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FDIC Releases Joint Notice of Proposed Rulemaking on Resolution Plans and Credit Exposure Reports

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I. Introduction

On March 29, 2011, the FDIC released a joint notice of proposed rulemaking ("**NPR**") that would implement the requirements in Section 165(d) of the Dodd-Frank Act. The Federal Reserve has not yet released its version of the joint rule proposal.

Under Section 165(d) the Federal Reserve must require the following types of companies to submit periodic resolution plans and credit exposure reports to the Federal Reserve, the FDIC and the FSOC:

- U.S. and foreign bank holding companies with assets of $50 billion or more; and
- U.S. and foreign nonbank financial companies that have been designated as systemically important under Title I and are therefore subject to the Federal Reserve's supervision.

Under the NPR, the assets of a foreign company would be determined on the basis of its ***worldwide*** assets, but its required resolution plan would be limited ***mainly*** to its U.S. operations. The Paperwork Reduction Act analysis portion of the NPR estimates that 124 companies will be subject to Section 165(d),[1] and FDIC officials were quoted as saying that 26 of that number would be U.S. bank holding companies and the ***remaining 98*** would be ***subsidiaries of foreign-owned banks***.[2]

Among other things, Section 165(d) requires the Federal Reserve and the FDIC to jointly determine whether each resolution plan is credible and would facilitate an orderly resolution of the company ***under the U.S. Bankruptcy Code***.

The proposed rules would provide that the resolution plans must be prepared, and therefore the credibility review would be conducted, assuming that:

- ***Bankruptcy Code***. The covered company, or its U.S. operations, would be liquidated or reorganized under the Bankruptcy Code;[3]
- ***Financial Panic***. The company's financial distress or failure could either be idiosyncratic or occur at a time when the entire financial system would also be under stress,[4] such as during the global financial panic in the Fall of 2008; and
- ***No Extraordinary Support***. No "extraordinary support" by the United States or any other government to prevent the covered company's failure would be available.[5]

The NPR will be subject to a 60-day comment period, which begins the date the proposed rules are published in the *Federal Register*. We understand that publication in the *Federal Register* will not occur until the Federal Reserve releases its version of the joint rule proposal.

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[1] FDIC, Notice of Proposed Rulemaking, *Resolution Plans and Credit Exposure Reports Required*, Mar. 29, 2011, at page 27 [NPR].

[2] Victoria McGrane and Alan Zibel, *FDIC Drafts Rule on 'Living Wills' for Banks*, WALL ST. J., Mar. 29, 2011.

[3] According to the adopting release, but not the text of the rules, if a covered company such as an insurance company would not be subject to the Bankruptcy Code, the resolution plan must be prepared under whatever other insolvency law would normally apply (*e.g.*, the relevant state insurance insolvency code or other applicable U.S. or foreign insolvency law). NPR, page 7, note 5. FDIC officials have stated, however, that the resolution plans mandated by Section 165(d) would ***not*** be permitted to assume that Title II of the Dodd-Frank Act would apply.

[4] NPR, page 8.

[5] Michael Krimminger, General Counsel of the FDIC, emphasized these proposed assumptions in his presentation of the NPR at the FDIC's board meeting approving the proposal: "I want to stress this point because it holds the resolution plans under Section 165(d) to a very high standard to be resolved without government intervention and without access to funding from the Orderly Liquidation Fund [under Title II]." *The Federal Deposit Insurance Corporation Holds an Open Session*, LexisNexis at 13 (Mar. 29, 2011).

II. Key Observations

Requiring systemically important financial institutions ("**SIFIs**") to prepare living wills has the potential to be one of the most effective tools in improving risk management, reducing systemic risk and mitigating the "too big to fail" and the "too big to save" problems. But these benefits will only be realized at a sensible cost if living will requirements are administered reasonably, with adequate attention to both costs and benefits. By living will, we mean a plan that ranges the full spectrum from risk management, to crisis avoidance, to recovery of going concerns under conditions of severe financial distress, to liquidation, reorganization or other resolution of gone concerns under any economic conditions. Thus, a credible living will would include recovery plans or other remediation efforts under Section 166 of the Dodd-Frank Act, as well as resolution plans under any insolvency statute that might apply under any particular set of circumstances, such as the Bankruptcy Code, the bank receivership provisions of the Federal Deposit Insurance Act (the "**FDI Act**"), the Securities Investor Protection Act ("**SIPA**"), any state insolvency code, Title II of the Dodd-Frank Act or even any applicable foreign insolvency law.

The NPR is related solely to resolution plans under the Bankruptcy Code. The NPR raises a number of very serious legal and policy issues and leaves a number of fundamental issues unanswered, including:

- **A Real Plan and an Artificial Plan?**
  - **Limits of the Bankruptcy Code or Other Applicable Insolvency Laws**. The justification for Title II of Dodd-Frank was that a domestic or global U.S. SIFI or the U.S. operations of a foreign SIFI that would otherwise be subject to the Bankruptcy Code or other applicable insolvency laws might not be able to be liquidated or reorganized in an orderly fashion under the Bankruptcy Code or one or more of those other insolvency laws during a system-wide financial panic because of deficiencies in the Bankruptcy Code or such other laws and the lack of any source of emergency liquidity.
  - **Credible Resolution Plans**. Thus, we believe that a credible resolution plan would need to assume that the Bankruptcy Code, Title II of the Dodd-Frank Act, the bank receivership provisions of the FDI Act, SIPA, any applicable state insurance insolvency statute, or any other applicable U.S. or foreign insolvency law might apply to a SIFI or all or any part of its subsidiaries or operations, and that some source of emergency liquidity, including access to the Orderly Liquidation Fund if Title II of the Dodd-Frank Act were invoked, may or may not be available during a system-wide financial panic. In other words, it would cover all reasonably potential contingencies and what the implication of each contingency might be.
  - **Limits of Section 165(d) Resolution Plans**. The resolution plans required by Section 165(d), however, are limited to plans assuming that the Bankruptcy Code would apply.
    - ***Implied Assumptions***. This statutory limitation, together with the justification for Title II, would seem to imply that the resolution plans mandated by Section 165(d) should be prepared, and the credibility of such plans reviewed, on the assumption that the conditions for invoking Title II have ***not*** been satisfied.
    - ***Proposed Assumptions***. Instead, the proposed rules would appear to require each covered company to prepare its resolution plan on the assumption that all of the conditions for invoking Title II would likely have been satisfied, namely that:

- the firm's asset values have become too uncertain and its assets too illiquid for the firm to survive a panicked run by its creditors during a financial panic;[6]
- its liquidation or reorganization under the Bankruptcy Code or other applicable insolvency laws could therefore have severe adverse effects on the financial stability of the United States by encouraging the spreading of such panic and runs throughout the financial system;[7]
- such adverse effects could be avoided or mitigated by giving the covered company access to normal emergency liquidity facilities from a U.S. or foreign lender of last resort, such as the Federal Reserve's discount window or a program created under Section 13(3) of the Federal Reserve Act; and
- if such normal emergency liquidity facilities were not sufficient to provide sufficient liquidity or restore public confidence, such adverse effects could be avoided or mitigated by invoking Title II of the Dodd-Frank Act in order to preserve the going concern value of the firm's core business lines and critical operations for the benefit of the firm's creditors by, for example, transferring them to a creditworthy bridge financial company and providing the bridge with liquidity from the Orderly Liquidation Fund under Title II. [8]

- ***Guaranteed Failure***. The proposed rules therefore seem to guarantee that the mandated plans will fail the credibility test under at least some of the conditions required to be assumed.
- ***Irrelevance***. Unless covered companies are permitted to assume that Title II might apply, the mandated resolution plans will be largely irrelevant under circumstances when they could be most useful.
- ***Other Insolvency Law***. According to the proposed rule's adopting release, if a covered company (such as an insurance company) would not be subject to the Bankruptcy Code, the required resolution plan must be prepared assuming the otherwise applicable insolvency law would apply.[9]

- **Title II Plans**. The FDIC has indicated that it, rather than each covered company, will prepare a separate resolution plan for each covered company assuming Title II would apply. While the FDIC will consult the resolution plans submitted under Section 165(d) in preparing its separate plan under Title II, it is not clear whether covered companies will have any input into the FDIC's plan.

- **Credibility Review**
  - **Unrealistic assumptions**. Is it even possible for a ***perfect*** resolution plan to survive the sort of credibility review contemplated under the proposed rules under the unrealistic assumptions described above?
    - ***Bankruptcy Code and Financial Panic Assumptions***. The statute requires the credibility of the required resolution plan to be determined by reference to the

[6] *See* Sections 203(b)(1),(b)(7) and (c)(4) of the Dodd-Frank Act.

[7] *See* Sections 203(b)(2), (3) and (6) of the Dodd-Frank Act.

[8] See Sections 203(b)(4) and (5) of the Dodd-Frank Act.

[9] NPR, page 7, note 5.

Bankruptcy Code, but it leaves the agencies free to allow the plans to be prepared, and to review the credibility of such plans, on the assumption that the conditions for invoking Title II have not been satisfied.

- ***No Extraordinary Support***. Depending on how the undefined term "extraordinary support" is construed, this assumption could be highly unrealistic.
  - ***Lender of Last Resort?*** Does the term "extraordinary support" include emergency liquidity extended to the covered company or its banking subsidiaries by their U.S. or foreign lenders of last resort, such as the Federal Reserve's discount window or any emergency liquidity program created under Section 13(3) of the Federal Reserve Act or other Congressionally authorized source of authority?

- **Need to Consider Amending the Bankruptcy Code?** The proposed rules would seem to create a need for Congress to reconsider the resolution framework of the Dodd-Frank Act. Congress may need to consider appropriate amendments to the Bankruptcy Code, such as the creation of a new chapter designed for financial companies. Otherwise, Section 165(d) could be used to break up U.S. and foreign SIFIs based on an artificial credibility review under highly unrealistic assumptions. The new chapter might need to include some of the features that distinguish Title II from the Bankruptcy Code, such as the power to transfer assets and liabilities to a bridge financial company.

- **Board Approvals**. The proposed rule would require the board of directors of each covered company to approve the company's resolution plan. Unless the agencies make it clear that such approval is not tantamount to certifying that the company's resolution plan is credible notwithstanding the unrealistic assumptions required – *i.e.*, that it will "work" despite those unrealistic assumptions – a responsible board may not be able to provide the required approval.

- **Sanctions.** The proposed rules would authorize the FDIC and the Federal Reserve to jointly impose the following sanctions on any covered company, including the U.S. operations of a foreign company, without requiring consultation with its home country supervisor, if the agencies jointly determine that the company's resolution plan is not credible under the unrealistic assumptions described above:
  - more stringent capital, leverage or liquidity requirements;
  - restrictions on growth, activities or operations; or
  - divestiture of any assets or operations if necessary to facilitate an orderly resolution of the Covered Company under the Bankruptcy Code.

- **Confidentiality**. The proposed rules would require covered companies, including foreign companies, to provide extremely granular information about their operations, including core businesses, critical operations, trading books, and counterparty exposures – information that could expose them to serious competitive, political or other harm or even destabilize the U.S. or global financial systems if improperly disclosed to the public at a time when its highly contingent relationship to results of operation or financial condition means that it is not necessarily material to shareholders and creditors.
  - ***Thoughtful Consideration of Disclosure and Confidentiality***. The proposed rules simply punt on the important area of how highly sensitive confidential portions of the mandated resolution plans, which are highly contingent, would be treated. There will, of course, be questions that firms will have to face on the extent to which applicable securities laws might require certain information in their resolution plans to be disclosed to the public. But disclosing such information because the ***information is material*** to investors is very

different from situations in which the ***act of disclosing*** the information is itself adverse to the company and its investors because, for example, the disclosure disrupts the internal operations of the company, harms its competitive position or subjects it to exploitation by unregulated competitors.

