The Meeting of the Systemic Resolution Advisory Committee

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

December 10, 2012 - 8:53 A.M.

The meeting of the FDIC Systemic Resolution Advisory Committee ("Committee") was called to order by Martin J. Gruenberg, Chairman of the Board of Directors, Federal Deposit Insurance Corporation ("Corporation" or "FDIC").

The members of the Committee present at the meeting were: Anat R. Admati, Professor, Graduate School of Business, Stanford University, Stanford, California; Charles A. Bowsher, Chairman and Member of the Research Advisory Council of Glass, Lewis & Company, LLC, Bethesda, Maryland; Michael Bradfield, Mercersburg, Pennsylvania; William H. Donaldson, Chairman, Donaldson Enterprises, New York, New York; Richard J. Herring, Jacob Safra Professor of International Banking and Professor of Finance, The Wharton School, University of Pennsylvania, Philadelphia, Pennsylvania; Simon Johnson, Ronald A. Kurtz Professor of Entrepreneurship, MIT Sloan School of Management, Cambridge, Massachusetts; Donald Kohn, Senior Fellow, Economic Studies Program, Brookings Institution, Washington, D.C.; John A. Koskinen, Non-Executive Chairman of the Board of Freddie Mac, Washington, D.C.; Douglas Peterson, President, Standard and Poor's, New York, New York; Paul A. Volcker, Chairman, Trustees of the Group of 30, New York, New York; and David J. Wright, Secretary-General, International Organization of Securities Commissioners (IOSCO), Madrid, Spain.

Members Michael Bodson, Chief Operating Officer, The Depository Trust and Clearing Corporation (DTCC), New York, New York; H. Rodgin Cohen, Senior Chairman, Sullivan & Cromwell LLP, New York, New York; Peter R. Fisher, Senior Managing Director,

BlackRock Investment Institute, New York, New York; Janine Guillot, Chief Operating Investment Officer, CalPERS, Sacramento, California; John S. Reed, Chairman, Corporation of MIT, New York, New York; and Gary H. Stern, Director, The Depository Trust and Clearing Corporation (DTCC), The Dolan Company, and the National Council on Economic Education, New York, New York were absent from the meeting.

Members of the Corporation's Board of Directors present at the meeting were: Martin J. Gruenberg, Chairman; Thomas M. Hoenig, Vice Chairman; and Jeremiah O. Norton, Director (Appointive).

Corporation staff who attended the meeting included: Steven O. App, M.P. Azevedo, Christine E. Blair, Annmarie H. Boyd, Jason C. Cave, Kymberly K. Copa, Carolyn D. Curran, Christine M. Davis, Patricia B. Devoti, Bret D. Edwards, Diane Ellis, Pamela J. Farwig, Robert E. Feldman, Ralph E. Frable, George French, Alice C. Goodman, Andrew Gray, Shannon N. Greco, Marianne Hatheway, Michele A. Heller, David S. Hoelscher, James J. Hone, Alan W. Levy, Christopher Lucas, Roberta K. McInerney, Arthur J. Murton, Richard Osterman, Bimal V. Patel, Stephen A. Quick, Jack Reidhill, Barbara A. Ryan, John F. Simonson, Eric J. Spitler, Marc Steckel, David Wall, Cottrell L. Webster, John D. Weier, and James R. Wigand.

Garry Reeder, Chief of Staff, Office of the Director, Consumer Financial Protection Bureau, and William A. Rowe, III, Deputy to the Chief of Staff and Liaison to the FDIC, Office of the Comptroller of the Currency, were also present at the meeting.

Chairman Gruenberg opened and presided at the meeting. He began by welcoming the Committee members and advising that, since the Committee's last meeting, the FDIC has focused on three core issues relating to the resolution of systemically important financial institutions ("SIFIs"): (1) the development of internal resolution plans to implement the FDIC's authorities under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")("Title II") for the resolution of systemically important financial institutions; (2) the process of reviewing the first round of resolution plans or so-called "living wills" that bank holding companies with consolidated assets greater than $50 billion are required to prepare under Title I of the Dodd-Frank Act ("Title I")—a joint responsibility that the FDIC shares with the Board of Governors of the Federal Reserve System ("Federal Reserve"); and (3) the

engagement of the FDIC's foreign counterparts—on both a bilateral and multilateral basis—on systemic resolution.

Chairman Gruenberg then provided an overview of the meeting agenda, advising that the two afternoon sessions would focus on the Title II resolution plans and the Title I review process for the resolution plans that the companies themselves have been preparing; and that Paul Tucker, Deputy Governor for Financial Stability, Bank of England, would lead the morning session which would be devoted to a discussion of the FDIC's cross-border international work. He noted that Mr. Tucker, in his capacity as Deputy Governor for Financial Stability, oversees the Bank of England's responsibilities for the resolution of SIFIs and has been the point person for the United States' ("U.S.") engagement and collaboration with the United Kingdom ("U.K.") regarding resolution planning for SIFIs, which has resulted in the release today of a joint paper by the Bank of England and the FDIC on resolving globally active systemically important financial institutions ("G-SIFIs"). He also noted that Mr. Tucker serves as a member of the steering committee of the G20 Financial Stability Board ("FSB") and, in that capacity, serves as Chairman of its Resolution Steering Group; that he oversaw the development of the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions ("Key Attributes")—the first international standards for the resolution of financial institutions; and that he has also been deeply involved in the European Commission's pending directive on recovery and resolution planning. Chairman Gruenberg concluded his remarks by noting that the Bank of England and the FDIC have developed a very good partnership, based in part on mutual interest because the U.S. and the U.K. are the respective hosts of the largest foreign operations of the U.S. SIFIs, and advising that Mr. Tucker would discuss the joint work of the FDIC and the Bank of England and the broader international efforts relating to systemic resolution. After introducing James R. Wigand, Director, Office of Complex Financial Institutions ("OCFI"), who briefly covered a few administrative matters on the conduct of the meeting, Chairman Gruenberg turned the discussion over to Mr. Tucker.

