Loss Absorbing Capacity

December 10, 2014

Background

- Firms need a sufficient amount of unsecured liabilities to absorb losses and to immediately stabilize the critical functions of the firm following a failure
  - This is in addition to requirements to hold sufficient equity capital to potentially avoid a resolution through recovery measures
- In the U.S., since late 2012 - early 2013, the FRB has discussed a potential requirement for firms to issue minimum amounts of unsecured long-term debt
- Internationally, the FSB recently developed a proposal on total loss absorbing capacity, or TLAC

TLAC – Status

- Consultation on loss absorbing capacity for global systemically important banks released by FSB in November 2014
  - The comment period runs through February 2, 2015
- Quantitative Impact Study and market survey to be carried out by early 2015
- Standard to be implemented at the national level

Key Terms – External TLAC

- Minimum external TLAC requirement of 16-20% RWAs; twice Basel 3 Tier 1 leverage ratio requirement
  - Jurisdictions may impose more stringent requirements
- Requirement applicable to each 'resolution entity' within the group
- Debt component: At least 33% of the minimum requirement should be met with T1/T2 debt or non-regulatory capital instruments
- Subordination requirement

Key Terms – Internal TLAC

- Loss absorbing capacity is required to be prepositioned with 'material subsidiaries'
- Each material subsidiary must maintain internal TLAC of 75-90%
  - Jurisdictions may impose more stringent requirements
- Internal TLAC should be pre-positioned on-balance sheet, unless otherwise agreed
- Secured guarantees may be utilized if agreed between home and host

Comments to SPOE Notice

December 10, 2014

SPOE Notice

29 written comments received

Issues:

- Global cooperation
- Liquidity and capital
- Valuation/Claims
- Exit from bridge financial holding company
- Subsidiarization

Global Cooperation

Comments focused on:

- Cooperation during a crisis
- Desire for binding agreements by the FDIC
- Local-level loss absorbing capacity
- Possibility of amending Chapter 15 of the Bankruptcy Code to add the recognition of foreign resolution regimes

Capital and Liquidity

Comments focused on:

- Private-sector financing in a crisis
- Recapitalization and the amount of intercompany debt needed at each subsidiary
- Insolvent subsidiaries (especially if financial distress infects the entire group)
- Repayment of counterparties
- Perception of OLF as a bail-out mechanism

Valuations/Claims

Comments focused on:

- Need for specific information about claims and valuation processes
- Difficulty of valuing assets and determination of which claims are fully secured
- Ability of creditors to price risk
- Disparate treatment
- Creditors' committee
- Franchise value

Exit from Bridge Financial Holding Company

Comments focused on:

- Maximizing value
- Creating multiple firms that are less complex

Subsidiarization

Comments focused on:

- Promotion of simpler and more transparent corporate structures
- Equivalence to pre-ring fencing
- Separation of subsidiaries for support services

Wind-Down in an SPOE Resolution

December 10, 2014

Imperative for Wind-Down in Resolution

- Title II requires a report to Congress within 60 days:

  "describing the plan of, and actions taken by, the Corporation to wind down the covered financial company"

