DATE:	October 11, 2022
MEMORANDUM TO:	Board of Directors
FROM:	John P. Conneely, Director Division of Complex Institution Supervision and Resolution
SUBJECT:	Advanced Notice of Proposed Rulemaking entitled "Resolution-Related Resource Requirements for Large Banking Organizations"

Summary: In response to the global financial crisis of 2007-2008, the Federal Deposit Insurance Corporation (FDIC) and Board of Governors of the Federal Reserve System (FRB) (Agencies) promulgated rules and guidance, both jointly and individually, to support the orderly resolution of large banking organizations.[1] While currently there are regulatory requirements for long-term debt (LTD) at holding companies of certain global systemically important banking organizations (GSIBs), the Agencies are now exploring whether requiring additional ex ante financial resources, such as qualifying forms of LTD, would improve the prospects for successful resolution of other large banking organizations as well.

Staff is presenting for the approval of the FDIC Board of Directors (FDIC Board) the attached Advanced Notice of Proposed Rulemaking entitled "Resolution-Related Resource Requirements for Large Banking Organizations" (ANPR), seeking public feedback on various aspects related to the concept of a LTD requirement for certain large banking organizations. The Agencies are

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[1] *See*, e.g., 12 CFR Part 381, 12 CFR Part 252, 12 CFR Part 382, 12 CFR § 360.10, and Federal Reserve SR No. 14-8 (Sept. 25, 2014). Certain of these rules and related guidance are tiered based on the complexity and risks of different banking organizations: the most stringent rules apply only to U.S. global systemically important bank holding companies (U.S. GSIBs) and include requirements to submit a resolution plan every two years, follow a "clean-holding company" requirement that prohibits top-tier holding companies from entering certain financial arrangements (such as short-term borrowings or derivatives contracts) that might impede orderly resolution, adopt resolution-related stay provisions in qualified financial contracts (for example, establishing a set period of time during which a party to a qualified financial contract is restricted from terminating, liquidating, or netting such contract in the event of resolution), and maintain minimum outstanding amounts of total loss-absorbing capacity (TLAC) and long-term debt. The FRB has issued supervisory guidance on recovery planning that applies to GSIBs. The FDIC also has issued a rule to require certain covered insured depository institutions (CIDIs) to periodically submit resolution plans to ensure that the FDIC can effectively carry out its responsibilities for the resolution of a CIDI in the event that it is appointed receiver under the Federal Deposit Insurance Act (FDI Act).

interested in public comment on how a LTD requirement and potentially other elements of resolution-related policies and standards applied to GSIBs and other large banking organizations, such as the clean holding company requirement, could be applied to a range of large banking organizations to, among other things, enhance the FDIC's options to resolve these institutions in a manner that reduces the risk of disorderly resolution and the potential impacts on financial stability, and how these policies might be structured to achieve those goals most effectively.

Recommendation: Staff requests that the FDIC Board approve the ANPR and authorize its publication in the *Federal Register* with a comment period ending 60 days after publication, and authorize the General Counsel, or designee, and the Executive Secretary, or designee, to make technical, non-substantive or conforming changes to the text of the draft *Federal Register* document to prepare for publication.

While the ANPR requests comments on a number of issues, as discussed below, the following subjects are major areas of focus for the FDIC Board's consideration and for public comment.

Scope

In this ANPR, the agencies are focused on domestic large banking organizations in Categories II and III,[2] which generally exceed a threshold of $250 billion in total consolidated assets. However, it contains questions related to, among other things, alternative approaches to scope and how and whether any new requirement should be applied to the U.S. subsidiaries of foreign banking organizations.

Long-Term Debt

The FRB adopted certain rules for U.S. top-tier bank holding companies to maintain outstanding minimum loss-absorbing instruments, including a minimum amount of LTD, and clean holding company requirements. These current LTD requirements were designed to ensure that U.S.

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[2] Category II banking organizations have $700 billion or more in average total consolidated assets or $75 billion or more in cross-jurisdictional activity. Category III banking organizations have between $250 billion and $700 billion in average total consolidated assets or $75 billion or more in off-balance sheet exposures, nonbank assets, or short-term wholesale funding. *See* 12 CFR 252.5(c), (d).

GSIBs maintain greater loss-absorbing capacity on a "gone-concern" basis in resolution and have resources available to recapitalize subsidiaries and maintain continuous operations even as the parent enters bankruptcy (as would be the case in a Single Point of Entry (SPOE) resolution). They enable proceeds of loss-absorbing instruments issued at the holding company level to be down-streamed to subsidiaries in a pre-positioned fashion (including through the purchase of LTD issued by such subsidiaries), as well as to be made available on a flexible incremental basis where called for under stress.