- ***Memorandum of Understanding and Sharing with Foreign Regulators***. The proposed rule also does not deal with how the resolution plans will be shared with foreign regulators or provide any comfort to a foreign regulator about the confidentiality of any resolution plan or living will by a foreign company that such regulator might share with the FDIC, Federal Reserve or the FSOC.
- ***Rules of the Road Needed***. Resolution plans will involve complex issues of the timing of any disclosure under securities laws and the scope of confidentiality of shared data by U.S. and foreign regulators, as well as the consequences for valuation and diligence related to acquisitions, sales and capital markets transactions.
- ***FOIA***. The agencies need to confirm that the confidential portion of a resolution plan will would be treated as confidential supervisory information by each and every member of the FSOC under the Freedom of Information Act ("**FOIA**") and that, as a practical matter, the wide sharing of this data among multiple regulatory agencies and their staff will not lead to the increased risk of leaks or unauthorized access to the confidential portions of such documents and their supporting materials.[10]

- **Cost / Benefit Analysis**. Although the NPR attempted to estimate the paperwork burden of the proposed rules, it did not attempt to estimate the full costs of the proposed rules in terms of compliance burdens; the potential adverse impact of the potential sanctions for a resolution plan found to be deficient under the proposed rules on the supply and cost of credit, efficient risk management or safety and soundness generally; or the potential adverse impact of encouraging companies to structure and manage themselves for failure rather than for success.
  - ***FDIC Board Meeting***. Concerns about these costs were raised and discussed, however, at the FDIC's board meeting that approved the NPR:
    - ***Acting Comptroller of the Currency John Walsh***. "I would suggest that there are grounds for caution in a couple of areas. I believe that it is likely there will be conflicts at times between planning for sound and efficient business operations and planning for resolution, and preparing sensible plans will require a careful balance among the pursuit of profitable operation of the enterprise, meeting the needs of the economy for efficient intermediation and providing an effective path to resolution. Given the novelty of the undertaking for both companies and regulators, the process will need to be flexible and dynamic. The rule appropriately contemplates an iterative process to develop initial plans and continuing dialogue to keep them relevant as was discussed in the presentation. It will be important that the range of acceptable outcomes may be large and we should not really be expecting or seeking plans that fit a single approach or framework."[11]

[10] For a more in-depth discussion of FOIA and suggestions of what the agencies might do, see Annette Nazareth & Margaret Tahyar, *Transparency and Confidentiality in the Post-Financial Crisis World—Where to Strike the Balance?*, Harvard Bus. L. Rev., (forthcoming Spring 2011).

[11] *The Federal Deposit Insurance Corporation Holds an Open Session*, LexisNexis at 17 (Mar. 29, 2011).

- ***Acting Director of the Office of Thrift Supervision John Bowman***. "I have one concern which relates to the fact that the proposal establishes specific requirements for these resolution plans. Although some of the requirements are described vaguely to permit more flexible development plans, others will be left to agency guidance or case-by-case input by the appropriate regulator when necessary. Given the flexibility required and given the influence of the regulator on that process, I believe it is critical to the extent practicable that transparency on the part of the regulator and regulators be as open and forthcoming as possible so as to allow the entire industry as well as the country to develop a level of understanding and appreciation for some of these plans and how they will in fact be utilized in the event they are necessary."[12]
- ***FDIC Chairman Sheila Bair***. "The resolution plan requirement and the Dodd-Frank Act appropriately places the responsibility on financial companies to develop their own resolution plans with oversight by the FDIC and the Federal Reserve. But the FDIC and the Federal Reserve wield considerable authority to shape the content of these plans . . . through ongoing monitoring of the institution's compliance and through direct access to the company's relevant information . . . . If resolution plans are not found to be credible, the FDIC and the Fed can compel the divestiture of activities that would unduly interfere with the orderly liquidation of these companies. And let us be clear, we will require these institutions to make substantial changes to their structure and activities if necessary to ensure orderly resolution."[13]
- ***FDIC General Counsel Michael Krimminger***. "The analysis necessary to meet this standard [the credibility of the mandated resolution plans] will require covered companies to conduct a thorough analysis of the business justifications for the current complexity and operating structures. This could lead to a rethinking of how the company is organized and should lead to a consideration of whether its current operational structure optimizes shareholder value. However, of more particular interest to the FDIC is the rethinking should lead to simplification to meet the high standard set out in Section 165(d) and make available to us a great deal of strategic thinking and information that will also be essential to any Title II liquidation or resolution we may have to perform in the future." [14]

[12] *Id*. at 17.

[13] *Id*. at 18-19.

[14] *Id.* at 13-14.

III. Summary

A. Resolution Plans

Applicability. The proposed rules implement Section 165(d) by requiring that each "Covered Company" periodically submit to the Federal Reserve and the FDIC (1) a Resolution Plan, and (2) a Credit Exposure Report.

- "**Covered Company**" means:
  - ***U.S. and Foreign Nonbank SIFIs***. A systemically important nonbank financial company designated for heightened supervision under Title I of the Dodd-Frank Act, including companies incorporated or organized outside the United States.
  - ***Large U.S. or Foreign BHCs***. Any U.S. or foreign company that controls a U.S. bank and has total consolidated assets of $50 billion or more.
  - ***Large Foreign Banks with a U.S. Commercial Banking Presence and Parents***. Any foreign bank with a U.S. branch, agency or commercial lending company subsidiary or that controls an Edge corporation acquired after March 5, 1987 (a "**U.S. commercial banking presence**"), and any company of which the foreign bank is a subsidiary, if such foreign bank or parent company has total consolidated assets of $50 billion or more.
  - ***Exclusions***:
    - ***U.S. Government-Owned Companies***. Any company that is majority owned by the United States or any state would be effectively excluded from the term "covered company", even though such government-owned companies could be subject to Title II of the Dodd-Frank Act.
    - ***Bridge Financial Companies***. Any bridge financial company organized under Title II would be excluded from the term "covered company."
- **Calculation of Assets**
  - ***Large U.S. BHCs***. Consolidated assets are calculated based on the average of the bank holding company's four most recent consolidated financial statements as reported to the Federal Reserve on Form FR Y-9C.
  - ***Large Foreign BHCs and Banks with U.S. Commercial Banking Presence and Parents***. Consolidated assets are calculated based on ***worldwide assets***[15] based on the foreign bank's or the parent's most recent annual, or as applicable the average of the four most recent quarterly, capital and asset reports as reported to the Federal Reserve on Form FR Y-7Q.
- ***$50 Billion Threshold.*** The Federal Reserve may, pursuant to a recommendation of the FSOC, raise the $50 billion threshold applicable to any bank holding company or to any foreign bank with a U.S. commercial banking presence or its parent.

