

FDIC Issues “Living Wills” Proposal

On March 29, 2011, the Federal Deposit Insurance Corporation (“FDIC”) issued a proposed rule (the “Proposed Rule”) initiating a formal process for clarifying the so-called “living wills” requirement for certain large financial companies mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). Under the Proposed Rule, which has a sixty-day comment period, covered companies would be required to submit and periodically update a detailed strategic analysis of how they could be resolved under the Bankruptcy Code (the “Code”). The living wills requirement is intended in part to address concerns about institutions that are “too big to fail” by facilitating the ability of regulators to conduct advance resolution planning.¹ It remains unclear whether and to what extent the regulators will also use the living wills as a tool to require restructuring or downsizing where they deem a resolution plan inadequate to address potential systemic risks that would result from an institution’s failure.

The Proposed Rule, to be issued jointly with the Federal Reserve Board (“FRB”), implements the requirement of Section 165(d) of Dodd-Frank that certain large financial institutions submit detailed resolution plans and credit exposure reports to the FDIC and the FRB. Key provisions of the Proposed Rule include:

- **Covered companies.** The Proposed Rule applies to (i) all bank holding companies (“BHCs”) with at least \$50 billion in total global consolidated assets, (ii) all foreign banks and companies that are BHCs or are treated as BHCs under section 8(a) of the International Banking Act (“foreign banking organizations” or “FBOs”) and have at least \$50 billion in total global consolidated assets, and (iii) all nonbank financial companies (“NFCs”) designated by the Financial Stability Oversight Council (“FSOC”) for enhanced supervision by the FRB (“designated NFCs”, and together with the BHCs and FBOs described in (i) and (ii), “Covered Companies”).

¹ Other important new regulatory tools aimed at addressing too big to fail include the Orderly Liquidation Authority (“OLA”) provisions of Title II of Dodd-Frank creating a special resolution regime applicable to certain systemically important financial institutions (“SIFIs”) and other institutions; authority to impose restrictions (including divestitures) on SIFIs that are deemed to pose a “grave threat” to financial stability; authority to impose heightened standards on any practice or activity deemed to create systemic risks to the U.S. financial system; limits on the growth of financial companies; and other heightened prudential standards for SIFIs.

- **Timing of required filings.** Each Covered Company would be required to file its resolution plan and credit exposure report within 180 days of the effective date of a final rule, and annually within 90 days of the calendar year end thereafter. An interim resolution plan would have to be filed within 45 days after any event, occurrence or change that results in, or could reasonably be foreseen to have, a material effect on the company's existing resolution plan.
- **Content of a resolution plan.** A resolution plan would need to provide a plan for the rapid and orderly resolution of the Covered Company under the Code that would substantially mitigate serious adverse effects to the financial stability of the United States. To satisfy this requirement, each plan would be expected to contain a detailed description of the Covered Company's resolution strategy, governance, organization and financial information. Among other things, a resolution plan would be required to contain:
 - an executive summary highlighting key elements, material changes and company actions since the filing of the last resolution plan;
 - a strategic analysis supporting the plan, including a description of the company's key assumptions and supporting analysis, planned actions, financial needs and available resources, contemplated time frame, potential material weaknesses to the effective and timely execution of the plan, and valuation processes;
 - corporate governance structures, policies, procedures and internal controls relating to resolution planning;
 - voluminous organizational and financial information that would identify all material legal entities, map key business lines and functions to those legal entities, and set forth a detailed description of material on- and off-balance sheet exposures, financial positions, booking and hedging practices, major counterparties and trading, payment, clearing and settlement systems;
 - an inventory and description of management and information systems; and
 - a map of the interconnections and interdependencies among the Covered Company and its material entities, critical operations and core business lines.
- **Regulatory review.** The FRB and the FDIC will jointly review each resolution plan to determine whether the plan meets the rule's minimum information requirements, and if so, whether the plan is (i) credible and (ii) would facilitate orderly resolution of the Covered Company under the Code.

