
4 ing the year if necessary.

5 **SEC. 105. FUNCTIONS OF COMMISSION.**

6 (a) ESTABLISHMENT OF PRINCIPLES AND STAND-  
7 ARDS.—

8 (1) The Commission shall establish principles  
9 and standards related to capital, accounting, disclo-  
10 sure, suitability, or other appropriate regulatory ac-  
11 tions for the supervision of financial institutions en-  
12 gaged in derivatives activities by the Federal finan-  
13 cial institutions regulatory agencies.

14 (2) Each Federal financial institutions regu-  
15 latory agency shall issue substantially similar regula-  
16 tions governing derivatives activities for purposes of  
17 implementing paragraph (1), unless it finds that im-  
18 plementation of substantially similar regulations is  
19 not necessary or appropriate in the public interest.

20 (3) Any financial institution not subject to su-  
21 pervision by a Federal banking agency or the Com-  
22 modity Futures Trading Commission shall be super-  
23 vised by the Securities and Exchange Commission to  
24 the extent of their derivatives activities, except as  
25 otherwise provided by the Commission.

1 (b) RECOMMENDATIONS REGARDING SUPERVISORY  
2 ACTIONS.—

3 (1) In establishing principles and standards  
4 under subsection (a), the Commission shall consider  
5 and may make recommendations for comparable reg-  
6 ulatory action by the Federal financial institutions  
7 regulatory agencies in other matters related to fi-  
8 nancial institutions engaged in derivatives activities,  
9 such as, but not limited to, the need to establish  
10 principles and standards for:

11 (A) Strong capital requirements (with par-  
12 ticular attention to a leverage ratio where ap-  
13 propriate) to guard generally against risks at fi-  
14 nancial institutions, including added risks that  
15 may be posed by derivatives activities;

16 (B) Discouraging active trading in deriva-  
17 tives markets by financial institutions, particu-  
18 larly those with access to federally insured de-  
19 posits, unless management can demonstrate  
20 that the institution has both adequate capital  
21 and technical capabilities;

22 (C) Joint regulatory examinations by the  
23 Federal banking agencies of insured depository  
24 institutions that are derivatives dealers and any  
25 affiliates;

1 (D) Board of director responsibility with  
2 respect to the oversight of derivatives activities,  
3 including specific written policies approved by  
4 the board of directors to be in place for dealers  
5 and end users of derivatives setting prudential  
6 standards for management of the risks involved  
7 in derivatives activities and establishing a  
8 framework for internal controls;

9 (E) Guidelines for the prudent use of col-  
10 lateral by counterparties to derivatives trans-  
11 actions;

12 (F) The appropriate parameters, models  
13 and simulations of purposes of evaluating a fi-  
14 nancial institution's credit and market risk  
15 posed by derivatives activities;

16 (G) Guidelines as to appropriate credit risk  
17 reserves in connection with derivatives activi-  
18 ties;

19 (H) Increased standardization of docu-  
20 mentation and the use of standard documents  
21 by all market participants;

22 (I) Minimum prudential practices for mu-  
23 nicipalities and pension funds that may use de-  
24 rivatives;

1           (J) Enhanced disclosures to mutual fund  
2 customers of the risks that may be posed to  
3 mutual funds that are end users of derivatives  
4 products;

5           (K) Guidelines related to legal risk, includ-  
6 ing, but not limited to, foreign legal risk. Such  
7 guidelines may address the steps a financial in-  
8 stitution should take to obtain adequate assur-  
9 ances of legal enforceability of derivatives con-  
10 tracts, including the assurances of legal enforce-  
11 ability of netting provisions that should be ob-  
12 tained before an institution relies on such net-  
13 ting provisions; and

14           (L) Regulations to protect against systemic  
15 risk.

16           (2) When a recommendation of the Commission  
17 is found unacceptable by one or more of the applica-  
18 ble Federal financial institutions regulatory agencies,  
19 the agency or agencies shall submit to the Commis-  
20 sion, within a time period specified by the Commis-  
21 sion, a written statement of the reasons the rec-  
22 ommendation is unacceptable and such statement  
23 shall be published in the Federal Register.