Timing of Resolution Plan Submissions. The proposed rules describe timing requirements for the submission of an initial Resolution Plan, as well as annual and other interim updating requirements.

[15] *See* NPR, pages 23, 33.

However, the Federal Reserve and the FDIC (in each case, acting jointly) retain considerable discretion to change those requirements.

- ***Initial Plan.*** A Covered Company must submit a Resolution Plan to the Federal Reserve and the FDIC within 180 days of the effective date of the final rule on Resolution Plans or such later date as when a company becomes a Covered Company.
    - If we assume that the rules become final, as they are supposed to be under the Dodd-Frank Act, by January 2012, this deadline implies that the first resolution plans could be due as early as June 2012, if not earlier.
- ***Annual Plans.*** Following submission of an initial Resolution Plan, a Covered Company must submit a Resolution Plan to the Federal Reserve and the FDIC no later than 90 days after the end of each calendar year.
- ***Interim Updates.*** A Covered Company must submit an updated Resolution Plan no later than 45 days after material events, as described below.
- ***Material Event***. A material event is any event, occurrence, change in conditions or circumstances or other change that results in, or could reasonably be foreseen to have, a material effect on the Covered Company's previously submitted Resolution Plan.
    - ***Material Changes***. The adopting release provided the following non-exhaustive list of examples of material change:
        - Significant acquisition or series of such acquisitions;
        - Significant sale, other divestiture or series of such transactions;
        - Discontinuation of the business or dissipation of the assets;
        - Bankruptcy or insolvency of a material entity;[16]
        - Material reorganization;
        - Loss of a material servicing subsidiary or material servicing contract;
        - Unavailability or loss of a significant correspondent or counterparty relationship, source of funding or liquidity facility;
        - Transfer or relocation of 5% or more of the total consolidated U.S. assets to a location outside the United States;
        - Reduction in the market capitalization or book value of the consolidated capital of 5% or more; and
        - Transfer, termination, suspension or revocation of any material license or other regulatory authorization required to conduct a core business line or critical operation.
    - ***Exception***. An interim update is not required if such update would be due within the 90-day period prior to the due date of an annual Resolution Plan update (*i.e.*, if such update would be due between January 1 and March 31).

[16] The term "material entity" includes a subsidiary or foreign office, but does not include a U.S. office, which appears to be an oversight, at least as far as a foreign-based Covered Company is concerned.

- ***Timing Requirements Are Subject to Broad Regulatory Discretion.*** Notwithstanding the deadlines described above, the Federal Reserve and the FDIC may jointly impose different requirements. They may jointly:
  - Require Resolution Plan submissions more frequently than annually;
  - Require interim updates within fewer than 45 days after material events;
  - Require interim updates under circumstances other than those listed in the rule;
  - Extend any time period for Resolution Plan submission; and
  - Waive updating requirements.

Board-Level Approvals. The initial Resolution Plan must be approved by the Covered Company's board of directors and noted in the minutes prior to submission. According to the adopting release, each annual Resolution Plan may be approved by a delegee of the board.[17]

- ***Foreign-Based Companies***. For a foreign-based Covered Company, approval of both the initial and each annual Resolution Plan by a delegee acting with express authority of the board to approve the Resolution Plan is sufficient.

FSOC Access. Any Resolution Plan or update submitted by a Covered Company will be made available to the FSOC upon request.

Confidential Treatment of Resolution Plans. Covered Companies must request confidential treatment, if desired, pursuant to otherwise applicable rules of the Federal Reserve, the FDIC and the FSOC.

- ***FOIA Exemption***. The proposed rules are silent on whether any confidential information in the resolution plans would be treated as confidential supervisory information for FOIA purposes.
- ***No Specified Penalty for Unauthorized Disclosure***. The proposed rules would not specify any penalties for the unauthorized disclosure of confidential information in the Resolution Plans, by any agency personnel or otherwise.

Informational Content of a Resolution Plan.

- ***Domestic Covered Companies*** must provide the required information with respect to their subsidiaries and operations domiciled in the United States as well as foreign subsidiaries, offices, and operations, including any critical operations and core business lines.
  - "***Critical operations***" are those operations of the Covered Company, including associated services, functions, and support, that, in the view of the Covered Company, or as jointly directed by the Federal Reserve and the FDIC, upon a failure of, or discontinuance of such operations, would likely result in a disruption to the U.S. economy or financial markets.
  - "***Core business lines***" are those business lines of the Covered Company, including associated operations, services, functions and support, that, in the view of the Covered Company, upon failure would result in a material loss of revenue, profit or franchise value.
- ***Foreign-Based Covered Companies***, including foreign banking organizations, must provide the required information with respect to their subsidiaries, branches, agencies, critical operations and

[17] NPR, page 10.

core business lines that are domiciled in the United States, ***or*** conducted in whole or in material part in the United States (the "**U.S. operations**").

- ***Domiciled***. The proposed rules do not include a definition of the term "domicile."
- ***Conducted in Whole or in Material Part in the United States***. The proposed rules do not define or provide any other guidance on what is meant by any "critical operations and core business lines that are . . . conducted in whole or material part in the United States."
- ***Integration with Groupwide Contingency Plan***. The Resolution Plan for a foreign-based Covered Company must also include an explanation of how resolution planning for its U.S. operations is integrated into the foreign-based Covered Company's overall contingency planning process.