Although some portion of going-concern regulatory capital might in certain circumstances remain available to absorb losses after a firm has entered resolution, LTD requirements would address the fact that the firm's regulatory capital, and especially its equity capital, is highly likely to have been significantly or completely depleted in the lead-up to a resolution or bankruptcy. While the current LTD requirement applicable to U.S. GSIBs was designed with the SPOE resolution strategy in mind, it is possible that for other large banking organizations an appropriately adapted form of LTD requirement is needed to preserve options for an FDIC-led resolution of an insured depository institution (IDI) under the FDI Act.

These rules have been effective in bolstering the resources available for resolution to ensure that the amount of total loss absorbing capacity held by a company would be commensurate with its overall risk profile among U.S. GSIBs and certain other U.S. holding companies of GSIBs. Exploring this type of requirement for certain large banking organizations, including at the level of the insured depository institution subsidiary, could be useful in keeping various resolution options open for the FDIC to resolve a subsidiary IDI in a way that minimizes the long-term risk to financial stability and preserves optionality for resolving a large IDI across a range of scenarios in a manner that is least-costly to the Deposit Insurance Fund (DIF).

Large Banking Organizations

For the vast majority of bank resolutions, the FDIC pursues a strategy of selling the failed IDI to another depository institution, as this is generally least costly to the DIF and minimizes disruption to local communities and to the financial system. The criteria used by the FDIC to select potential bidders include asset size, capital level, regulatory ratings, geographic location,

and minority-owned status. The challenges associated with the acquisition of a large, failed IDI would be significant, both operationally and financially; as a result, only the largest of banks (including GSIBs) would have the capacity to make such an acquisition. While size alone limits options and increases the potential of possible negative impacts in the resolution of an IDI, other complexities presented by some large banking organizations create risks from and impediments to resolution of the IDI, including significant international operations requiring cross-border cooperation, and material operations, assets, liabilities and services outside the bank chain. These complicating features can raise challenges due to multiple competing insolvencies, discontinuity of operations, and the destruction of value, and result in a disorderly and costly resolution.

While the majority of institutions that the FDIC has resolved have been relatively small in size, experience has shown that the failure of a larger institution without significant non-deposit liabilities can have an outsized impact on the DIF. For example, the 2008 failure of IndyMac Bank (IndyMac) resulted in losses to the DIF of approximately 40 per cent of the asset size of the institution. While IndyMac had assets of only about $30 billion, a failure of a large banking organization would have been catastrophic to the DIF. On the other hand, the failure of Washington Mutual Bank (WaMu), also in 2008, the largest resolution ever undertaking by the FDIC resulted in minimal costs to the DIF. This is due in large part to the fact that WaMu had significant long-term debt outstanding at the time of failure. In addition to facilitating a whole bank resolution over a weekend such as the WaMu resolution, the availability of loss-absorbing resources at the depository institution will protect deposits and thereby increase the likelihood that a transfer to a bridge depository institution to preserve franchise value would be less costly to the DIF and less disruptive to the financial system and local communities than a liquidation of the IDI and a payout of insured deposits. Use of a bridge depository institution enhances the FDIC's ability to pursue options that could involve breaking up the institutions for sale to multiple acquirers, and/or spinning off some remaining streamlined operations as a restructured entity with ongoing viability depending on which strategy is most desirable.

For these reasons, staff recommends including comments requested in the ANPR concerning the universe of institutions that would be appropriate. We recognize the need for rules to be tailored

to the range of IDIs that may be appropriately scoped into a future rulemaking. Staff foresees developing an approach, in conjunction with the FRB, that will both address the risks to the DIF that are intended to be minimized while balancing the cost and other burdens associated with any such requirement for LTD.

Conclusion

Staff recommends that the FDIC Board (1) approve the attached ANPR and authorize its publication in the *Federal Register* with a comment period ending 60 days after publication and (2) authorize the General Counsel, or designee, and the Executive Secretary, or designee, to make technical, non-substantive or conforming changes to the text of the draft *Federal Register* documents to prepare for publication.

Concur:

Harrel M. Pettway
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CISR
Andrew J. Felton, Deputy Director, Systemic Risk Branch
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David Wall, Assistant General Counsel, Complex Financial Institutions

Attachments:
(1) Board Resolution
(2) Proposed *Federal Register* notice