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Navigating the U.S. Living Wills Requirements

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Section 165(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")[2] requires large bank holding companies and systemically important nonbank financial companies to prepare plans for their rapid and orderly resolution under the Bankruptcy Code in the event of material financial distress or failure. The recent release of two rules on resolution planning by the FDIC and the Federal Reserve means that the basic contours of the U.S. regulatory framework for resolution plans are now known. In this article, we have focused on how certain aspects of the rules and their implementation by regulators are likely to have a different impact on regional bank holding companies and certain foreign banking organizations, than on other firms subject to the requirements.

Though foreign-headquartered firms subject to the plan requirements may be able to take advantage of the later submission date allowed under the staggered submission process, in light of home country resolution plan requirements many such firms will have to grapple with the U.S. requirements much earlier than such date.

Regional bank holding companies with a small amount of nonbanking assets (under 15% of total assets) also receive some relief under the final rule for resolution plans, because they are allowed to submit "tailored" resolution plans for the bank holding company that focus specifically on the nonbanking operations of the bank holding company. There too, however, the benefits may be illusory as the parent will have to submit a plan under the companion rule for large insured depository institutions, and therefore will ultimately have to provide the same or similar information for both the bank and nonbanking operations of the covered company.

In both cases, dialogue with the regulators in order to assess the applicability and impact of the rule requirements to any particular firm will be critical to navigating the living will requirement in the U.S.

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[2] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

Background

The requirement that large bank holding companies and systemically important nonbank financial companies prepare plans for their rapid and orderly resolution under the Bankruptcy Code in the event of material financial distress or failure was enacted into law in the U.S. as part of the Dodd-Frank Act on July 21, 2010. The FDIC and the Federal Reserve, acting jointly as required by statute, proposed a rule in April 2011 to implement this resolution plan requirement, and the FDIC has now approved a modified version of the proposed rule, in final form (the "Section 165(d) Rule").[3]

Separately, and acting alone, the FDIC also adopted an interim final rule that will require insured depository institutions ("IDIs") with $50 billion or more in total assets to prepare plans for how they could be resolved in the event of failure by the FDIC as receiver under the Federal Deposit Insurance Act (the "IDI Rule").[4] The Section 165(d) and IDI Rules are intended to work in tandem, both from a process perspective with the regulators and in terms of their substantive requirements, but firms will have to carefully review how those coordinated requirements are met in the plan preparation process.

Many aspects of the rules—such as the requirement that a portion of a firm's resolution plan be made public,[5] the potentially severe consequences that can follow from the FDIC and the Federal Reserve deeming a plan to be deficient[6] or the IDI Rule's "least cost resolution" requirement[7]—will be

[3] FDIC and Federal Reserve, Resolution Plans Required (effective November 30, 2011), to be codified at 12 C.F.R. Part 243 and 12 C.F.R. Part 381 [hereinafter Section 165(d) Rule].

[4] FDIC, Resolution Plans Required for Insured Depository Institutions with $50 Billion or More in Total Assets, 76 Fed. Reg. 58379 (Sept. 21, 2011) (to be codified at 12 C.F.R. pt. 360) [hereinafter IDI Rule].

[5] The Section 165(d) and IDI Rules both require resolution plans to have a public section that consists of an executive summary of the resolution plan that describes the business of the covered company or covered IDI and includes certain specified information "to the extent material to an understanding of the [covered company or covered IDI]." Section 165(d) Rule at 40; IDI Rule § 360.10(f).

[6] The Section 165(d) Rule permits the FDIC and the Federal Reserve, as an initial consequence of failure to cure plan deficiencies, to jointly impose on a covered company, or any subsidiary of a covered company, more stringent capital, leverage or liquidity requirements or restrictions on growth, activities or operations. A covered company upon which the foregoing types of requirements and restrictions are imposed faces the further threat of mandated divestitures if it fails, within the first two years following the imposition of such requirements and restrictions, to submit a revised resolution plan that adequately remedies the deficiencies. Section 165(d) Rule at 38--39.

[7] The IDI Rule requires that an IDI resolution plan describe how the strategies for separation of the IDI from the parent company's organization and sale or disposal of the deposit franchise, core business lines and major assets of the IDI can be demonstrated to be the least costly (…continued)

carefully reviewed and analyzed by firms and their advisers in the implementation of the plan requirements.