- ***Guiding Assumptions***. In preparing its plan for rapid and orderly resolution in the event of material financial distress or failure, a Covered Company must:
  - ***Financial Panic***. Take into account that such material financial distress or failure may occur when financial markets, or other significant companies, are also under stress; and
  - ***No Extraordinary Support***. Not rely on the provision of extraordinary support by the United States or any other government to the Covered Company or its subsidiaries to prevent the Covered Company's failure.
    - ***No Definition "Extraordinary Support"***. The proposed rules do not provide any definition or guidance on what constitutes "extraordinary support . . . to prevent the failure of the Covered Company."
      - ***Lender of Last Resort?*** It is therefore unclear whether it would include emergency liquidity from a lender of last resort, such as under the Federal Reserve's discount window or pursuant to Section 13(3) of the Federal Reserve Act.
- ***Key Definitions***. A "***Resolution Plan***" is defined as a report regarding the plan of the Covered Company for rapid and orderly resolution ***under the Bankruptcy Code*** in the event of material financial distress at, or failure of, the Covered Company.
  - "***Rapid and orderly resolution***" means a reorganization or liquidation of a Covered Company under the Bankruptcy Code that can be accomplished within a reasonable period of time and in a manner that substantially mitigates the risk that the failure of the Covered Company would have serious adverse effects on financial stability in the United States.
    - ***Relationship to Title II***. This definition is designed to mimic the conditions for invoking Title II contained in Section 203(b)(2) and (5) of Title II.
    - ***Foreign-Based Covered Companies***. In the case of a foreign-based Covered Company, the scope is limited to the subsidiaries and operations of such company that are domiciled in the United States.
  - ***Other Normal Insolvency Law***. According to the proposed rule's adopting release, if an entity is subject to an insolvency regime other than the Bankruptcy Code, the analysis should be in reference to that applicable regime.
    - ***U.S. Branches of Foreign Banks***. For uninsured, state-licensed branches of foreign banks, a category that includes the vast majority of such branches, the applicable regime would be liquidation under applicable state banking laws, most commonly the New York Banking Law.

- "***Material financial distress***"
  - ***Definition***. This term means that a Covered Company:
    - Has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion;
    - The assets of the Covered Company are, or are likely to be, less than its obligations to creditors and others; or
    - The Covered Company is, or is likely to be, unable to pay its obligations in the normal course of business.
  - ***Relationship to Title II***. This definition is substantially similar to the definition of "default or in danger of default" in Section 203(c)(4) of Title II.

- ***Required Content***. A Resolution Plan has eight required elements, which are listed below and described in greater detail in Annex A.
  - Executive summary;
  - Strategic analysis;
  - Corporate governance related to resolution planning;
  - Organizational structure and related information;
  - Management information systems;
  - Interconnections and interdependencies;
  - Supervisory and regulatory information; and
  - Contact information.

- ***Data Production***. The Covered Company must be able to demonstrate, within a reasonable period of time after the effective date of the rule, as determined by the Federal Reserve and FDIC, the Covered Company's capability to promptly produce, in an acceptable format, the data underlying the key aspects of the Resolution Plan.
  - ***No Definition of "Promptly"***. The proposed rules do not define what is meant by promptly.
  - ***No Phase-in or Acknowledgment of External Impediments***. The proposed rule does not acknowledge that investments in such data and information systems may take some time and that some impediments may be external to the firms.

- ***Discretion to Exempt***. The Federal Reserve and the FDIC may jointly exempt a Covered Company from one or more requirements of the Resolution Plan.

- ***Comments***. At the FDIC board meeting, the board members were largely approving of the informational requirements. However, Director Bowman noted his concern that while the proposal included certain specific requirements for Resolution Plans, some requirements are left to agency guidance on a case-by-case basis. He noted that it is critical that regulators be as "open and forthcoming as possible" in order to allow for the development of industry-wide understanding and standards regarding the contents of Resolution Plans.[18]

[18] *The Federal Deposit Insurance Corporation Holds an Open Session*, LexisNexis at 17 (Mar. 29, 2011).

Review and Resubmission Procedures.

- ***Initial Review and Request for Additional Information***. The proposed rule contemplates an initial review process pursuant to which the Federal Reserve and the FDIC may jointly request additional information. Such a request would not amount to a joint determination that a Resolution Plan contains "deficiencies."
  - Within 60 days of receiving an initial Resolution Plan or annual Resolution Plan, the Federal Reserve and the FDIC must jointly determine whether the Resolution Plan satisfies the minimum informational requirements.
  - If the Federal Reserve and the FDIC jointly determine that it is incomplete or that substantial additional information is required to facilitate review, they must jointly inform the Covered Company in writing of the areas with respect to which additional information is required.
  - The Covered Company must resubmit its Resolution Plan or any additional information jointly requested no later than 30 days after receiving notice, unless the Federal Reserve and the FDIC jointly prescribe otherwise.
- ***Information Access***. In order to allow evaluation of its Resolution Plan, a Covered Company must provide the Federal Reserve and the FDIC with such information and access to personnel as the Federal Reserve and the FDIC jointly determine is necessary to assess the credibility of the Resolution Plan and the ability of the Covered Company to implement the Resolution Plan. The Federal Reserve and the FDIC must rely to the fullest extent possible on examinations conducted by or on behalf of the appropriate Federal banking agency for the relevant company.
- ***Notice of Resolution Plan Deficiencies***. If the Federal Reserve and the FDIC jointly determine that an initial Resolution Plan or annual Resolution Plan update is not credible or would not facilitate an orderly resolution ***under the Bankruptcy Code***, they must jointly notify the Covered Company in writing of such determination.
  - ***Consultation***
    - ***All Covered Companies***. Before issuing any notice of deficiencies with respect to a Covered Company that is likely to have a significant impact on a functionally regulated subsidiary or a depository institution subsidiary of a Covered Company, the Federal Reserve ***must*** consult with each FSOC member that primarily supervises such subsidiary. The Federal Reserve ***may*** also consult with any other federal, state or foreign supervisor as it considers appropriate.
    - ***Foreign-Based Covered Companies***. Before issuing any notice of deficiencies with respect to the U.S. operations of a foreign-based Covered Company, the Federal Reserve ***may***, but is not required to, consult with any foreign supervisor as it considers appropriate.
  - ***Submission of Revised Resolution Plan***. The Covered Company must submit a revised Resolution Plan within 90 days of receiving notice of any deficiencies, or within such shorter or longer period as the Federal Reserve and the FDIC may jointly determine.
    - ***Contents of Revised Resolution Plan***. The revised Resolution Plan must address all deficiencies identified and discuss in detail (1) the revisions made to address the deficiencies; (2) any changes to business operations and corporate structure the Covered Company proposes to undertake to facilitate implementation of the revised Resolution Plan (including a timeline for execution of such changes); and (3) why the Company believes the revised Resolution Plan is credible and ***would result*** in an orderly resolution ***under the Bankruptcy Code***.

- ***Extension Requests***. A Covered Company may request an extension of time to submit a revised Resolution Plan in response to a notice of deficiencies. Such extension request must be supported by a written statement describing the basis and justification for the request.

Sanctions for Failure to Cure Deficiencies.