Mr. Tucker expressed his gratitude for being invited to address the Committee, noting that Committee member Donald Kohn is a colleague and that he has also worked with Committee member David Wright, who, as a member of the FSB Resolution Steering Group for many years, has made significant contributions to addressing resolution issues in Europe. He stated that, from an FSB perspective, the approach to the too-big-to-fail problem

adopted by the FSB has been described as a "bookends" strategy because, at one end of the spectrum, there are more capital and liquidity to make it less likely that these SIFIs will fail and, at the other end of the spectrum, there are resolution regimes to ensure that they get through failure in an orderly way without taxpayer support. He noted that the adoption of this approach by the FSB is especially significant for the U.K., which serves as both a significant home jurisdiction and a very significant host jurisdiction; that almost every significant bank or broker-dealer in the world has very large operations in London; that a number of very significant institutions are domiciled in the U.K.; and that, for many years, the U.K. has not had a resolution regime that can cope with failure on a cross-border basis.

Mr. Tucker then provided background information on the U.K.'s legislative framework, explaining that, as it entered this crisis, the U.K. did not have a legislative framework for resolutions other than standard bankruptcy procedures, which do not work well for depository institutions; that, in 2009, the U.K. Parliament introduced a resolution regime modeled almost word for word on the FDIC's legislation for resolving depository institutions; and that the U.K. Parliament is currently processing a bill that will extend that resolution regime to bank holding companies and broker-dealers and, prospectively, to central counterparties. For various other strengthening of the its system, he continued, the U.K. will rely on the European Union Recovery and Resolution Directive ("E.U. Directive") scheduled for implementation next year, which will establish a common resolution regime for all of the 27 European Union member states and ensure a common language for European resolutions; and that the implementation of the E.U. Directive is separate from progress on the European continent toward a banking union within the monetary union, which, in the future could facilitate the establishment of a common resolution authority across the European Union. He noted that the U.K does not plan to be part of the banking union and is primarily concerned with the E.U. Directive; and that the directive, among other things, will extend the tools available to resolution agencies in Europe to include writing down debt liabilities by converting a part of such liabilities into equity—widely known as "bail-in"—and will remove some impediments embedded in European law that affect the resolution of a large and complex firm, such as the ability to impose stays on derivatives or netting of contracts.

Mr. Tucker continued, stating that there are two very different problems in resolving the largest and most complex firms: (1) determining where the losses go—which after equity holders should go to the debt holders or, in the case of insured deposits, to the deposit insurance firm which can then collect any losses from the industry, and (2) determining how to apply this on a cross-border basis—which presents a special challenge on a global basis for a large and complex firm because of the cross-border elements and the value destruction entailed by putting so much into liquidation. He noted that the Key Attributes, the Dodd-Frank Act in the U.S., and, prospectively, the E.U. Directive in Europe, give resolution authorities the ability to take a different approach by writing down the liabilities of a large bank or broker-dealer at the holding company or operating company level. He advised that the FSB recently issued draft guidance on resolution strategies and made a distinction between two types of strategies: (1) single point of entry, which involves a single resolution authority resolving the entire financial group from the top of the group, and (2) multiple points of entry, which involves authorities around the globe each resolving their part of the group in a coordinated manner. He also advised that the joint paper issued today by the FDIC and the Bank of England focuses on applying bail-in by a single point of entry resolution strategy from the top of the group; and that the importance of this cross-border cooperation is that the home and host authorities can each understand what steps the home authority would take and decide whether or not to rely on the home resolution authority.

To illustrate the single entry strategy, Mr. Tucker outlined a scenario—applicable to all of the significant U.S. SIFIs and most of the European SIFIs—in which a financial group with a holding company issues equity and bonded debt to finance its operating banking subsidiaries in the U.K. and elsewhere globally, and one of those operating companies encounters severe financial difficulty that results in its failure. In this example, he continued, the single point of entry resolution strategy would involve pushing those losses up to the holding company, having the resolution authority take control of the holding company and write off the equity and a sufficient amount of the outstanding debt issued by the holding company to cover the losses, and then converting part of the residue of outstanding debt of the holding company into equity to recapitalize the financial group by following broadly the order of priority of creditors that would be followed in a liquidation. He advised that the debt holders or a layer of debt holders in this strategy would become the owners of the

financial group, and the distressed subsidiary would be recapitalized by pushing the losses out to the holding company level; that this could be accomplished through the use of a bridge holding company in the U.S. or the U.K., as well as through a trust structure in the U.K.; that both the U.S. and the U.K. versions of this strategy would involve an upfront valuation of the financial group—an *ex ante* assessment of the losses; and that this would involve a significantly different process than the FDIC's typical purchase and assumption transaction for failed insured depository institutions through which the insured deposits, cash, and certain of the good assets are sold to another insured depository institution and the valuation—or the scale of the losses—emerges only *ex post* through the liquidation of the remaining assets.

Mr. Tucker next expressed his views on the valuation process, noting that the single point of entry strategy would not work for a distressed bank or broker-dealer if the institution is so completely toxic or the records of its assets and liabilities so incomplete that a reliable valuation of the assets could not be made in advance to determine the amount of the expected losses; that the Bank of England and the FDIC continue to debate how quickly a valuation of the amount of the expected losses could be made in the run-up to a crisis; and that supervisors and resolution authorities would likely need to establish requirements for firms to maintain detailed books and records of their assets. He advised that an important aspect of the strategy described in the joint paper is that, except for the distressed subsidiary, the subsidiaries keep operating in the domestic jurisdiction of the country where the financial group is headquartered, as well as all the other countries throughout the world; that only in the country of the distressed subsidiary that has caused the difficulties are the losses pushed up to the holding company and the subsidiary recapitalized; that, with respect to the continuous operation of the subsidiaries, there would need to be a dialogue with all of the relevant host authorities to effect this strategy on a global scale; and that he believes the U.K. authorities are prepared, in principle, to stand back and allow the U.S. authorities execute a resolution of the massive U.S. financial groups with extensive operations in the U.K. without interference with respect to the subsidiaries and branches or the assets of the businesses domiciled in the U.K. He emphasized that, through this resolution strategy, no one is being let off the hook—the equity holders would lose all value; the subordinated and unsecured debt holders, if necessary, would lose all value; culpable senior management would be removed; and

the unprofitable businesses would be discontinued. He also advised that the whole group could be restructured, either within the resolution or subsequently; and that this resolution would not be a disguised form of bailout or an easy option for the firms, and would not be subsidized by the taxpayers or result in the taxpayers bearing the losses.

