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Introduction

It is a pleasure to be here this evening. I want to thank the Volcker Alliance for arranging this program and Jones Day for serving as host. I especially want to thank Chairman Volcker for honoring me with the invitation to address this distinguished audience. As suggested, my remarks will focus on the development of the FDIC's strategy under the Dodd-Frank Act for the resolution of large, systemically important financial institutions, including the progress we have made internationally.

Broadly speaking, prior to the recent crisis, the major national authorities here and abroad did not envision that these large, systemically important financial institutions (SIFIs) could fail, and thus little thought was devoted to their resolution. These SIFIs, although large and complex, were diversified and operated in global markets, putting them, it was thought, at a low risk of failure. It was assumed that, should problems arise, these global SIFIs would have access to the financial markets with the ability to raise large amounts of equity or debt. In hindsight, that proved to be a mistaken assumption. After Lehman Brothers filed for bankruptcy in 2008, market liquidity dried up and the capital markets were unwilling to provide additional capital to financial firms whose viability appeared uncertain.

In retrospect, the major countries of the world were unprepared for the challenge they faced. When failing, these global SIFIs required not only a forceful national response but also close cross-border communication and cooperation among home- and host-country regulators. The necessary national authorities and cross-border arrangements simply did not exist.

Over the intervening years, U.S. regulators, foreign regulators, and the Financial Stability Board of the G-20 on a multilateral basis have tried to come to grips with these issues that were not well appreciated in 2008. In my remarks, I will describe the progress the FDIC has made in developing a resolution strategy for these SIFIs. I also will briefly discuss the progress we have made toward international cooperation in planning to successfully resolve a globally active SIFI. In order to place this in perspective, let me outline the new authorities the FDIC received under the Dodd-Frank Act.

The Dodd-Frank Act

When the financial crisis developed in 2008, the FDIC's receivership authorities were limited to federally insured banks and thrift institutions. The FDIC lacked the authority to place the holding company or affiliates of an insured depository, or any other non-bank financial company like Lehman Brothers that might pose a risk to the financial system, into an FDIC receivership. The G-SIFIs were, of course, complex, highly integrated global companies. Resolution authority limited to the insured depository was wholly inadequate to deal with their orderly resolution. In addition, since the possibility of failure of these companies was not

seriously contemplated, there was no planning for their resolution. The only option available for failure was the bankruptcy process, which was equally unprepared to handle the failure of a SIFI as was demonstrated by the Lehman Brothers case. This left extraordinary public support to these firms on an open institution basis as the last resort to mitigate further damage to the financial system and the economy.

To address these critical gaps in authority, the Dodd-Frank Act signed in July 2010 provided significant new authorities to the FDIC and other U.S. regulators to effectively plan for and manage the orderly failure of a SIFI. Title I of the Act requires all bank holding companies with assets over $50 billion, as well as non-bank financial companies designated as systemic by the Financial Stability Oversight Council, to prepare resolution plans, or "living wills," to demonstrate how they would be resolved in a rapid and orderly manner under the Bankruptcy Code in the event of material financial distress or failure. Title II of the Act provides the FDIC with a back-up authority to place a failing SIFI, including a consolidated bank holding company or a non-bank financial company deemed to pose a risk to the financial system, into an FDIC receivership should an orderly resolution under the Bankruptcy Code not be possible.

Title I – Living Wills

I'd like to first discuss the living will process. As I indicated, U.S. SIFIs present a challenge to resolution in bankruptcy or under an FDIC receivership because they are organized under a holding company structure with a top-tier parent and operating subsidiaries that comprise

hundreds, or even thousands, of interconnected entities that span legal and regulatory jurisdictions across international borders and share funding and critical support services.

Title I of the Dodd-Frank Act provided new authority intended to make these companies more resolvable under the Bankruptcy Code. Title I requires all covered companies, holding companies with over $50 billion in assets and designated non-bank financial companies - to prepare a resolution plan, often referred to as a "living will" to demonstrate that the firm could be resolved under the Bankruptcy Code. The Title I process is jointly overseen by the FDIC and the Federal Reserve Board of Governors.

Following review of the initial resolution plans received in 2012 from the 11 largest, most systemically significant SIFIs, the Federal Reserve and the FDIC developed guidance which provided benchmarks for the firms to address in their second-round resolution plans that were submitted on October 1st. The benchmarks included global cooperation with foreign regulators, multiple insolvencies of subsidiaries, counterparty derivative actions, maintenance of critical operations, and funding and liquidity. The firms were required to provide analysis to support the strategies and assumptions contained in the resolution plans. These revised plans, as I indicated, have now been submitted and will be evaluated by the agencies under the standards provided in the statute.