- ***Initial Imposition of Various Requirements or Restrictions***. As an initial consequence of failure to cure deficiencies in a Resolution Plan, the Federal Reserve and the FDIC may 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.
  - The Federal Reserve and the FDIC may jointly impose such restrictions or requirements if either (1) the Covered Company fails to submit a revised Resolution Plan within the required time period; or (2) the Federal Reserve and the FDIC jointly determine that the revised Resolution Plan does not adequately remedy the deficiencies identified.
  - Any requirements or restrictions imposed in response to a failure to cure Resolution Plan deficiencies would only apply until the date when the Federal Reserve and the FDIC jointly determine that the Covered Company has submitted a revised Resolution Plan that adequately remedies the deficiencies.
- ***Divestitures***. A Covered Company on which the foregoing types of requirements or 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. After two years, the Federal Reserve and the FDIC may jointly require the Covered Company to divest assets or operations upon a joint determination that the divestiture of such assets or operations is necessary to facilitate an orderly resolution of the Covered Company ***under the Bankruptcy Code***.
- ***Consultation***
  - ***All Covered Companies***. Before determining to jointly impose any requirements or restrictions or require any divestitures with respect to a Covered Company that are likely to have a significant impact on a functionally regulated subsidiary or a depository institution subsidiary of a Covered Company, the Federal Reserve ***must*** consult with each FSOC member that primarily supervises such subsidiary. The Federal Reserve ***may*** also consult with any other federal, state or foreign supervisor as it considers appropriate.
  - ***Foreign-Based Covered Companies***. Before determining to jointly impose any requirements or restrictions or require any divestitures with respect to the U.S. operations of a foreign-based Covered Company, the Federal Reserve ***may***, but is not required to, consult with any foreign supervisor as it considers appropriate.
- ***Enforcement***. The Federal Reserve and the FDIC may jointly enforce any order imposing initial requirements or restrictions or divestitures. The Federal Reserve, in consultation with the FDIC, may take action to address any violation under section 8 of the FDI Act.
- ***No Limiting Effect***. A Resolution Plan has no binding effect on a court or trustee in a proceeding under the Bankruptcy Code, a receiver appointed or a bridge financial company chartered under Title II of the Dodd-Frank Act or any other authority that is authorized to resolve a Covered Company.

B. Credit Exposure Reports

Applicability. Credit Exposure Report requirements apply to the same Covered Companies subject to the Resolution Plan requirements. However, the scope of the reporting requirement is narrower for non-U.S. Covered Companies, as described below.

- ***Based on Aggregate Group Exposures***. Although the language of the proposed rule is not entirely clear, it appears to require reporting based on the aggregate credit exposures of a Covered Company and its subsidiaries (as opposed to each individual constituent company) to each Significant Company and its subsidiaries (as opposed to each individual company), and vice versa.

Frequency of Credit Exposure Reporting. Covered Companies must submit a Credit Exposure Report to the Federal Reserve and the FDIC not later than 30 days after the end of each calendar quarter. However, the Federal Reserve may require submission on a more frequent basis or extend the time a Covered Company has to submit a Credit Exposure Report.

FSOC Access. Any Credit Exposure Report submitted by a Covered Company will be made available to the FSOC upon request.

Confidential Treatment of Credit Exposure Reports. Covered Companies must request confidential treatment, if desired, pursuant to otherwise applicable rules of the Federal Reserve, the FDIC and the FSOC.

- ***FOIA Exemption***. The proposed rules are silent on whether any confidential information in the Credit Exposure Reports would be treated as confidential supervisory information for FOIA purposes.
- ***No Specified Penalty for Unauthorized Disclosure***. The proposed rules would not specify any penalties for the unauthorized disclosure of confidential information in the Credit Exposure Reports, by any agency personnel or otherwise.

Contents of Report.

- The Federal Reserve will prescribe the form and manner of reporting. Each Credit Exposure Report must contain the information listed in Annex B.
- ***Proposed Definition of "Significant Company."*** Much of the required information relates to exposures between Covered Companies and "Significant Companies." The Federal Reserve is responsible for defining the latter term, and they have done so in a proposed rule published February 11, 2011. The proposed rule would define "Significant Company" to mean:
  - A SIFI (*i.e.*, a systemically important nonbank financial company designated for heightened supervision under Title I of the Dodd-Frank Act);
  - A bank holding company, or a foreign bank that is or is treated as a bank holding company, that has total consolidated assets of $50 billion or more as of the end of the most recently completed calendar year; and
  - Any other nonbank company "predominantly engaged in financial activities" that has total consolidated assets of $50 billion or more as of the end of its most recently completed fiscal year. As set forth in greater detail in the February 11 proposed rule, the "predominantly engaged" test looks to consolidated annual gross financial revenues and consolidated total financial assets.

  - For more information, see Davis Polk's Summary of Federal Reserve Proposed Rule on Definitions Related to Nonbank Financial Companies and Interconnectedness of Systemically Important Firms.

- ***Foreign-Based Organizations***. The Credit Exposure Report of a foreign-based Covered Company must include the required information only with respect to subsidiaries, offices and operations domiciled in the United States.

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Annex A

Required Minimum Content[19] of Resolution Plans

The proposed rules list the following as required minimum content of a Resolution Plan:

- ***Executive Summary***. Each Plan must include an executive summary describing (1) the key elements of the Covered Company's strategic Resolution Plan; (2) any material changes from the most recently filed Resolution Plan; and (3) any actions taken by the Covered Company to improve the effectiveness of the Plan or remediate or mitigate material weaknesses to the Plan's execution.
- ***Strategic Analysis***. Each Plan must include a strategic analysis describing the Covered Company's plan for rapid and orderly resolution in the event of material financial distress or failure of the company.[20] The analysis should:
  - ***Descriptions***. Include descriptions of:
    - ***key assumptions and supporting analysis*** underlying the Plan (including any assumptions made concerning the economic or financial conditions present at the time the Covered Company sought to implement the Plan);
    - ***the range of specific actions to be taken*** by the Covered Company to facilitate a rapid and orderly resolution of the Covered Company, its material entities, critical operations, and core business lines;
    - ***funding, liquidity, capital needs and available resources***, which shall be mapped to the Covered Company's core business lines and critical operations;
    - the Covered Company's ***strategy for maintaining operations of and funding*** for the Company and its material entities,[21] which shall be mapped to its critical operations and core business lines;[22]
    - the Covered Company's strategy in the event of a ***failure or discontinuation of a material entity, core business line or critical operation***, and the actions that will be taken to prevent or mitigate any adverse effects of such failure or discontinuation on the financial stability of the United States; and

[19] The adopting release observed that "plans will vary by company and, in their evaluation of plans," the agencies "will take into account variances among companies in their core business lines, critical operations, foreign operations, capital structure, risk, complexity, financial activities (including the financial activities of their subsidiaries), size and other relevant factors." NPR, pages 8-9.