Mr. Tucker concluded by stating that, as a result of the global efforts over the past three years, there is a globally-shared conception of the structure for a resolution regime, which the FSB will ensure by reporting to the G20 leaders that a resolution regime is being established in all of the G20 countries, as well as Hong Kong and Singapore; that this resolution regime is already established in the U.S. through the Dodd-Frank Act and, prospectively, will be established in Europe, as well as Asia and other parts of the world; that, as the next step, there is a global effort with the FSB to articulate the resolution strategies that could be followed in the application of that global resolution regime; and that, as evidenced by the joint paper released today, the U.K. authorities and the U.S. authorities, especially the FDIC, have done some detailed planning with respect to implementing those strategies.

At the conclusion of Mr. Tucker's remarks, Chairman Gruenberg opened the floor for questions or comments from the Committee members. Mr. Kohn began the discussion by emphasizing that it may be extremely difficult to complete an upfront valuation, particularly in a crisis situation such as the one encountered in the Lehman Brothers case. He asked if the resolution strategy would leave enough in the holding company to continue absorbing any unexpected losses or to keep other subsidiaries well capitalized. In response, Mr. Tucker noted that there are two approaches to the valuation: (1) make a conservative estimate of the losses that errs on the high side of the valuation and provides the relevant layer of debt with some form of a claw back through warrants or similar instruments, or (2) make a less conservative estimate of the losses that errs on the low side of the valuation but leaves enough equity in the holding company to cover further unexpected losses; and that both approaches achieve the objective of writing down the debt and converting part of the residue of the debt into equity. Ms. Admati then asked whether the trigger for a resolution would be default or insolvency, which depends on the valuation. Mr. Tucker responded by noting that there are criteria for being authorized as a financial institution in the U.K., and the trigger for a resolution is that the supervisory

agency concludes that the criteria for authorization are not met and that there is no reasonable prospect of meeting the criteria in the future in the absence of a resolution. He cautioned that this does not mean the financial institution's balance sheet is bankrupt on the day it is put into a resolution, but that it would be bankrupt in the future if events were left to follow their normal course, which could be partly through a liquidity crisis; and that serves as the trigger for the resolution of any authorized financial institution within the scope of our resolution regime.

Mr. Johnson commended the FDIC and the Bank of England for their work on this very difficult problem, noting that it represents some steps in the right direction. He then asked if there must be a minimum amount of debt at the holding company level relative to the exposures in the operating companies for the bail-in strategy to work. In response, Mr. Tucker noted that this resolution approach could be done at the operating subsidiary level as well as the holding company level; that, when these resolution regimes are in place everywhere, the regulatory authorities would have to determine whether to prescribe a minimum amount of debt issued from the holding company or the operating companies; and that the E.U. Directive and the legislation going through the U.K. Parliament each have provisions concerning this issue. Chairman Gruenberg emphasized that this is an issue that has been given considerable attention because it is the central issue relating to this resolution strategy built around debt at the holding company level; that, in the U.S. context, the current structure of large institutions is one that has a large amount of debt at the holding company level, which makes the strategy imaginable and creates incentives for these companies to shift their structure; and that this issue has been discussed extensively with the Federal Reserve, which has broad authority to establish capital requirements at the holding company level. Mr. Wigand noted that there must be an adequate amount of bonds and other types of unsecured credits that could be converted into equity to absorb losses of the operating companies below the holding company level in order for this strategy to work; that alternative resolution frameworks with multiple points of entry using the legal entities below the holding company level, such as the depository institution and the broker-dealer, would need to be considered if there is an insufficient amount of debt at the holding company level; and that the single point of entry strategy is more appealing from an economic standpoint because the companies typically operate as single enterprises—rather than multiple enterprises—and, therefore, the creditors of the

single holding company at the top are the ones that should bear the cost of the support to keep it as an integrated whole because they have benefitted from the operations of the company as an integrated whole.

Mr. Volcker questioned whether the U.S. would be willing to stand back if it is the U.K.'s or another country's home institution being resolved; he also noted that this approach is, *de facto*, insuring the deposits of large institutions. In response, Mr. Tucker indicated that, historically, the question concerning the level of cooperation between home countries and host countries around the world has not been addressed until the heat of the crisis; and that it is important to bring that conversation forward and address that question in advance of, rather than during, a crisis, when there may be insufficient international cooperation. On the issue of deposits being insured, Mr. Tucker also noted that deposits would remain insured up to the deposit insurance limit, but with the deposit insurer taking losses; that it would be possible to bail-in the deposit insurer within Europe and the U.K. to avoid the deposit insurer only losing money at the end of a process of realization; and that, if the U.K. authorities could not bail-in from the holding company level, then ring-fencing of the domestic deposit-taking institution could be considered a fallback strategy as part of a multiple points of entry resolution strategy, with the U.K. resolving at the level of the ring-fenced deposit taker. Following up on the issue of the U.K. or another country taking the lead in a troubled situation, Mr. Bradfield noted that, if the U.S. would not stand back, the alternative would be the multiple points of entry approach. He asked how that approach would work in practice and, if secured debt is not included in the bail-in assets and liabilities, whether the market would react by making all of its credits available to resolvable institutions with secured credit or repurchase agreements, thus leaving no debt that can be turned into equity using the bail-in approach. On the issue of encumbrance, Mr. Tucker responded by noting that having more encumbered assets results in less available for the deposit insurance agency to cover its losses, which creates an incentive for using the bail-in approach or another approach to push the losses away from the taxpayer onto the debt holders. He also noted that there is currently an active debate concerning the tracking and disclosure of encumbrance, as well as limitations on encumbrance, which must be done with a level of transparency that does not undermine the central banks that are themselves lenders against assets. On the issue of multiple points of entry, Mr. Tucker emphasized that one of the important elements

of the FSB's Key Attributes is that the home authority has to be responsible for ensuring that there is a coherent plan for the resolution of the group worldwide—they are the coordinator of a multiple points of entry resolution, even if it involves a number of different countries. Noting that many of the financial groups have thousands of legal entities providing services to one another, he stressed that, at a minimum, it is important that those services are documented in contracts that are enforceable if the legal entities are split up through a resolution, that those operating companies are in jurisdictions where the rule of law is good, and that there are contracts with all the relevant entities that would survive a multiple points of entry resolution.

