April 8, 2010

TO: Board of Directors

FROM: Sandra L. Thompson
Director
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SUBJECT: Special Reporting, Analysis and Contingent Resolution Plans at Certain Large Insured Depository Institutions – Notice of Proposed Rulemaking

EXECUTIVE SUMMARY

This recommends that the Board approve publication of a proposed rule that would require certain identified insured depository institutions that are affiliates of large and complex financial companies to submit to the FDIC analysis, information, and plans that address and demonstrate the insured institution's ability to be separated from its parent structure, and to be wound down or resolved in an orderly fashion. Following standards set forth in the proposed rule, and subject to the FDIC's review and validation, covered insured depository institutions would submit information and contingent resolution plans that would allow the FDIC to assess the risks posed to the deposit insurance fund and to develop effective resolution strategies and conduct contingency planning for a period of severe financial distress.

RECOMMENDATION

The Division of Supervision and Consumer Protection and Division of Resolutions and Receiverships recommend that the Board of Directors authorize publication of the attached Notice of Proposed Rulemaking in the *Federal Register* for a 60-day comment period.

DISCUSSION

The FDIC is charged by Congress with the very large and critical responsibility of insuring the deposits of banks and thrifts in the United States, and with serving as

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receiver of all such institutions if they should fail. As of December 31, 2009, the FDIC insured approximately $4.75 trillion in deposits in more than 8,000 depository institutions. In implementing the deposit insurance program, and in efficiently and effectively resolving failed depository institutions, the FDIC contributes importantly to the vital goal of maintaining public confidence in the banking industry in the United States. In its efforts to achieve this objective and to implement its insurance and resolution functions, the FDIC requires a complete and comprehensive understanding of the organization, operation and business practices of banks and thrifts in the United States, with particular attention to the nation's largest and most complex insured depository institutions affiliated with complex financial companies, which account for nearly half of the FDIC's insurance risk.

The Federal Deposit Insurance Act gives the FDIC broad authority to carry out these critical responsibilities assigned to it by Congress, and to obtain the information required by the proposed regulation. The basic authority for the regulation is provided by Section 9(a) Tenth of the FDI Act, 12 U.S.C. §1819(a)Tenth, authorizing the FDIC to prescribe, by its Board of Directors, such rules and regulations as it may deem necessary to carry out the provisions of the FDI Act or of any other law that the FDIC is responsible for administering or enforcing. The FDIC also has authority to adopt regulations governing the operations of its receiverships pursuant to Section 11(d)(1) of the FDI Act, 12 U.S.C. 1821(d)(1). Collection of the information required by the regulation is also supported by the FDIC's broad authority to conduct examinations of depository institutions to determine the condition of the IDI, including special examinations (12 U.S.C. § 1820(b)(3). A failure of an IDI to provide the information required by this regulation would constitute a regulatory violation that would allow the FDIC to initiate the process of deposit insurance termination (12 U.S.C. § 1818(a)(2)), or lead to use of backup enforcement authority of the FDIC under 12 U.S.C. § 1818(t).

The proposed regulation requires a limited number of large insured depository institutions to provide the FDIC with essential information concerning their structure, operations, business practices and financial responsibilities and exposures. Approximately forty (40) insured depository institutions would be required to submit annual contingent resolution plans. The parent companies for these forty (40) institutions possess total assets of $8.3 trillion, and hold approximately 47.9% of all deposits insured by the FDIC. The proposed regulation requires these institutions to develop and submit specific information and plans demonstrating how such depository institutions could be separated from their affiliate structure and wound down in an orderly and timely manner in the event of receivership. The FDIC will review the plan in consultation with appropriate primary Federal regulator(s) and the institution to ensure the plan is effective, workable and satisfactory. The proposed rule responds to and complements ongoing international and domestic initiatives and recommendations to enhance financial stability.

The information and plans that would be obtained through this regulation is needed because these large IDIs reside within bank, thrift and financial holding company structures that include an extensive network of affiliated companies offering both financial and non-financial products and services. Management and operation of these complex entities is typically organized along business lines, rather than by legal entity. Key decisions affecting the IDI, and key services or functions relating to the IDI, are often made or provided outside the

IDI, by parent companies or affiliates of the IDI. Complex financial and other interrelationships within such groups (for example, guaranties, derivatives trades, contractual commitments, service agreements, information technology agreements, staffing allocations, human resource and related administrative support ties) create further interdependencies that can significantly impact resolution strategy and the conduct of an orderly and timely resolution. IDIs often rely upon affiliates for the provision of critical operations and services, without which the IDI cannot continue to smoothly function, which in a resolution context threatens the IDI's franchise value, impairs the FDIC's ability to conduct an effective resolution, and poses unacceptable risks to the DIF. These complexities make it extremely difficult, if not impossible, for the FDIC to fully understand – and control – the concentrated insurance risks presented by these large institutions.

Further complications result from the presence of distinct statutory insolvency regimes, specific to the various legal entities within the conglomerate, which often have different, and sometimes competing, goals. Insured banks and thrifts are subject to the FDI Act and are resolved by the FDIC. The insolvency of bank, thrift and financial holding companies and most of their non-insured financial subsidiaries are subject to the Bankruptcy Code. These competing regimes result in disputes over assets, intra-affiliate claims and litigation, and can increase the cost of the resolution and impair its efficiency. The information and plans that would be obtained through this regulation would materially aid the FDIC in understanding and controlling its insurance risks, and in effectively and efficiently resolving these large institutions if that becomes necessary.

CONCLUSION

Assessment of FDIC's insurance risk and planning for resolution of covered IDIs require access to timely, complete and accurate information regarding the nature and structure of the IDI within the organization as well as its ability to extract and separate itself from its parent structure in contemplation of failure. These information and contingency planning requirements are the foundation for meaningful risk assessment and analysis of IDI franchise value, least-cost resolution strategies, strategies to mitigate systemic risks and overall planning for an orderly resolution in the possible event of failure. The recent financial crisis has demonstrated that the risk of insolvency to an IDI can arise quickly, and that preparedness and planning must be conducted on an ongoing basis, before problems become evident, and not merely in response to after-the-fact supervisory indicators.

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