[20] In the adopting release, the agencies also stated that the Plan should address and provide for the continuation and funding of critical operations. NPR, page 8.

[21] The adopting release provides that the Plan should include the Covered Company's strategy for maintaining and funding its critical operations and core business lines, and how such resources would be used to facilitate an orderly resolution, in an environment of material financial distress. NPR, page 12.

[22] The adopting release provides that the analytical mapping of the core business lines and critical operations and the mapping of funding, liquidity, critical service support and other resources to legal entities should demonstrate how those core business lines and critical operations could be resolved and transferred to potential acquirers. The analysis should show how these critical elements of the business operations could survive in an environment of material financial distress as well as the failure or insolvency of one or more entities within the Covered Company. This is particularly important for internal as well as external service level agreements that provide the business services essential for continued operation of the core business lines and critical operations. NPR, page 13.

- the Covered Company's strategy for ensuring that any ***insured depository institution subsidiary*** will be ***adequately protected from risks*** arising from the activities of any ***nonbank subsidiaries*** (other than those that are subsidiaries of an insured depository institution).

- ***Time Horizons***. Identify the time periods the Covered Company expects it would need to execute each material aspect of the Plan; any potential material weaknesses or impediments to effective and timely execution of the Plan; and actions that the Covered Company has taken, or proposes to take, to remediate or mitigate such weaknesses or impediments, including a timeline for the proposed remedial or mitigatory action.

- ***Processes***. Describe, in detail, the processes employed for:

  - ***Market Values***. Determining the current market values of core business lines, critical operations and material asset holdings;

  - ***Feasibility***. Assessing the feasibility of plans (including time frames) for executing sales, divestitures, restructurings, and recapitalizations; and

  - ***Impact***. Assessing the impact of such actions on value, funding and operations of the Company, its material entities and critical operations and core business lines.

- ***FDIC Board Meeting***. At the FDIC board meeting, FDIC staff stressed the importance of using such information to ensure that even if one portion of the Covered Company is troubled, other portions may continue to function.[23]

- ***Corporate Governance Related to Resolution Planning***. Each Resolution Plan must include:

  - A ***detailed description*** of:

    - ***Integration of Resolution Planning into Corporate Governance***. How resolution planning is integrated into the corporate governance structure and processes of the Covered Company;

    - ***Internal Controls***. The Covered Company's policies, procedures and internal controls governing the preparation and approval of its Plan;

    - ***Responsible Senior Management***. The identity and position of the senior management official(s) primarily responsible for overseeing the development, maintenance, implementation and filing of the Covered Company's Plan, and for the Covered Company's ongoing compliance; and

    - ***Reporting***. The nature, extent and frequency of reporting to the senior executive officers and the board of directors of the Covered Company on the development, maintenance and implementation of its Plan.

  - ***Data Collection and Reporting Processes and Systems***. A description of the capabilities of the Covered Company's processes and systems to collect, maintain and report the information and other data underlying the Plan to its senior executive officers and board of directors.

[23] *The Federal Deposit Insurance Corporation Holds an Open Session*, LexisNexis at 15 (Mar. 29, 2011).

- ***War Games***. A description of the nature, extent and results of any contingency planning or similar exercise conducted by the Covered Company after its most recently filed Plan in order to assess or improve the Plan's viability.
- ***Risk Measures***. An identification of the relevant risk measures used by the Covered Company to report credit risk exposures both internally to its senior management and board of directors and externally to investors or the appropriate Federal regulator.
- ***Central Planning Function***. The background to the proposed rule noted that for the largest and most complex companies, it may be necessary to establish a central planning function that is headed by a senior management official.

- ***Organizational Structure and Related Information***. Each Resolution Plan must:
  - ***Organizational Structure***. Provide a detailed description of the Covered Company's overall organizational structure, including a hierarchical list of all material legal entities, jurisdictional and ownership information. The Plan must map critical operations and core business lines to material entities.
  - ***Unconsolidated Balance Sheet***. Provide an unconsolidated balance sheet for the Covered Company and a consolidating schedule for all entities that are subject to consolidation.
  - ***Liabilities***. Include a description of the material components of the liabilities of the Covered Company, its material entities, critical operations and core business lines that identifies types and amounts of long- and short-term, secured and unsecured, and subordinated liabilities.
  - ***Collateral Management***. Identify and describe the processes used by the Covered Company to determine to whom it has pledged collateral, identify the person or entity that holds such collateral, and the jurisdiction in which the collateral is located (together with the jurisdiction in which the security interest in the collateral is enforceable, if different).
  - ***Off-Balance Sheet Exposures***. Describe any material off-balance sheet exposures (including guarantees and contractual obligations) of the Covered Company and its material entities, including a mapping to its critical operations and core business lines.
  - ***Trading and Derivatives Activities***. Describe the practices of the Covered Company, its material entities and core business lines related to the booking of trading and derivatives activities.
  - ***Hedges***. Identify material hedges of the Covered Company, its material entities and core business lines related to trading and derivatives activities, including a mapping to legal entity and describe the hedging strategies of the Covered Company.
  - ***Exposure Limits***. Describe the process undertaken by the Covered Company to establish exposure limits.
  - ***Counterparties***. Identify major counterparties of the Covered Company, describe interconnections, interdependencies, and relationships with such counterparties, and analyze for each major counterparty whether its failure would likely have an adverse impact on, or result in the material financial distress or failure of the Covered Company.
  - ***Trading Systems***. Identify each system on which the Covered Company conducts a material number or value amount of trades. Map membership in each to the Covered Company's material entities and critical operations and core business lines.