Mr. Peterson questioned the ability to apply international accounting standards in a way that ensures consistency on legal vehicle structures—as well as loan equivalent valuations and mark-to-market accounting—and addresses very large distortions that can exist across borders. He also raised the issue of so-called "shadow banking" and asked what would be done to deal with unregulated financial institutions that are taking increasingly larger positions within the financial markets. With respect to the accounting standards issue, Mr. Tucker indicated that the international authorities must keep pressing the international and U.S. accounting standards authorities to converge on good accounting standards; that, if necessary, the financial regulatory authorities must put their own standards in place; and that, rather than capital being set aside for unexpected losses, regulators could consider requiring that capital be set aside against expected losses that are not covered by loss provisions—similar to the expected loss provisioning employed by bank supervisors around the world in the context of the Latin American and Eastern European debt crisis in the early 1980s. On the issue of shadow banking, Mr. Tucker expressed agreement, noting that resolution powers—such as those established by Title II—should extend to nonbank financial institutions, and that those resolution powers were not included in the E.U. Directive but are planned for a parallel directive which would apply resolution powers to nonbank financial institutions. Commenting that progress has been made on the single point of entry strategy with the cooperation of the U.K., Mr. Herring raised concerns that the mechanism of forcing losses up to the holding company level has the appearance of looking to the holding company as a source of strength, and that the multiple points of entry strategy as a backup position leads to uncertainty that could cause creditors—especially in wholesale markets—to run very quickly at the first

hint that the operating subsidiary that they deal with could be one of those in which losses will be crammed down. In response, Mr. Tucker indicated that the point of forcing losses up to the holding company is an important one that can be addressed by having the holding company guarantee its subsidiaries or face higher haircuts on collateral that is pledged to the central banks, or by imposing unlimited liability; that it is also important that the supervisors and resolution authorities have the power to require organizational or financial restructuring of financial groups to ensure that they are resolvable; and that there are risks with the multiple points of entry strategy that creditors—particularly short-term creditors—are going to retreat, but, if the resolution plan is credible, the creditors should be better off than they would be in a liquidation and the central banks should be prepared to lend to companies that are solvent and viable on a short-term basis to bridge liquidity difficulties. Mr. Volcker then asked if, in a resolution, the remaining financial company would be broken up or sold off in parts. In response, Mr. Tucker advised that, from the U.K.'s perspective, it could be broken up in some circumstances but that good parts of the business may continue provided the shareholders have been wiped out, debt holders have taken losses and become exposed to risk as new equity holders, and management has been replaced.

After thanking Mr. Tucker for his presentation and the insights that he provided to the Committee, Mr. Wigand announced that the meeting would briefly recess. Accordingly, at 10:36 a.m., the meeting stood in recess.

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The meeting reconvened at 11:02 a.m. the same day, at which time Chairman Gruenberg thanked Mr. Tucker for an interesting discussion with the Committee members. After inviting Mr. Tucker to join the Committee for the remainder of its meeting, Chairman Gruenberg turned the discussion over to Mr. Wigand, who introduced M.P. Azevedo, Deputy Director, International Outreach and Coordination, OCFI, and David N. Wall, Assistant General Counsel, Complex Financial Institutions Section, Legal Division, to continue the meeting with a discussion of the work of the FDIC's international coordination group.

Ms. Azevedo began by advising that she would provide an overview of the FDIC's efforts to operationalize global resolution strategies, focusing on three key areas: (1) an update of the heat mapping exercise findings on key

jurisdictions since the Committee's last meeting and new criteria that were used beyond that of "total activity"—defined as foreign activity comprised of on-balance sheet assets and off-balance sheet assets of SIFIs outside of the United States; (2) a description of the outreach efforts based on key jurisdictional findings; and (3) the identification of key obstacles to cross-border resolution. She advised that the FDIC has developed a work program to operationalize its preferred global resolution strategy—the single point of entry strategy—by first understanding each U.S. SIFI's global footprint to enable the FDIC to mitigate the systemic impact of a failure by sustaining critical operations and core functions at viable foreign entities, to identify key jurisdictions involved in a particular SIFI's strategy from the heat mapping exercises and work together with supervisors and resolution authorities in those jurisdictions, and to identify obstacles to cross-border resolution.

Ms. Azevedo next provided an update of the FDIC's heat mapping exercise, noting that the number of top U.S. SIFIs used in the heat mapping has been increased to seven institutions; that the key findings remain unchanged, with more than 90 percent of the total foreign activity for the top seven U.S. SIFIs located in three jurisdictions and the U.K. still having the largest footprint; that 15 jurisdictions cover more than 97 percent of the total reported foreign activity of the top seven U.S. SIFIs; and that one to seven legal entities account for more than 85 percent of each SIFI's total reported foreign activity. A new criterion used in the heat mapping, she continued, was liquidity surpluses for the organization, with the findings indicating that liquidity surpluses are also concentrated in a handful of jurisdictions, primarily the U.K. and a few other jurisdictions such as Japan, Ireland, and Switzerland. She explained that the mapping of clusters of intercompany funding sources and funding interdependencies suggests which entities might be integral to funding the enterprise, both in terms of operating in a business as usual mode in normal times and continuing critical operations in a resolution mode or the execution of a successful Title II strategy; and that excess third-party assets covering third-party liabilities was also considered because it may heighten susceptibility to ring-fencing in those jurisdictions and at particular affiliates. She also reported that another criterion was data and operational centers—which provide shared services, support critical operations, and underpin core business lines globally; that the available information showed that clusters of data and operation centers outside of the U.S. tend to be

centered around European financial centers, notably the U.K., and Asia; and that the data and operation centers are often housed in unregulated legal entities, typically subsidiaries and not branches. Finally, she noted that the last criterion was key memberships in non-U.S. financial market utilities ("FMUs"), with the findings indicating that a handful of FMU memberships concentrated in a few key jurisdictions outside of the U.S. appear to be essential to continuing foreign operations.