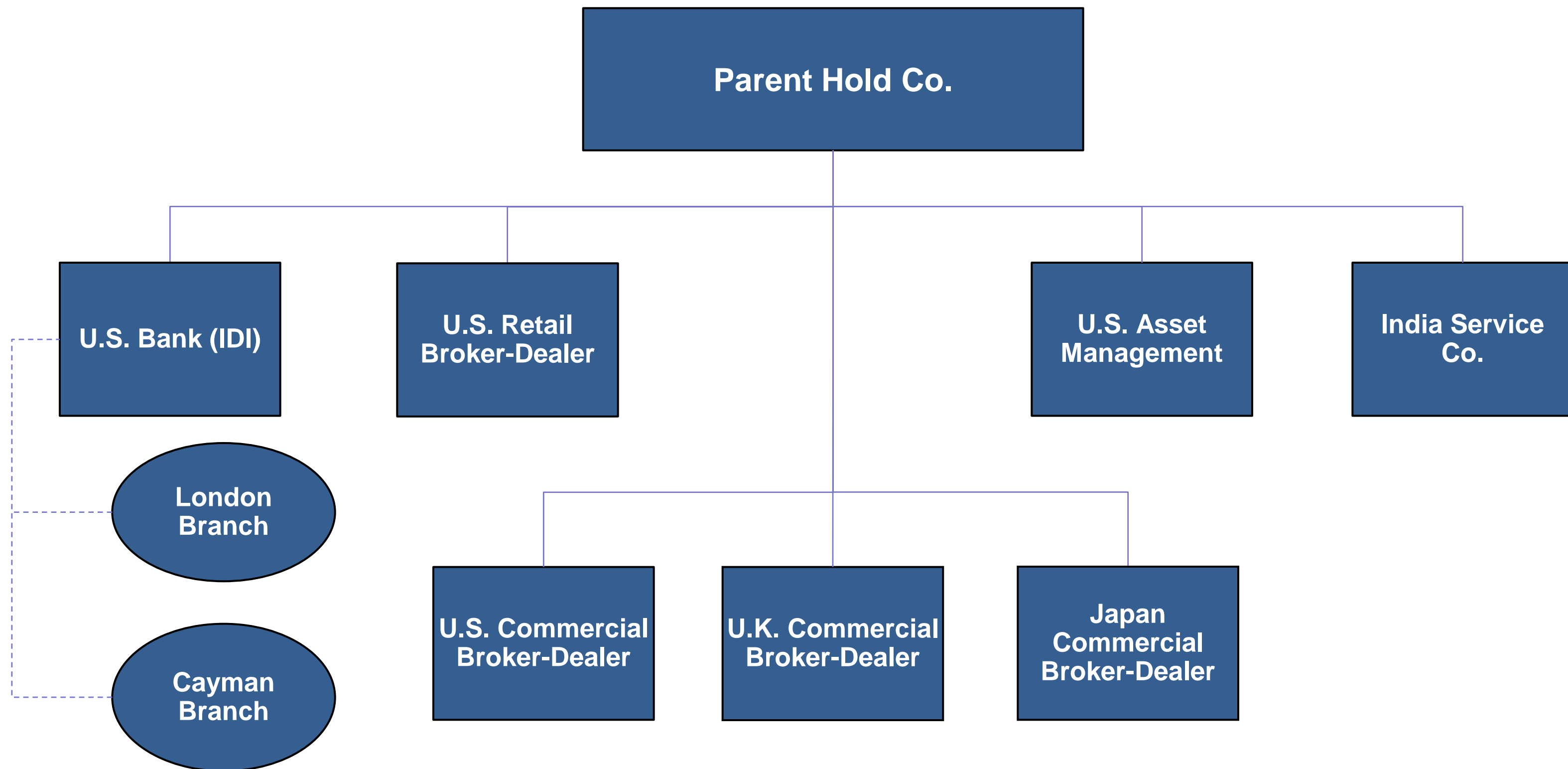
- The FDIC has established winding-down as an integral part of the single point of entry resolution process
- In addition to changes that occur during the bridge period, a plan for winding down would be required by the FDIC for any entities that emerge from the bridge
- This plan would ensure that any emerging entities:
  - Would not pose systemic risk
  - Are resolvable under the Bankruptcy Code

Driving Factors of Wind-Down Process:

- Current efforts to simplify operations and provide for optionality in resolution will facilitate winding down under bankruptcy or Title II
- In Title II, an initial operating agreement would require bridge management to formulate a plan for winding down
  - This would necessarily include identifying and addressing the causes of failure to ensure viability
  - Other steps to make the firm smaller and less complex might entail:
    - More closely aligning operations and legal entity structure
    - Dividing the company into several companies or selling parts of entities
- Some parts of the business would likely be liquidated as a result of the failure

Type of Activities Would Impact Approach:

Representative G-SIFI Organizational Chart (Simplified)



Timeframe and Post Bridge Requirements:

- It will likely be necessary that some divestitures, liquidations, or other wind down actions initiated during the 6 to 9 month bridge period will be completed after the termination of the bridge
- Wind-down plans would require FDIC approval and be enforceable subsequent to the termination of the bridge
- Ongoing requirements for winding down would need to be disclosed and factored into any valuation
- Living will requirements would further ensure ongoing resolvability under the Bankruptcy Code