24           (c) DEVELOPMENT OF UNIFORM REPORTING SYS-  
25 TEM.—The Commission shall develop uniform reporting

1 systems for financial institutions engaged in derivatives  
2 activities. The authority to develop uniform reporting sys-  
3 tems shall not restrict or amend the requirements of sec-  
4 tion 781(i) of title 15 of the United States Code.

5 (d) TRAINING FOR EXAMINERS AND ASSISTANT EX-  
6 AMINERS.—The Commission shall sponsor training pro-  
7 grams concerning derivatives activities for examiners and  
8 assistant examiners employed by the Federal financial in-  
9 stitutions regulatory agencies. Such training programs  
10 shall be open to enrollment by employees of State financial  
11 institutions supervisory agencies and employees of the  
12 Federal Housing Finance Board and the Department of  
13 Housing and Urban Development’s Office of Federal  
14 Housing Enterprise Oversight under conditions specified  
15 by the Commission.

16 (e) EFFECT ON FEDERAL REGULATORY AGENCY RE-  
17 SEARCH AND DEVELOPMENT OF NEW FINANCIAL INSTI-  
18 TUTIONS SUPERVISORY METHODS.—Nothing in this title  
19 shall be construed to limit or discourage Federal financial  
20 institution regulatory agency research and development of  
21 new financial institutions supervisory methods and tools  
22 related to derivatives activities, nor to preclude the field  
23 testing of any innovation devised by any Federal financial  
24 institution regulatory agency.

1 (f) ANNUAL REPORT.—Not later than April 1 of each  
2 year, the Commission shall prepare a report covering its  
3 activities during the preceding calendar year.

4 **SEC. 106. STATE LIAISON.**

5 To encourage the application of uniform examination  
6 principles and standards by State and Federal supervisory  
7 agencies, the Commission shall establish a liaison commit-  
8 tee composed of five representatives of State agencies  
9 which supervise financial institutions which shall meet at  
10 least twice a year with the Commission. Members of the  
11 liaison committee shall receive a reasonable allowance for  
12 necessary expenses incurred in attending meetings.

13 **SEC. 107. ADMINISTRATION.**

14 (a) AUTHORITY OF CHAIRMAN OF COMMISSION.—  
15 The Chairman of the Commission is authorized to carry  
16 out and to delegate the authority to carry out the internal  
17 administration of the Commission, including the appoint-  
18 ment and supervision of employees and the distribution  
19 of business among members, employees, and administra-  
20 tive units.

21 (b) USE OF PERSONNEL, SERVICES, AND FACILITIES  
22 OF FEDERAL FINANCIAL INSTITUTIONS REGULATORY  
23 AGENCIES.—In addition to any other authority conferred  
24 upon it by this title, in carrying out its functions under  
25 this title, the Commission may utilize, with their consent

1 and to the extent practical, the personnel, services, and  
2 facilities of the Federal financial institutions regulatory  
3 agencies, with or without reimbursement therefor.

4 (c) COMPENSATION, AUTHORITY, AND DUTIES OF  
5 OFFICERS AND EMPLOYEES; EXPERTS AND CONSULT-  
6 ANTS.—In addition, the Commission may—

7 (1) subject to the provisions of title 5 relating  
8 to the competitive service, classification, and General  
9 Schedule pay rates, appoint and fix the compensa-  
10 tion of such officers and employees as are necessary  
11 to carry out the provisions of this title, and to pre-  
12 scribe the authority and duties of such officers and  
13 employees; and

14 (2) obtain the services of such experts and con-  
15 sultants as are necessary to carry out the provisions  
16 of this title.

17 **SEC. 108. RISK MANAGEMENT TRAINING.**

18 The Commission shall develop training seminars in  
19 risk management techniques related to derivatives activi-  
20 ties for employees of the Federal financial institution reg-  
21 ulatory agencies and the employees of financial institu-  
22 tions.

23 **SEC. 109. INTERNATIONAL NEGOTIATIONS.**

24 The Chairman of the Board of Governors of the Fed-  
25 eral Reserve System, in consultation with the members of

1 the Commission, shall encourage governments, central  
2 banks, and regulatory authorities of other industrialized  
3 countries to work toward maintaining and, where appro-  
4 priate, adopting comparable supervisory standards and  
5 regulations, particularly capital standards, for financial  
6 institutions engaged in derivatives activities.