Ms. Azevedo then discussed the FDIC's bilateral engagement, noting that FDIC's efforts have placed particular emphasis on building trusting relationships with foreign resolution authorities by initiating bilateral dialogue to promote better understanding of resolution strategies and resolution regimes and to identify obstacles and issues that need to be addressed. She advised that the FDIC has participated in 23 FSB Crisis Management Group meetings in eight jurisdictions; that these are multilateral meetings with respect to particular SIFIs in both the U.S. and foreign jurisdictions that provide the opportunity for in-depth bilateral dialogue and presentations on the FDIC's single point of entry strategy. Next, she advised that another initiative is to conclude bilateral memoranda of understanding ("MOUs") with resolution authorities and financial regulators in key foreign jurisdictions; that the FDIC has been in active dialogues to conclude MOUs with 26 jurisdictions; that MOUs related to resolution-specific matters have been completed with the U.K, Ireland, Jersey, and China; and that discussions on MOUs are underway in six EMEA jurisdictions, as well as eight in Asia and five in the Americas, with seven more planned. She explained that the MOUs recognize the mutual importance of advance preparation for a resolution and attempt to establish a framework for consulting regularly on resolution developments, firm-specific resolution issues and strategies, and parameters for protecting the confidentiality of shared financial information. Finally, she advised that obstacles to cross-border resolution—particularly those that present obstacles to the continuity of critical foreign operations—have been identified in a number of the key heat-mapped jurisdictions, including: ring-fencing; change of control requirements; fit and proper requirements for senior managers and board members in the new entity; termination of contracts in jurisdictions without 24-hour stays, especially related to derivatives; and continuing access to securities, payments, derivatives, and foreign exchange clearing and settlement systems. She also noted that another key obstacle is access to collateral because it is critical to ensure that liquidity is available and continues to circulate within an enterprise in resolution; and that access to

data and operational services also is a key obstacle that needs to be addressed to ensure that services provided by affiliates are governed by enforceable contracts.

In closing, Ms. Azevedo commented on the keys to a successful cross-border resolution, noting that SIFIs have extensive global footprints covering 100 or more jurisdictions with thousands of legal entities; that the workload needs to be managed by prioritizing; that it is necessary to plan ahead by promoting global understanding of resolution strategies, as well as discussing key obstacles and issues associated with those strategies; and that it is important to enhance the possibilities for cross-border cooperation by promoting the adoption of common toolkits for resolution and shared goals.

During the discussion that followed, Committee members commented on a number of issues relating to a cross-border resolution. Mr. Donaldson asked what primary obstacles have been identified to a cross-border resolution. In response, Ms. Azevedo suggested that a primary obstacle—one that presents an operational issue—is to ensure that key foreign subsidiaries hosting critical operations have necessary funding in their respective time zones after the resolution strategy has been executed. Mr. Wigand indicated that, in a broader context, liquidity would be a key obstacle associated with resolution, particularly with regard to the issues that could arise from a misalignment among functions and operations, legal entities, and funding structures. He elaborated by explaining that misalignment presents a resolution challenge because operations and functions do not align with legal entities, which, in turn, do not necessarily align with funding structures; that, in the typical universal banking model, a company's operations are based on functional or business lines—such as retail banking, investment banking, and asset management—which are conducted through multiple legal entities that generally number in the thousands for the largest SIFIs; and that funding to support those businesses is handled through a variety of mechanisms, with that liquidity, as well as risk, being transferred within the enterprise to basically satisfy the business needs of the company. He continued, noting that those entities fail based on their legal charters, and, as a result, the integration that existed prior to failure ceases to exist and the resolution authorities—whether it is the FDIC through Title II, a bankruptcy court, or a foreign administrator through the respective insolvency regime for the subsidiary in that jurisdiction—would have to operate based on the authorities for that particular legal entity, which has the potential of

disrupting the provision of systemically important services and creating uncertainty that becomes the transmission mechanism for contagion and systemic risk. He emphasized that liquidity is likely to have evaporated in the run up to insolvency and immediately replacing that liquidity upon insolvency to maintain critical operations is a major obstacle. He also noted that ensuring that authorities in hosted jurisdictions understand how this process will unfold is a challenge, since it is critically important to avoid unintended actions being taken by other authorities that would frustrate the ability of the home authority to execute a resolution process. In addition, he advised that derivatives netting provisions present a key resolution challenge that the Dodd-Frank Act, as well as the FDI Act, each address with respect to domestic contracts, but that it remains problematic for those contracts that are booked overseas or written under a jurisdiction that does not have a similar preclusion of the ability to immediately unwind those contracts.

Ms. Admati then asked what information sources were used for heat mapping foreign activity and what parameters were used to define the critical operations and core functions. In response to the first question regarding information sources, Ms. Azevedo advised that reliable sources of information for heat mapping the top U.S. SIFSs are limited, but that the FDIC has been able to use confidential supervisory reports filed by the firms. Through the development of the living wills under Title I, Mr. Wigand added, there are resolution issues that would need to be addressed and that, hopefully, will serve as an avenue or mechanism to obtain better information and to address some of the issues concerning transparency. Turning to the definition of critical operations and core functions, he advised that, for purposes of developing the living wills and Title II resolution planning, critical operations are those operations whose path of succession will impact financial stability in some form; that core functions are those critical activities or operations that represent the core services provided by the firm and its market niche in the industry; that critical operations are of significant concern with respect to mitigating the effects of a failure and containing systemic risk, and core functions are important with respect to how the resolution authority deals with the issues of restructuring, how the firm exits resolution, and the value of that firm to both the stakeholders and the public at large. Noting that a number of countries may be moving toward increasing subsidiarization of functions in their particular countries, Mr. Kohn asked what effect this has had on the resolution process. In response, Mr.