Staggered Initial Submissions

The proposed Section 165(d) rule would have required all 124 firms estimated to be covered by the rule ("covered companies") to submit their initial resolution plans by a single date. In a key change, and one that the industry broadly supported,[8] the final Section 165(d) and IDI Rules establish three submission dates for initial resolution plans, based on total nonbank asset size:

- July 1, 2012, for covered companies with $250 billion or more in total nonbank assets (and any IDI subsidiaries of such companies that are subject to the IDI Rule);

- July 1, 2013, for covered companies with $100 billion or more, but less than $250 billion, in total nonbank assets (and any IDI subsidiaries of such companies that are subject to the IDI Rule); and

- December 31, 2013, for covered companies with less than $100 billion in total nonbank assets (and any other IDIs that are subject to the IDI Rule and not included in the first two groups).

In each case, for foreign-based covered companies, the measurement of nonbank assets is limited to total U.S. nonbank assets.

Foreign-based covered companies captured by the Section 165(d) Rule because they have total worldwide assets of over $50 billion are obvious beneficiaries of this approach, since the submission date is based solely on U.S. nonbank assets. The term "nonbank assets" is not defined, but we believe it is generally intended to mean assets held outside of an IDI's consolidation perimeter and that the regulators are likely to treat the assets of uninsured branches of foreign banks as banking assets. The deliberate decision not to define the term means that for those institutions, whether U.S. or foreign, that find themselves close to the line or that have interpretive questions, discussions with the regulators will be possible.

(continued…)

to the Deposit Insurance Fund of all possible methods of resolving the IDI. IDI Rule § 360.10(c)(vii). FDIC staff have indicated that they view this "least cost resolution" requirement to be as much a qualitative as a quantitative assessment.

[8] Joint Trade Association Comment Letter to the FDIC and the Federal Reserve on the Proposed Section 165(d) Rule, *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c08AD77.PDF.

Most firms subject to resolution plan requirements technically fall into the third group. Importantly though, the FDIC and the Federal Reserve have retained discretion to, with written notice (which must be a joint written notice, in the case of the Section 165(d) Rule), require individual firms to submit their plans earlier or later than provided for by the Rules' general three-tiered approach.

Tailored Plans

The scheme of staggered initial submissions, although helpful, does not in itself address the issue of proportionality, or "one-size-does-not-fit-all," that was raised by the resolution plan requirements as initially proposed. As a group of major regional bank holding companies commented in response to the proposed Section 165(d) rule, the informational requirements of resolution plans should take into account the significant differences between, for instance, a bank holding company with one large IDI subsidiary and just $51 billion in total assets—in other words, a "barely systemic" institution[9]—and the largest and most complex banking organizations that have substantial nonbank and foreign operations.[10]

In response to this issue, the final Section 165(d) Rule provides a tailored plan option. A firm may elect to submit a tailored plan if it has less than $100 billion in total nonbank assets and its total IDI assets are 85% or more of its total consolidated assets.[11] For a foreign-based covered company to meet the tailored plan requirements, the assets of its U.S. IDIs, branches and agencies must comprise 85% or more of the company's total U.S. consolidated assets. The resolution plan of a firm that so elects is subject under the Section 165(d) Rule to the same extensive informational requirements as any other covered company, but with respect to most of the requirements, the plan may be limited in scope to nonbanking operations and business lines. So, though a tailored plan must contain strategic analysis and information regarding corporate governance, organizational structure, management information systems and supervisory and regulatory contacts, the tailored plan submitted under the Section 165(d) Rule may limit such analysis and information to nonbanking operations and business lines.[12] By definition for a firm eligible to submit a tailored plan, such operations and business lines will be fairly limited.

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[9] *See* Donna Borak, *Fed Will Differentiate Barely "Systemic" from Truly TBTF*, AMERICAN BANKER, May 6, 2011 (quoting Federal Reserve Chairman Bernanke as saying, "We're going to be very careful not to have a discrete drop, a discrete change, a discrete difference between $49 billion and $51 billion banks. . . . It will not be the case that community banks, or medium-sized regional banks, or international giants will face the same changes in regulation").

[10] The PNC Financial Services Group, Inc., *et al.*, Comment Letter to the FDIC and the Federal Reserve on the Proposed Section 165(d) Rule, *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c06AD77.PDF.

[11] Section 165(d) Rule at 30--31.