7 **SEC. 110. CREDIT UNIONS.**

8 Insured credit unions (as defined in section 101(7)  
9 of the Federal Credit Union Act) shall be supervised for  
10 purposes of derivatives activities by the National Credit  
11 Union Administration under standards no less stringent  
12 than standards under which Federal depository institu-  
13 tions (as defined in section 3(c) of the Federal Deposit  
14 Insurance Act) are supervised by the Federal banking  
15 agencies.

16 **TITLE II—SUPERVISORY IMPROVEMENTS**

17 **SEC. 201. UNSAFE OR UNSOUND BANKING PRACTICES.**

18 (a) IN GENERAL.—Failure of an institution-affiliated  
19 party engaged in derivatives activities to have adequate  
20 technical expertise may be deemed by the appropriate Fed-  
21 eral banking agency to constitute an unsafe or unsound  
22 banking practice within the meaning of section 8 of the  
23 Federal Deposit Insurance Act (12 U.S.C. 1818).

24 (b) RULE OF CONSTRUCTION.—This section shall be  
25 in addition to and not in derogation of the authority of

1 any appropriate Federal banking agency under section 8  
2 of the Federal Deposit Insurance Act to determine unsafe  
3 or unsound banking practices.

4 **SEC. 202. INTERNAL CONTROLS.**

5 Section 39(a)(1)(A) of the Federal Deposit Insurance  
6 Act (12 U.S.C. 1831p-1(a)(1)(A)) is amended by striking  
7 “internal controls” and inserting “internal controls (in-  
8 cluding internal controls for derivatives activities”.

9 **SEC. 203. FOREIGN BANK SUPERVISION.**

10 Section 7(d)(2)(A) of the International Banking Act  
11 of 1978 (12 U.S.C. 3105(d)(2)(A)) is amended after  
12 “country” by inserting “, including, in the case of a for-  
13 eign bank engaged in derivatives activities, comprehensive  
14 supervision and regulation for derivatives activities (as  
15 that term is defined in the Derivatives Supervision Act  
16 of 1994). In making any determination under this para-  
17 graph, the Board shall consider whether the home country  
18 maintains comprehensive supervision and regulation of de-  
19 rivatives activities, including capital and disclosure stand-  
20 ards, not less stringent than United States standards.”.

21 **TITLE III—FINANCIAL INSTITUTION**

22 **INSOLVENCY REFORMS**

23 **SEC. 301. CONFORMING DEFINITIONS.**

24 (a) Section 11(e)(8)(D)(vi) of the Federal Deposit In-  
25 surance Act (12 U.S.C. 1821(e)(8)(D)(vi)) is amended—

1 (1) by striking “purchased” each time it ap-  
2 pears; and

3 (2) after “currency option” inserting “, equity  
4 derivative, equity or equity index swap, equity or eq-  
5 uity index option, bond option, spot foreign exchange  
6 transaction”.

7 (b) Section 101(55) of the Bankruptcy Code (11  
8 U.S.C. 101(55)) is amended—

9 (1) in paragraph (A), by inserting “any quali-  
10 fied financial contract within the meaning of section  
11 1821(e)(8)(D)(i) of title 12, United States Code,”  
12 after “currency option,”; and

13 (2) in paragraph (C) by inserting “and trans-  
14 actions documented thereunder.” after “supple-  
15 mental”.

16 **SEC. 302. FAILED AND FAILING INSTITUTIONS.**

17 Section 11(e)(8) of the Federal Deposit Insurance  
18 Act (12 U.S.C. 1821(e)(8)) is amended by adding the fol-  
19 lowing new subparagraphs:

20 “(F) PREEMPTION.—Notwithstanding any  
21 other provision of law, no automatic stay, in-  
22 junction, avoidance, moratorium, or other re-  
23 straint, whether issued or granted by a bank-  
24 ruptcy court or any other judicial body, any ad-  
25 ministrative body, or whether created by statute

1 or otherwise, shall limit or delay the ability of  
2 the Corporation, in any capacity, to exercise its  
3 authority, rights or powers in accordance with  
4 section 11(e)(8) of this Act. This provision shall  
5 not limit any other right, power or authority of  
6 the Corporation in any capacity.