Wigand stated that the problem with subsidiarization is not the number of subsidiaries but how they relate to and interact with one another; that a better term would be "compartmentalization" because it describes how a set of activities within a firm are compartmentalized in a manner that allows the legal entities associated with those activities to fail without either bringing down the rest of the firm or the financial system; that the single point of entry strategy is not at all in opposition to that structuring since, by minimizing the number of insolvencies, there would be greater predictability of the outcome that potentially mitigates the key risks associated with the failure of the SIFI; and that a compartmentalized approach, in many respects, works hand-in-hand with or supports a single point of entry strategy because it identifies those activities which may be more independent and less in need of an integrated approach since the losses can be absorbed as an independent operation of the compartmentalized group and do not need to be pushed up to the holding company.

Mr. Johnson expressed concern that managing a large SIFI failure in the middle of the week across different time zones would be incredibly complex, and suggested that G-SIFIs, domiciled in the U.S., ultimately may not be resolvable across multiple jurisdictions under this resolution authority without having massive adverse economic consequences. Ms. Azevedo responded by suggesting that, while a Tuesday failure is not as preferable as a Friday failure, some of the operational challenges can be overcome with advance planning and the cooperation of local authorities. Noting that the FDIC is considering the best mechanisms to address this difficult challenge, Mr. Wigand emphasized that the outreach component of the FDIC's international coordination is extraordinarily important for engaging in dialogues with local authorities to build the level of understanding, confidence, and trust that would allow a resolution authority—or a coordinated effort of resolution authorities—to actually implement resolutions in multiple entities within a failing enterprise. Mr. Tucker then asked if, in addition to the heat mapping of the most important jurisdictions outside of the U.S., the FDIC will look at a different set of jurisdictions such as those where a firm's local presence might not be systemic in the U.S. but would have a systemic impact on the host country's economy, particularly since these are the host countries with the greatest incentive to quickly grab control of the firm's assets for fear of a domestic economic crisis. In response, Ms. Azevedo indicated that the FSB Crisis Management Groups are becoming aware of those jurisdictions and factoring them into the strategy; Mr.

Wall noted that the FDIC will likely participate in any FSB initiatives on those issues; and Mr. Wigand indicated that, in the context of the living will preparation exercise, the FDIC has considered whether there are services provided by the firm that may not be systemically important domestically but which would be very important to a jurisdiction that is dependent on that service. In reference to cross-border resolution obstacles, Mr. Wright suggested that clarity of ownership of the firm's securities and assets, in addition to depositor preference, present potentially significant problems on a cross-border basis and should be addressed. Mr. Wigand responded by noting that one of the reasons the single point entry of strategy is viewed as the optimal mechanism for dealing with an insolvency is that the holding company has a very limited set of stakeholders and, therefore, it becomes easier to handle a claims process for a very narrow set of creditors than to dealing with literally the exponential number that would arise from multiple insolvency proceedings, particularly at key operating subsidiaries. On the issue of depositor preference, Chairman Gruenberg noted that, from the FDIC's standpoint, it is an issue that involves the FDIC's relationship with some of its foreign counterparts and a subject that is receiving substantial attention.

Chairman Gruenberg then announced that the meeting would recess for lunch. Accordingly, the meeting stood in recess at 12:17 p.m.

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The meeting reconvened at 1:29 p.m. on that same day, at which time Mr. Wigand introduced John F. Simonson, Deputy Director, Systemic Resolution Planning and Implementation, OCFI, to present the next panel discussion on the Title II resolution authority, focusing on two specific issues: (1) the decisions and triggers for implementing Title II liquidation authority; and (2) the relationship between Title I responsibilities for reviewing living wills and Title II liquidation authority.

Mr. Simonson began by reporting that, since the introduction of the single point of entry strategy at the Committee's last meeting, the FDIC has been engaged in a number of activities focused on refining and operationalizing that strategy, including internal work streams—and the use of external consultants—to address topics identified by the Committee, such as governance, valuation, exit strategies, accounting, and claims management. He summarized a number of

those activities, noting that the FDIC has continued to develop and refine the single point of entry strategy for the characteristics of the top five U.S. G-SIFIs, sharing summaries of those plans with domestic and international regulators; that interagency events have been hosted on a number of topics, such as: issues related to qualified financial contracts under Title II, funding and the use of the Orderly Liquidation Fund to ensure liquidity for necessary subsidiaries, logistical and practical components involved in the "three keys" process for exercising Title II authority, issues related to hedge funds and large counterparties that are not G-SIFIs but which create systemic risk, and the impact of a SIFI failure on central counterparties; and that the FDIC has engaged in outreach efforts to educate key stakeholders on the single point of entry strategy.

Turning to the triggers for implementing the Title II liquidation authority, Mr. Wigand recalled that, in order to make the decision to implement the Title II authority, the recommending officials and the determining official—the U.S. Secretary of the Treasury—must consider a number of factors set forth in the Title II statutory framework; that a key issue among those factors is whether the financial company is in default or in danger of default; and that, in the context of the need to resolve a SIFI, the most probable pathway is one in which liquidity becomes constrained and affects the firm's ability to meet its obligations or honor a contract, which then becomes the proximate cause that necessitates the Title II decision. He indicated that there may be underlying issues involving asset valuation or, if it is an idiosyncratic type of failure, fraud or another type of a situation that results in the market no longer providing liquidity to the firm, but that it will, in all likelihood, be a liquidity-driven event. As a result, he continued, there is likely to be a relatively short period of time from when the firm's distress is known until some dynamic accelerates the level of distress very quickly and necessitates a decision to implement Title II liquidation authority.

Mr. Wigand next addressed the relationship between Title I and Title II, noting that Title I is basically an enhanced prudential supervisory tool designed to mitigate the probability of the default of a company subject to the provisions of Title I and to minimize the costs in the event of failure; that companies subject to Title I are required to produce living wills; and that the content of those living wills is very useful for informing the FDIC at a granular level on its planning with

respect to the implementation and execution of the Title II authority. He advised that the first option or course of action that the recommending officials would consider implementing is a resolution under the Title I framework—through bankruptcy, the FDI Act for insured depository institutions, Securities Investors Protection Act for broker-dealers, or the existing resolution regimes in the jurisdictions that host subsidiaries of the company—with a resolution under the Title II framework only serving as a backup option if it is determined that the Title I resolution would result in systemic consequences. He concluded by emphasizing that it is important to consider the Title I and Title II processes together because the planning that is built around the Title I process informs the FDIC on how to implement a Title II resolution on that specific firm, as well as the specific issues and impediments associated with that firm.