[12] *Id.*

Impact for Foreign-Based Companies

It is our expectation that different types of financial institutions will benefit differently from the tailored plan option. Foreign banks with no insured depository institution in the U.S. will likely reap the greatest benefits as they will not be subject to the IDI Rule, and the tailored plan, as applied to them, may have fewer informational requirements. This result is a compromise position short of that advocated by foreign banks, who argued that subjecting companies to the Section 165(d) Rule based on their worldwide assets, rather than U.S. assets, was unwarranted by statute and over-inclusive.[13] The regulators did not modify the test for whether a firm is subject to the rule—so as under the proposed rule, approximately 98 of the estimated 124 covered companies are foreign banks—but they appear to have lessened the burden of being subject to the rule for many foreign firms.

However, the benefits of the later submission date for foreign banks may be illusory as many will be subject to home country resolution plan requirements. To the extent that a home country plan is required to be submitted earlier than December 2013, and will include the foreign bank's operations and businesses in the U.S., the foreign bank will have to contend with the U.S. resolution plan requirements as part of its home country submission. Foreign banks facing such coordination challenges, including discrepancies in definitions and scope, have been invited by the regulators to discuss their particular situations with the Federal Reserve and the FDIC.

Impact for Large Regional Bank Holding Companies

In addition, it is unclear whether the largest regional bank holding companies will, in practice, gain much from their ability to use the tailored plan option under the Section 165(d) Rule since they will also be subject to the companion IDI Rule with its nearly identical requirements applied at the insured depository institution level. As a result, some regional bank holding companies may find that their overall planning is not reduced. That said, the Section 165(d) Rule's tailoring concept is still helpful because, combined with the significant flexibility and discretion that the regulators have retained in applying the Rule, it seems likely that even those firms with large IDIs will be able to work with the regulators to customize resolution plans for their business model, size and complexity. For the barely systemic covered companies the tailored plan is likely to be even more helpful as the resolution of the IDI may be viewed as a simpler process for the FDIC.

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[13] *See* Institute of International Bankers, Comment Letter to the FDIC and the Federal Reserve on the Proposed Section 165(d) Rule, *available at* http://www.iib.org/associations/6316/files/20110610ResPlanNPR_IIB_final.pdf.

For both large regional bank holding companies and the barely systemic covered companies, later initial submission dates will also mean that those institutions will benefit from the experience gained by the regulators in assessing the resolution plans of the largest, most complex institutions. Indeed, the regulators have indicated that they expect to provide guidance on the resolution plan elements and the structure of the plan submission to firms as they work on their living wills, and that such guidance will be revised and refined for firms with later submission dates based on the experience with the initial set of submissions.

Discretion and Dialogue

As is clear from the foregoing, discretion and flexibility are key themes of the resolution plan rules. Some firms will be permitted to submit tailored plans, but the regulators may disallow tailoring in whole or in part even for firms that meet the technical eligibility requirements. Virtually all of the rules' timing and substantive elements can be varied at the FDIC's and the Federal Reserve's discretion, and the rules acknowledge that plans will vary by firm in accordance with variances in capital structure, risk, complexity, financial activities, size and other factors. The iterative nature of the process and comments from regulators suggest that the focus of the regulators will shift over time from the resolvability analysis at the heart of the plans, to the data and informational elements, and eventually to deficiency assessments.

Particularly for the diverse group of firms that compose the third group that will be required to submit plans under the rules, discussion and dialogue with the FDIC and Federal Reserve will thus be crucial. The FDIC releases accompanying the rules make clear that the regulators expect this to occur.[14] For firms to produce credible resolution plans, and for those plans to play a meaningful role as a building block in the emerging system of enhanced prudential regulation for systemically important firms, cooperation and follow-through on both sides will be required.

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For more comprehensive information about the Section 165(d) and IDI Rules, see the Davis Polk client publications [Credible Living Wills Under the U.S. Regulatory Framework] (September 19, 2011) and [FDIC Releases Joint Notice of Proposed Rulemaking on Resolution Plans and Credit Exposure Reports] (April 5, 2011), available at www.davispolk.com.

[14] *See, e.g.*, Section 165(d) Rule at 22 ("[T]he [FDIC and the Federal Reserve] expect the process of submission and review of the initial resolution plan iterations to include an ongoing dialogue with firms.").