Office of the Comptroller of the Currency

Interpretive Letter #748

Published in Interpretations and Actions October 1996

September 13, 1996

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Re: Enforceability of Netting and Collateral Agreements with Federal Branches and Agencies

Dear [ ]:

This is in response to your letter to the Office of the Comptroller of the Currency ("OCC") on behalf of Exchange Clearing House Organization ("ECHO"), an English company. ECHO provides financial institutions dealing in foreign exchange with a means for netting their transactions through the substitution of ECHO as the counterparty to each transaction pursuant to transactions and agreements governed by English law.

You requested clarification of the enforceability of ECHO arrangements with participants that are uninsured Federal branches or agencies of foreign banks in the event the OCC appoints a receiver for such a Federal branch or agency. You represented that ECHO's rules, which are incorporated into the participant agreement, provide for netting payment obligations and entitlements among the participants, as well as termination of transactions upon appointment of a receiver for a participant. Participants will also agree to pledge collateral to secure their obligations under their netting contracts through the provision of initial collateral in the form of U.S. government securities and cash and additional collateral later on in the event specified trading limits are exceeded.

1. *Receivership Will Not Interfere With Rights of Secured Creditor Concerning Collateral*

You asked us to confirm that a receiver for an uninsured Federal branch or agency of a foreign bank appointed by the Comptroller under section 4(j) of the International Banking Act ("IBA"), and acting under receivership authority of the National Bank Act, would not have the right to stay, delay or hinder a secured party's remedies with respect to collateral security under the following assumptions: The obligations of the branch or agency under a netting contract, such as the ECHO rules and the related agreements, are secured pursuant to an agreement that constitutes a valid and perfected security interest under applicable U.S. law. In addition, at the time of execution the security agreement was not entered into in contemplation of the foreign bank's insolvency, or that of the branch of agency.

We agree. The National Bank Act does not provide the receiver the right to stay, delay or hinder a secured party's remedies with respect to collateral security in the described circumstances. There is no automatic stay or other provision in the National Bank Act that

authorizes such interference with the rights of a secured creditor. In addition, there are no court cases or

interpretations that would permit the receiver to disregard the rights of a secured creditor in this situation. Rather, the cases and practice of receivership under the National Bank Act instruct that a Comptroller-directed receivership is subject to longstanding legal principles upholding the rights of secured creditors and creditors with set off rights. *See Bell v. Hanover National Bank*, 57 F. 821, 822 (C.C.S.D.N.Y. 1893) ("It is only such balance of [the collateral] as may be left after the lien upon it is satisfied that either the [bank] or the receiver is entitled to ...."). *See also Scott v. Armstrong*, 146 U.S. 499, 510 (1892) (ratable payments by the receiver to claimants are made only "from what belongs to the bank, and that which at the time of insolvency belongs of right to [a creditor with set off rights] does not belong to the bank.").

With regard to this question, you have also asked our opinion as to the effect of section 4(j)(2) of the IBA, which provides that, with respect to the receivership of a branch or agency, the Comptroller shall turn over the remainder of assets and proceeds to the head office of the foreign bank or its liquidator after "there has been paid to each ... creditor ... the full amount of such claims arising out of transactions had by them with any branch or agency ... and all expenses of the receivership." Section 4(j)(1) of the IBA provides that a receiver appointed for a federal branch or agency shall take possession of all property and assets of the foreign bank and "exercise the same rights, privileges, powers, and authorities with respect thereto as are now exercised by receivers of national banks appointed by the Comptroller." However, because nothing in section 4(j)(2) expressly limits or alters the law of secured transactions applicable to a receivership conducted under the National Bank Act, as provided in section 4(j)(1), paragraph (1) and paragraph (2) together yield a consistent result: the IBA does not provide authority for the receiver of a Federal branch to defeat the rights of a secured creditor. As noted above, under the National Bank Act only the balance of collateral left over after satisfaction of the security interest would be an asset available to the receiver for distribution to general creditors.

This conclusion is consistent with the legislative history of section 4(j) and the IBA, generally. On one hand, the recognition of the rights of a secured creditor to the extent of its security interest in assets in the U.S. would not give rise to the concerns that prompted section 4(j)(2). On the other hand, to interpret section 4(j)(2) as prescribing different creditor priorities and elevating an unsecured creditor over a secured creditor would be at odds with the principles of secured transactions widely recognized under U.S. law. It would be virtually impossible for a foreign bank to operate branches and agencies in the U.S. under such a standard because of the bank's inability to enter into the secured arrangements necessary for market participation -- an absurd result that would violate the national treatment policy of the IBA.

The Comptroller's reasonable interpretation of section 4(j)(2), which he is responsible for administering, is entitled to substantial deference. *See, e.g., Smiley v. Citibank (South Dakota, N.A.*, 64 U.S.L.W. 4399 (1996). Moreover, it should be noted that the receiver of a Federal branch or agency acts as the agent of, and subject to direction and control by, the Comptroller of the Currency. *Kennedy v. Gibson*, 75 U.S. 498, 503 (1868). In our opinion, under the circumstances outlined in your letter, the receiver may not seek to stay, hinder, delay or otherwise interfere with the exercise of rights of a secured party in collateral security and may not interfere with the liquidation of such collateral by the secured party promptly following a default. The above principles would apply to liquidation or application of collateral obtained pursuant to a valid security agreement and the other provisions of the ECHO rules that provide for the delivery of initial collateral as well as additional collateral in the event that specified transaction limits are exceeded. In addition, the same principles would apply to liquidation or application of collateral securing obligations that arise from ECHO's right to assess a participant in the event of default by another participant.

2. *Receivership Will Not Prevent Secured Party from Applying Collateral Held in the U.S. to Obligations of a Non-U.S. Office Or Otherwise Interfere With the Exercise of Rights*

You also asked us to confirm that the receiver would not have the right to prevent ECHO from liquidating and applying the collateral held in the United States without delay to the obligations of a non-U.S. office or otherwise stay, delay or hinder the exercise of remedies against the foreign bank and the collateral pledged to secure the foreign bank's obligations, under the following assumptions. The netting contract, in the circumstances you describe, is entered into by the head office or another non-U.S. office of the foreign bank. The non-U.S. office secures its obligations under the contract by a pledge of collateral located in the United States pursuant to a collateral security arrangement that would constitute a valid and perfected security interest under applicable U.S. law. At the time of its execution, the security agreement was not entered into in contemplation of the foreign bank's insolvency, or that of the branch or agency.

We agree. As discussed above, the National Bank Act does not provide authority to a receiver appointed by the Comptroller to interfere with the rights of a secured party. As noted, U.S. legal principles under which a secured party may enforce its interests are fully applicable to a receivership of a Federal branch or agency conducted under the National Bank Act. Thus, the restrictions on actions in contemplation of insolvency contained in 12 U.S.C. 91 would not interfere with ECHO's rights, as a secured creditor, to liquidate and apply margin or other collateral taken after execution of the security agreement so long as the right to do so was provided for in the security agreement itself and the applicable ECHO rules, which were not entered into in contemplation of insolvency as that term is used in section 91. Also, the direction to the receiver in section 4(j)(1) of the IBA to "take possession" of all the property and assets of the foreign bank in the U.S. does not supersede the applicable law of secured transactions. In our opinion, based upon the facts you described, the receiver may not interfere with the application of collateral held in the U.S. to obligations of a non-U.S. office or otherwise interfere with the exercise of remedies pursuant to a collateral security arrangement that would constitute a valid and perfected security interest under applicable U.S. law.

We trust this is responsive to your inquiry.

Very truly yours,
/s/
Julie L. Williams
Chief Counsel