During the discussion that followed, Committee members commented on a number of issues relating to the exercise of Title II authority. Mr. Herring expressed concern regarding the adequacy of a liquidity trigger, noting that one of the U.S. SIFIs is so well protected by deposit insurance that it is not likely to have a liquidity problem, even if it is deeply insolvent; he also questioned the use of book values to determine insolvency because book values lag substantially behind what is actually occurring on the balance sheet. In response, Mr. Wigand noted that knowing there is capital insolvency ahead of time would probably allow all of the authorities additional time to develop and modify the resolution approach, but the FDIC's expectation is that some market perception of the firm's capital solvency will result in a liquidity starvation before any determination of the true capital insolvency. Noting that the courts are going to give the regulatory authorities a very broad degree of discretion, Mr. Bradfield commented that this type of issue has been tested in the context of the FDIC's authority and the courts basically have said that a regulated institution has consented to this framework; he added that the protections are in all the procedures that the authorities must follow to implement it, particularly the sound judgment that has to be employed to protect stability of the financial system. Mr. Peterson suggested that there is an interesting shift underway in the financial markets—particularly the debt markets—because interest rates are very low; and that the FDIC should look at the hierarchies and levels of subordination of the different types of debt instruments inside a financial institution to determine whether there may be less interest in providing financing to

holding companies. Mr. Wigand indicated that the FDIC has done that exercise on a general level within both holding companies and operating subsidiaries; that there is clearly an incentive to lend or borrow at the operating company level if there is an expectation of better protection at that level; and that the FDIC needs to address that incentive, since it may become a stronger incentive in the future.

Commenting on the likelihood of a scenario with multiple failures due to systemic problems within sovereigns, such as the current crisis in the European banking system, Mr. Volcker asked how the resolution process deals with a systemic problem resulting in multiple failures. In response, Mr. Wigand noted that this question gets into territory beyond the scope of the implementation of Title II; that Title II is focused on developing a framework for allowing a company to fail without having its failure cause systemic consequences to the economy and financial services industry; and that the issues associated with the prospect of a systemic problem—or some level of distress in the financial services industry—that is causing a high degree of distress and multiple failures of companies shifts the focus to determining what types of other programmatic responses should be implemented by supervisors or governments to deal with the systemic problem that is causing the failures. Noting that, as a matter of policy, earlier action is generally better in a resolution because delay increases the costs, Mr. Wright then asked if the FDIC can act earlier in the process, before there is a threat of bankruptcy. In response, Mr. Wigand advised that Title II defines what constitutes being in default or in danger of default; that, in order to implement Title II there has to be a super majority of the relevant regulatory authorities making that recommendation; and that one of the considerations in making that recommendation is that failure through the bankruptcy process would have negative consequences for the stability of the financial system. Mr. Wall also noted that it is the U.S. Secretary of the Treasury that makes the final decision under Title II and the condition of being in default or danger of default is one of only two bases through which that decision could be challenged in court.

Chairman Gruenberg advised that, under the U.S. framework, the Federal Reserve has substantial enhanced prudential authorities relating to SIFIs, and this revised statutory framework provides an enhanced set of supervisory authorities over SIFIs that, in collaboration with an enhanced set of resolution authorities, serves as an institutional mechanism for the FDIC and the Federal Reserve to work together through the

Title I resolution planning process to ensure some engagement between the prudential supervisor of the SIFIs and the resolution authority. He stated that, in 2008, the FDIC had very limited authorities—none at all over nonbank financial companies, limited authorities over bank holding companies, and no resolution authority over the holding company or affiliates of a bank regardless of how large or complex the institution—and no planning process or international engagement on cross-border issues, which made it very difficult to handle the crisis. Noting that the landscape today is very different than the one that existed four years ago but remains a work in progress, he emphasized that meaningful progress has been made to identify and respond to a crisis as it develops and the FDIC is in a much stronger position today than four years ago if it has to deal with a failed institution. On that point, Mr. Volcker agreed that significant progress has been made if the failure of an individual SIFI is envisioned, but he noted that the more likely scenario is a systemic problem in which this resolution procedure would have to be applied to multiple failing SIFIs. Mr. Tucker replied that that position is only a strong argument if the argument is made that an idiosyncratic failure will never occur. Citing some historical examples, such as Midland Bank and Continental Illinois, he emphasized that idiosyncratic failures do occasionally arise and that, if they can be resolved with an approach that puts the losses onto bondholders, it will increase market discipline and reduce the probability of wider systemic problems.

Mr. Wigand next indicated that the last agenda topic for the meeting is the Title I resolution plan review process. After introducing Barbara J. Bouchard, Senior Associate Director, Division of Supervision, Federal Reserve, Mr. Wigand stated that he would provide a brief background of Title I and the related rulemaking, and then Ms. Bouchard would describe the Title I resolution plan review process. He first explained that Title I currently applies to bank holding companies with assets greater than $50 billion and any nonbank financial companies designated by the Financial Stability Oversight Council as systemically important, requiring these covered companies to submit living wills—plans for rapid and orderly resolution under the U.S. Bankruptcy Code in the event of material financial distress or failure. He advised that the FDIC and the Federal Reserve jointly issued a final rule in November 2011 to implement the requirement for the resolution plans; that the FDIC and the Federal Reserve are currently in the process of reviewing the first round of plans; and that the plans must be submitted annually or in the event of a substantial material

change to the company or, in some cases, more frequently. He also noted that the companies would be required to resubmit and refresh those plans because the markets are dynamic and institutions may change in ways that affect how they would be resolved on a certain date. Recalling the morning session's discussion on international cooperation, he explained that many of the resolution implementation obstacles with an international dimension are also present domestically; that one of the key objectives associated with the initial round of plans is to identify resolution impediments—such as unwinding derivatives, netting out close-out positions, and dealing with misalignment of functions and operations with legal entities—to provide a more granular institution-specific analysis; and that 11 of the largest firms have submitted plans in the first round of filers.