7 “(G) UNDERCAPITALIZED INSURED DE-  
8 POSITORY INSTITUTIONS.—The Corporation, in  
9 consultation with the appropriate Federal bank-  
10 ing agencies, shall prescribe regulations requir-  
11 ing expanded recordkeeping for qualified finan-  
12 cial contracts (including market valuations) by  
13 insured depository institutions that are  
14 undercapitalized as defined in section 38 of the  
15 Federal Deposit Insurance Act (12 U.S.C.  
16 1831o).”.

17 **SEC. 303. QUALIFIED FINANCIAL CONTRACT TRANSFERS.**

18 Section 11(e)(10) of the Federal Deposit Insurance  
19 Act, (12 U.S.C. 1821(e)(10)), is amended by adding the  
20 following new subparagraphs:

21 “(C) EFFECT OF NOTICE.—If a person  
22 who is a party to a qualified financial contract  
23 is notified by the Corporation as receiver of a  
24 depository institution by the close of business  
25 (Eastern Standard Time) on the business day

1 following its appointment as receiver that the  
2 Corporation has transferred all qualified finan-  
3 cial contracts between the depository institution  
4 and such person or its affiliates pursuant to  
5 subparagraph (9)(A), then the provisions of  
6 subparagraph (8)(A) shall not apply. For pur-  
7 poses of this subparagraph, the Corporation as  
8 receiver shall be deemed to have notified a per-  
9 son if it has taken steps reasonably calculated  
10 to provide notice to such person.

11 “(D) NOTICE EXTENSION.—The Corpora-  
12 tion may extend the notice period described in  
13 paragraph (C) for a reasonable period not to  
14 exceed 5 days, if the Corporation determines  
15 that such an extension may maximize the net  
16 present value return from the sale or disposi-  
17 tion of such qualified financial contracts.

18 “(E) TREATMENT OF BRIDGE BANKS.—  
19 Neither a bridge bank nor an institution orga-  
20 nized by the Corporation and immediately  
21 placed into conservatorship or placed into  
22 conservatorship at the time of a purchase and  
23 assumption transaction with the receiver of a  
24 failed depository institution for which the Cor-  
25 poration has been appointed receiver shall be

1           considered a depository institution in default  
2           for purposes of this paragraph, paragraph 8  
3           and paragraph 9 of this section.”.

4 **SEC. 304. CLARIFYING AMENDMENTS.**

5           Section 11(e)(8)(D)(vii) of the Federal Deposit In-  
6 surance Act (12 U.S.C. 1821(e)(8)(D)(vii)) is amended to  
7 read as follows: “(vii) Notwithstanding any other provision  
8 of law, any master agreements for contracts or agreements  
9 described in clause (ii), (iii), (iv), or (vi), together with  
10 all supplements to such master agreement shall be treated  
11 as 1 swap agreement for purposes of this Act and title  
12 11 of the United States Code.”.

13 **SEC. 305. TECHNICAL AMENDMENTS.**

14           (a) Section 11(e)(8)(D) of the Federal Deposit Insur-  
15 ance Act (12 U.S.C. 1821(e)(8)(D)) is amended—

16               (1) in clause (i) by inserting “spot contract,”  
17               after “swap agreement,”.

18               (2) in clause (iv) by striking “(24)” and insert-  
19               ing “(25)”;

20               (3) in clause (v) by striking “101(41)” and in-  
21               serting “101(47)”.

22           (b) Section 11(e)(8)(E)(i) of the Federal Deposit In-  
23 surance Act (12 U.S.C. 1821(e)(8)(E)(i)) is amended by  
24 striking “;” and inserting “, other than a default based  
25 solely upon the appointment of a conservator;”.

1                   **TITLE IV—MISCELLANEOUS**

2   **SEC. 401. SAVINGS PROVISION.**

3           The provisions of this Act shall be in addition to and  
4 not in derogation of any existing authority of a Federal  
5 financial institution regulatory agency to supervise or reg-  
6 ulate derivatives activities provided under any other appli-  
7 cable law.

○