Title II –Orderly Liquidation Authority

Although the statute makes clear that bankruptcy is the preferred resolution framework in the event of the failure of a SIFI, Congress recognized that a SIFI may not be resolvable under bankruptcy without posing a systemic risk to the U.S. financial system and economy. Title II provides broad new back-up authorities to place any SIFI into an FDIC receivership process if no viable private-sector alternative is available to prevent the default of the financial company and if a resolution through the bankruptcy process would have serious adverse effects on U.S. financial stability.

In the three years since the passage of Dodd-Frank, the FDIC has concentrated its efforts on developing the capability to carry out a successful resolution under Title II. We have, I believe, developed a viable strategy, the Single Point of Entry (SPOE), under which the FDIC would take control of the parent holding company, allowing the firm's operating subsidiaries, domestic and foreign, to remain open and operating, diminishing contagion effects while removing culpable management and imposing losses on shareholders and unsecured creditors with no cost to the taxpayer.

Let me outline briefly how we envision this process playing out.

As you may know, the Dodd-Frank Act requires recommendations by two-thirds vote of the Federal Reserve Board and the FDIC Board and a determination by the Treasury Secretary, in consultation with the President, in order to invoke the Title II authorities which could be applied to any financial company whose failure is deemed to pose a risk to the financial system.

Once approved, the FDIC, in order to implement the single point of entry strategy, would place the holding company of the failed institution into an FDIC receivership. The FDIC would then organize a bridge financial holding company, as authorized by the Dodd-Frank Act, into which it would transfer assets from the receivership, leaving the liabilities behind.

The newly formed bridge financial holding company would continue to provide the holding company functions of the failed parent. The company's subsidiaries would remain open and operating, allowing them to continue critical operations and avoid the disruption that would otherwise accompany their closings.

Under the Dodd- Frank Act, officers and directors responsible for the failure cannot be retained and would be replaced. The FDIC would appoint a board of directors and would nominate a new chief executive officer and other key managers from the private sector to replace officers who have been removed. This new management team would run the bridge financial company under the FDIC's oversight during the first step of the process.

During the resolution process, restructuring measures would be taken to address the problems that led to the company's failure. These could include changes in the company's businesses including shrinking those businesses, breaking them into smaller entities, and/or liquidating certain subsidiaries or business lines or closing certain operations. An explicit objective of the Title II process would be the restructuring of the firm into one or more smaller companies that could be resolved under bankruptcy without causing significant adverse effect to the U.S. financial system or economy.

From the outset, the bridge financial company would be created by transferring sufficient assets from the receivership to ensure that the bridge company is well-capitalized. The well-capitalized bridge financial company should be able to fund its ordinary operations through customary private market sources. The FDIC's explicit objective is to ensure that the bridge financial company can secure private sector funding as soon as possible after it is established.

The Dodd-Frank Act does provide for an Orderly Liquidation Fund (OLF) managed by the FDIC using the proceeds of obligations issued by the Treasury to serve as a back-up source of liquidity support that would only be available on a fully secured basis. If needed at all, the FDIC anticipates that OLF borrowings would only be issued in limited amounts for a brief transitional period in the initial phase of the resolution process and would be repaid promptly once access to private funding resumed. Any OLF borrowing must be repaid either from recoveries on the assets of the failed firm or, in the unlikely event of a loss on the collateralized borrowings, from assessments against the largest financial companies. The law expressly prohibits taxpayer losses from the use of the Title II authority.

During the operation of the bridge, losses would be calculated as the assets of the failed company are marked to market. These losses would be apportioned according to the order of statutory priority among the claims of the former shareholders and unsecured creditors of the firm, whose equity, subordinated debt and unsecured debt remained in the receivership. If the assets of the parent company were not sufficient to absorb the losses, then creditors at the

subsidiary level would be at risk. Of course, under any circumstances insured depositors will be protected.

Through a securities for claims exchange, the claims of creditors in the receivership would be satisfied by issuance of securities representing debt and equity of the new company or companies that would be created from the bridge holding company. In this manner, debt in the failed company would be converted into equity that would serve to ensure that the new operations of the new company or companies would be well capitalized.

This strategy will only be successful if there is sufficient debt and equity at the holding company to both absorb losses in the failed firm and fully capitalize the newly privatized companies. That happens to be the way the largest U.S. firms are currently structured, but this strategy would obviously give these firms an incentive to change that structure. The Federal Reserve, in consultation with the FDIC, is currently developing a proposed rulemaking to require a minimum amount of unsecured holding company debt to address this issue.

The FDIC's objective is to limit the time during which the failed SIFI is under public control and expects the bridge financial company to be ready to execute its debt for equity exchange within six to nine months. Execution of this exchange will result in termination of the bridge financial company's charter and establishment of one or more new, well capitalized companies under private ownership and management.