- ***Consequences of a deficient resolution plan.*** Covered Companies would have an opportunity to remedy any deficiencies identified jointly by the FRB and FDIC. Failure to remedy identified deficiencies would permit the FRB and the FDIC jointly to impose additional capital, leverage or liquidity requirements, or restrict the growth, activities or operations of the Covered Company or its subsidiaries. If a Covered Company fails to remedy a deficient plan within two years of having been subjected to such requirements or restrictions, the FRB and the FDIC by joint order could require the company to divest assets or operations as necessary to facilitate orderly resolution under the Code.
 - Prior to issuing any notice of deficiency, imposing additional requirements or restrictions or issuing a divestiture order that would have a significant impact on a functionally regulated or depository institution subsidiary, the FRB would be required to consult with the FSOC member that primarily supervises any such subsidiary and may consult with other U.S. or foreign supervisors.
- ***Credit exposure reports.*** Covered Companies would also be required to file quarterly credit exposure reports. These reports would describe both (i) the exposure of the Covered Company and its subsidiaries to other “significant” BHCs and NFCs and their subsidiaries, and (ii) the exposure of each other “significant” BHC or NFC and its subsidiaries to the Covered Company and its subsidiaries.²

Key Observations and Open Questions

- ***Use of resolution plans.*** Under the Proposed Rule, a Covered Company’s resolution plan would have no binding effect on any party with responsibility for the company’s resolution (e.g., a trustee under the Code or a receiver under OLA). The FDIC noted that the information in a resolution plan will be a “vital element” in the FDIC’s planning for the resolution of a Covered Company under OLA, although we understand that the FDIC will conduct its own, separate resolution planning process to prepare for resolution under OLA.

While styled as a plan for addressing the insolvency of a Covered Company, resolution planning would also be a powerful regulatory tool allowing the FRB and FDIC to examine a Covered Company’s structure and interconnections in depth and, potentially, to require restructuring and simplification. FDIC Chairman Sheila Bair commented when the Proposed Rule was approved that regulators may require substantial structural changes of some companies if necessary.

² Credit exposure would be broadly defined to include extensions of credit, loans, leases, lines of credit (drawn and undrawn), deposits and money placements, repos and reverse repos, securities borrowing and lending, guarantees, acceptances, letters of credit, credit exposure from purchases of or investments in securities, and credit exposure from derivatives transactions.

- ***Role of OLA and other resolution regimes.*** The Proposed Rule requires resolution plans to be evaluated under the Bankruptcy Code and appears to preclude a resolution plan from relying on any special powers available under OLA (e.g., transfers of qualified financial contracts and other assets and liabilities, bridge financial companies, etc).³ Given that resolution plans must address insolvency scenarios during times of market stress, and that OLA was created because the Code was viewed as inadequate to protect the U.S. economy from a SIFI failure during periods of market stress, it may be challenging for a SIFI to produce a “credible” resolution plan that avoids serious adverse effects on U.S. financial stability without relying on OLA. The Proposed Rule would also prohibit a resolution plan from assuming that the government will provide any “extraordinary support”. It is unclear whether certain forms of government involvement—such as providing access to the FRB’s discount window or other lending facilities—would qualify as “extraordinary support”.

A footnote in the preamble notes that entities subject to insolvency regimes other than the Code should conduct their analysis according to the applicable insolvency regime. While somewhat unclear, we assume this means that the resolution plans for Covered Companies or their subsidiaries that are FBOs, regulated banks, broker-dealers, insurance companies, etc., should be created based on their applicable insolvency regimes, notwithstanding that the Proposed Rule refers to the Code only and does not clearly address how a resolution plan should treat functionally regulated or foreign entities that are subject to an alternative insolvency regime.

- ***Foreign banking organizations.*** The FDIC has reportedly indicated that it expects that 124 banks, and an unknown number of designated NFCs, will be subject to the Proposed Rule, and that only 26 of those 124 banks are U.S. BHCs. The remainder are FBOs, many of which are subject to the living wills requirement due to the size of their non-U.S. assets, rather than a determination that their failure would pose any significant threat to U.S. financial stability.