Ms. Bouchard then briefly described the Title I plan review process, noting that it is a two-part process involving: (1) a 60-day completeness review to ensure that all of the regulatory requirements were addressed; and (2) an evaluation of each plan's content and analysis—vertically firm by firm and horizontally across issues to compare the firms. She advised that certain assumptions were provided to the firms, including the following: an idiosyncratic failure occurs; the firm's failure does not significantly disrupt the market because other participants assume parts of the businesses; the firm has no access to unsecured funding; there is no extraordinary government support; and that all material entities fail. She reported that the strategies presented by the firms included: sale of the whole company or specific legal entities; liquidation of assets or wind-down of positions and operations; FDIC receivership for the insured depository institutions; and an orderly closeout of positions at broker-dealers. She also reported that the firms identified a number of impediments to resolution, including several impediments that presented challenges to many of the firms such as: management information systems' limitations on the ability to aggregate data at the legal entity level; uncertainty with respect to international regimes and actions; and liquidity needs and funding mechanisms. She concluded by noting that the next steps include the FDIC and the Federal Reserve providing feedback to the firms on their 2012 plans, as well as additional guidance on acceptable or unacceptable assumptions and strategies. Mr. Wigand then opened the floor to comments and questions from the Committee members.

Mr. Herring asked if the international aspects of the resolution plans would be shared with the FSB Crisis Management Groups. In response, Mr. Simonson indicated that the FDIC's discussions with the FSB Crisis Management Groups are currently more focused on the Title II strategies for those firms; and that it may be difficult to compare the firm-developed Title I resolution plans with the resolution plans for other jurisdictions, which are developed by those jurisdictions' resolution authorities. Mr. Tucker offered several observations on the Title I plans, noting that it is difficult to understand the relationship between Title I and Title II, and that, based on inquiries he has received regarding uncertain international regimes and actions as one of the assumptions, it appears some of the firms going through the Title I process have been confused; that the Title I plan is an essay that many firms are destined to fail because of the constraints put on them in order to set up the conditions for the exercise of Title II; that there would need to be changes to U.S. bankruptcy law and international bankruptcy law for other host countries, because a U.S. bankruptcy judge cannot plan *ex ante* with a bankruptcy judge in the U.K. or another jurisdiction; and that the challenge is determining how to set the discretionary constraints on the Title I essay question in a way that yields the most useful information for Title II resolution planning, but does not confuse either the firms or their bondholders and other creditors. Noting that a substantial amount of work has been done to deal with an idiosyncratic failure, Mr. Volcker indicated that, even if the possibility of a more systemic threat has not been eliminated, the FDIC is clearly in a much better position to handle a systemic crisis than it was in 2007 and 2008 because it now has the ability to provide liquidity support, arrange for recapitalization, and stabilize the situation.

Mr. Johnson indicated that a major change in the FDIC's ability to handle a systemic problem is the ability to provide liquidity support to different structures—not just to banks—and more tools for restructuring and replacing management. With respect to Title I, he suggested that part of legislative intent reflected in the Title I process is that the regulators can require structural or operational changes if they find something in the firm's Title I plan that would be an impediment to a Title II resolution; and that simplifying the legal structures of these companies to remove the discrepancies between functional organization and legal organization would help to simplify the Title II resolution process. Ms. Bouchard responded by noting that the whole Title I planning process has

been a useful mechanism to help the firm examine their structure and evaluate why they have that structure; and that, ultimately, those are the kinds of issues and options the FDIC is considering as it goes through this process. In response to Mr. Herring asking whether some of the firms have at least taken tentative measures to simplify their structure, Mr. Wigand advised that virtually all of the firms that filed the first round of plans have indicated that going through the Title I exercise and identifying impediments for resolution has informed them of inefficiencies they have as going concerns, as well as additional rationalization they need in their operations. He emphasized that whether or not structural simplification actually improves resolvability or what specific measures are necessary to improve resolvability remain open questions. Mr. Wall advised that, to the extent the firms make changes through the Title I process, it is important to ensure that those changes do not constitute greater impediments for the Title II process. In reference to the FDIC having more tools available for a resolution, Mr. Kohn expressed the opinion that a key tool is the *ex ante* commitment to bail-in long term creditors—at least at the holding company level—and that, hopefully, it facilitates a commitment from the regulators to make sure there is a sufficient amount of debt at the holding company level to make this thing work, because that is the source for capital that facilitates obtaining funding for the operating subsidiaries. In a follow up to Mr. Kohn's point, Mr. Johnson asked if rules are being proposed regarding how much capital there must be in relation to potential losses, as well as who holds that capital. Ms. Bouchard responded by advising that the FDIC does have the authority to impose that kind of requirement at the holding company level and is actively engaged in discussions on those issues to ensure that any such requirement fulfills the Title II needs.

In bringing the meeting to a close, Chairman Gruenberg thanked Mr. Tucker and the Committee members for their contributions, noting that their input is enormously valuable to the FDIC. Emphasizing that there are significant challenges that should not be underestimated, he stressed that substantial progress has been made from where the FDIC was in 2008, and that the framework in which the FDIC is operating today is really quite different; that there are challenging new issues relating to these global systemic institutions, including issues that are beyond the authorities in current laws which will be the subject of debate and discussion; and that, regardless of the outcome of that debate and discussion, there are authorities in place today that are very important and relevant for dealing with the issues

of these companies. He concluded by advising that both the Title I authorities relating to the resolution plans that the companies themselves must submit and the FDIC's new authorities under Title II should be utilized as effectively as possible.

There being no further business, the meeting was adjourned at 3:12 p.m.

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
and Committee Management Officer
FDIC Systemic Resolution Advisory
Committee

Minutes

of

The Meeting of the Systemic Resolution Advisory Committee

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

December 10, 2012 - 8:53 A.M.

I hereby certify that, to the best of my knowledge, the attached minutes are accurate and complete.

Martin J. Gruenberg
Chairman
Board of Directors
Federal Deposit Insurance Corporation