This description of our resolution strategy is a simple overview of a complex process, describing how it would address key issues of liquidity, capital, restructuring, and governance. These issues, as well as others, would benefit from broader review and discussion. With this in mind, the FDIC plans to release later this year a fuller description of this resolution process for public comment.

International Cooperation and Coordination

Given the global operations of our largest, most systemically important financial institutions, a threshold issue and priority for the FDIC for effective SIFI resolution is cross-border cooperation and coordination with foreign regulatory authorities. It is critical that home and host jurisdictions understand well the approach to resolution of their counterpart and work together to develop a cooperative approach to the orderly resolution of the failed company.

A review of the foreign operations of our major institutions makes clear that for the United States the starting point for cross-border cooperation has to be the United Kingdom. The FDIC estimates that nearly seventy percent of the on and off balance sheet assets of our major institutions are held in the UK. There is no close second. As a result establishing a close working relationship with the UK authorities – initially the Bank of England and the Financial Services Authority and now the Bank of England - was our first priority. The development of this relationship was greatly facilitated by the fact that when we sat down with the UK authorities to discuss cross-border cooperation on SIFI resolution, we found that we both had determined that the single point of entry approach appeared to be the most viable strategy for the resolution of

our respective systemically important financial institutions. As a result we were able relatively quickly to move to joint resolution planning on our institutions of common interest. The working relationship that we developed was such that last December the FDIC and the Bank of England were able to release a joint paper outlining our common approach to SIFI resolution. If I may say the collaboration continues to deepen at both the staff and principal level. We are planning a staff level cross border tabletop exercise later this year and hope to organize a principal level exercise next year.

We are also in the process of developing close working relationships with two other key foreign jurisdictions – Switzerland and Germany. We have had significant principal and staff level engagements with the responsible authorities in both jurisdictions, FINMA in the case of Switzerland, BAFIN in the case of Germany. Interestingly both jurisdictions have come to the conclusion that the single point of entry strategy is the most viable approach to the resolution of their SIFIs. We have discussed developing joint papers with both jurisdictions, similar to the one with the UK, as well as conducting cross border table top exercises and exchanging detailees. It is my observation that SIFI resolution has been made a high priority in both jurisdictions and they share a strong interest in developing a close working relationship with the FDIC.

The FDIC and the European Commission, I would note, have established a joint working group made up of senior executives from our respective organizations to focus on both resolution and deposit insurance issues. The agreement establishing the working group provides for meetings twice a year, one in Brussels and one in Washington, with electronic interchanges in between and the exchange of detailees. There have been two meetings held this year, the most

recent in Brussels last month. We have had detailed discussions with EC officials on the FDIC's experience with resolution and deposit insurance as well as our SIFI strategy. In turn we have had in depth discussions with the EC on their pending EU Recovery and Resolution Directive as well as the EC's proposal for a European Resolution Mechanism.

In regard to Japan, the Japanese Parliament recently enacted legislation to provide resolution authorities comparable to those provided in the Dodd-Frank Act and the pending European Directive. We have engaged actively with the Japanese authorities and will sign a memorandum of understanding on resolution in the near future. I would note that we will also shortly be signing an MOU on deposit insurance and resolution cooperation with China as well.

Finally, I should mention, in addition to our bilateral relationships, the important work of the Financial Stability Board of the G-20, which has made cross border resolution a top priority. The Resolution Steering Group of the FSB, of which the FDIC is a member, developed the first international standards for cross-border resolution, the Key Attributes of Effective Resolution Regimes, and is now in the process of developing a methodology for their implementation. The FSB has also established Crisis Management Groups for each of the G-SIFIs, which brings together regulators on a multilateral basis to discuss cross border cooperation on particular institutions.

Conclusion

The concluding point I would like to make is that there has been a quiet transformation in the aftermath of this recent crisis in the approach nationally and internationally to this challenging issue of SIFI resolution. From a position prior to the crisis where this was not an issue of attention or concern, it has risen to a matter of high priority for national and regional jurisdictions, as well as multilateral organizations. I would suggest that the recent crisis has produced a sea-change globally in how jurisdictions view the risks posed by G-SIFIS and a determination to develop alternatives to the provision of open-ended public support to address their potential failure.

Until an orderly failure of a G-SIFI is actually managed, there will no doubt continue to be skepticism about the capability and will of regulatory authorities to impose the consequences of failure on the shareholders, unsecured creditors, and managers of these firms. I would note, however, recent indications by rating agencies of the possibility of downgrades of some of these companies because of a reduced expectation of public support in the event of failure are a promising sign.

I believe through the authorities provided in the Dodd-Frank Act, both for resolution plans for these firms under Title I and the resolution authorities under Title II, as well as the progress we are making on cross-border cooperation, that we can have a different scenario for these firms the next time around.

Thank you.