- ***Payment and Settlement Systems***. Identify material payment, clearing and settlement systems of which the Covered Company is a member. Map membership in each such system to the Covered Company's material entities and critical operations and core business lines.
- ***Foreign Operations***
  - ***Risks to Foreign Operations***. The background to the proposed rule states that a company with foreign operations should identify the extent of the risks related to its foreign operations and its strategy for addressing such risks.
  - ***Foreign Laws***. The Plan should consider and address the complications created by differing national laws, regulations, and policies, and include in this analysis a mapping of core business lines and critical operations to legal entities operating in or with assets, liabilities, operations, or service providers located in foreign jurisdictions.
  - ***Foreign Core Business Lines and Critical Operations***. Evaluate the continued ability to maintain core business lines and critical operations in foreign jurisdictions during material financial distress and insolvency proceedings.

- ***Management Information Systems***. Each Resolution Plan will include:
  - ***Key Systems and Applications***. Detailed information regarding the Covered Company's key management information systems and applications, including systems and applications for risk management, accounting and financial and regulatory reporting, used by the Covered Company and its material entities, including a mapping to its critical operations and core business lines.
  - ***Intellectual Property Rights***. Identification of the legal owner of these systems, related service level agreements and associated intellectual property, including a mapping to the material entities and core business lines that use such intellectual property.
  - ***Reports***. Identification of the scope, content and frequency of the key internal reports used by senior management to monitor the financial health, risks and operations of the Covered Company, its material entities, critical operations and core business lines.
  - ***Access of Regulators***. A description of the process for the appropriate regulators to access these management information systems and applications.
- ***Interconnections and Interdependencies***.
  - ***All***. Each Resolution Plan must:
    - ***Mapping Interconnections and Interdependencies***. Identify and map to the material entities the interconnections and interdependencies among the Covered Company and its material entities, critical operations and core business lines that, if disrupted, would materially affect the funding or operations of the Covered Company, its material entities, critical operations or core business lines.[24]

[24] The adopting release stated that the continued availability of key services and supporting business operations to core business lines and critical operations in an environment of material financial distress and after insolvency should be a focus of resolution planning. Steps to ensure that service level agreements for such services, whether provided by internal or external service providers, survive insolvency should be demonstrated in the Plan. NPR, page 15.

- ***Scope***. These may include common or shared personnel, facilities, or systems, capital, funding or liquidity arrangements; existing or contingent credit exposures; cross-guarantees; risk transfers; and service level agreements.

- ***Foreign-Based Covered Companies***. A foreign-based Covered Company must identify, describe, and map to legal entity the interconnections and interdependencies among U.S. operations and any foreign-based affiliate.

- ***Supervisory and Regulatory Information***. Each Resolution Plan must identify the Covered Company's supervisory authorities and regulators, including identifying any foreign agency or authority with supervisory authority over material foreign-based subsidiaries or operations.

- ***Contact Information***. Each Resolution Plan must identify a senior management official serving as the point of contact for the Plan, and contact information for material entities, critical operations, and core business lines.

Annex B

Required Content of Credit Exposure Reports

Each Credit Exposure Report must contain the following information as of the end of the calendar quarter:

- ***Extensions of Credit***. The aggregate credit exposure associated with all extensions of credit,[25] including loans, leases and funded lines of credit, by (1) the Covered Company and its subsidiaries to each Significant Company and its subsidiaries and (2) each Significant Company and its subsidiaries to the Covered Company and its subsidiaries;
- ***Committed But Undrawn Lines of Credit***. The aggregate credit exposure associated with all committed but undrawn lines of credit by (1) the Covered Company and its subsidiaries to each Significant Company and its subsidiaries and (2) each Significant Company and its subsidiaries to the Covered Company and its subsidiaries;
- ***Deposits and Money Placements***. The aggregate credit exposure associated with all deposits and money placements by (1) the Covered Company and its subsidiaries with each Significant Company and its subsidiaries and (2) each Significant Company and its subsidiaries with the Covered Company and its subsidiaries;
- ***Repurchase Agreements***. The aggregate credit exposure associated with (on both a gross and net basis) of all repurchase agreements between the Covered Company and its subsidiaries and each Significant Company and its subsidiaries;
- ***Reverse Repurchase Agreements***. The aggregate credit exposure associated with all reverse repurchase agreements (on both a gross and net basis) between the Covered Company and its subsidiaries and each Significant Company and its subsidiaries;
- ***Securities Borrowing***. The aggregate credit exposure associated with all securities borrowing transactions (on both a gross and net basis) between the Covered Company and its subsidiaries and each Significant Company and its subsidiaries;
- ***Securities Lending***. The aggregate credit exposure associated with all securities lending transactions (on both a gross and net basis) between the Covered Company and its subsidiaries and each Significant Company and its subsidiaries;
- ***Guarantees and Letters of Credit***. The aggregate credit exposure associated with all guarantees, acceptances or letters of credit (including endorsement or standby letters of credit) issued by (1) the Covered Company and its subsidiaries on behalf of each Significant Company and its subsidiaries and (2) each Significant Company and its subsidiaries on behalf of the Covered Company and its subsidiaries;
- ***Investments***. The aggregate credit exposure associated with all purchases of or investments, as of the last day of the reporting quarter, in securities issued by each Significant Company or its subsidiaries by the Covered Company and its subsidiaries;

[25] Although the text of the rule does not say so, presumably this bucket of credit exposures is supposed to be reported net of any other bucket of credit exposures that might otherwise fall within the very broad scope of the term "extensions of credit," which is not otherwise defined in the proposed rules.

- ***Derivatives***. The aggregate credit exposure associated with all counterparty credit exposure (on both a gross and net basis) in connection with a derivative transaction between the Covered Company and its subsidiaries and each Significant Company and its subsidiaries;
- ***Data Collection and Aggregation Systems***. A description of the systems and processes that the Covered Company uses to collect and aggregate the data underlying the Credit Exposure Report and produce and file the Credit Exposure Report;
- ***Intra-day Credit Exposures***. The credit exposure associated with intra-day credit extended by the Covered Company to each Significant Company and its subsidiaries during the prior quarter; and
- ***Other Credit Exposures***. Any other transactions that result in credit exposure between a Covered Company and its subsidiaries and each Significant Company and its subsidiaries that the Federal Reserve, by order or regulation, determines to be appropriate.