FBOs’ resolution plans would be required to address their U.S. operations, map interconnections and interdependencies between their U.S. subsidiaries and operations and their foreign affiliates, and explain how the U.S. resolution plan is integrated into their overall resolution or contingency planning process. The proposal specifically invites comments on issues with respect to FBO resolution plans, including what should be required of an FBO whose home country does not require resolution or recovery plans.

³ Note that broker-dealer insolvency proceedings under the Securities Investor Protection Act (“SIPA”) may be proceedings under the Code as a technical matter. See 15 U.S.C. § 78fff(b) (Section 6 of SIPA).

- **Burden.** Compliance with the broad information requirements of the Proposed Rule is expected to require extensive, time-consuming work by Covered Companies. The FDIC itself estimates that it will take approximately 7,200 hours to prepare each initial resolution plan. Companies can expect to undergo an iterative process with the regulators in preparation of acceptable resolution plans and will be subject to ongoing monitoring for compliance.
- **Material changes and events.** Covered Companies would be required to file updated resolution plans following any event or change that results in, or could have, a “material effect” on the company’s existing resolution plan. Although materiality is not defined in the Proposed Rule, the preamble suggests that the requirement could be triggered in a number of circumstances—for example, by the loss of a significant counterparty relationship, a reduction in market capitalization of five percent over one year, or the transfer of five percent of U.S. assets to a non-U.S. jurisdiction. This requirement could become especially burdensome in the near term, as SIFIs are actively contemplating or undergoing significant restructuring in order to comply with other Dodd-Frank requirements.
- **Confidentiality.** Covered Companies would be permitted to request confidential treatment of their resolution plans and credit exposure reports, but the Proposed Rule would rely on preexisting rules implementing the Freedom of Information Act to determine whether to grant confidential treatment. In any event, public companies will need to consider any disclosure implications.

* * *

If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under “Banking and Financial Institutions” or “Bankruptcy and Restructuring” in the “Practices” section of our website (www.clearygottlieb.com).

CLEARY GOTTLIEB STEEN & HAMILTON LLP

NEW YORK

One Liberty Plaza
New York, NY 10006-1470
1 212 225 2000
1 212 225 3999 Fax

WASHINGTON

2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
1 202 974 1500
1 202 974 1999 Fax

PARIS

12, rue de Tilsitt
75008 Paris, France
33 1 40 74 68 00
33 1 40 74 68 88 Fax

BRUSSELS

Rue de la Loi 57
1040 Brussels, Belgium
32 2 287 2000
32 2 231 1661 Fax

LONDON

City Place House
55 Basinghall Street
London EC2V 5EH, England
44 20 7614 2200
44 20 7600 1698 Fax

MOSCOW

Cleary Gottlieb Steen & Hamilton LLC*
Paveletskaya Square 2/3
Moscow, Russia 115054
7 495 660 8500
7 495 660 8505 Fax
* an affiliate of Cleary Gottlieb Steen & Hamilton LLP

FRANKFURT

Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
49 69 97103 0
49 69 97103 199 Fax

COLOGNE

Theodor-Heuss-Ring 9
50688 Cologne, Germany
49 221 80040 0
49 221 80040 199 Fax

ROME

Piazza di Spagna 15
00187 Rome, Italy
39 06 69 52 21
39 06 69 20 06 65 Fax

MILAN

Via San Paolo 7
20121 Milan, Italy
39 02 72 60 81
39 02 86 98 44 40 Fax

HONG KONG

Bank of China Tower
One Garden Road
Hong Kong
852 2521 4122
852 2845 9026 Fax

BEIJING

Twin Towers – West
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
86 10 5920 1000
86 10 5879 3902 Fax

BUENOS AIRES

CGSH International Legal
Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
54 11 5556 8900
54 11 5556 8999 Fax