David Schraa
Regulatory Counsel

INSTITUTE OF INTERNATIONAL FINANCE

February 18, 2014

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: **FDIC's Notice and Request for Comments on the Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy (FR Docket No. 2013-30057)**

To the Federal Deposit Insurance Corporation:

The Institute of International Finance (the "IIF") has consistently been supportive of a strong, internationally consistent resolution regime for large banks, along the lines of the Financial Stability Board's *Key Attributes of Effective Resolution.*[1] The Notice titled *Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy*,[2] published by the Federal Deposit Insurance Corporation (the "FDIC"), is a significant contribution to making the vision of the *Key Attributes* real, providing a sound basis for international coordination of resolution, carrying out the purposes of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), removing moral hazard from the system, and ending Too Big to Fail ("TBTF") so taxpayers will never be at risk in the future.

Furthermore, the finalization of the FDIC's single point of entry strategy (the "SPOE Strategy") will have an important educational function, making clear to the market the fundamental facts of the Orderly Liquidation Authority ("OLA") – for example, that the OLA provides a well-organized process to marshal a bank's private capital resources to address major future crises in a way that preserves overall financial stability and avoids the need for a taxpayer "bail-out."[3]

[1] *See, e.g.*, IIF, *Making Resolution Robust – Completing the Legal and Institutional Frameworks for Effective Cross-Border Resolution of Financial Institutions*, June 2012.
[2] Federal Deposit Insurance Corporation, *Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy*, 78 Fed. Reg. 76,614 (Dec. 18, 2013).
[3] The term "bail-out" refers to any transfer of funds from public sources to a failed firm or a commitment by a public authority to provide funds with a view to sustaining a failed firm that results in benefits to the shareholders or uninsured creditors of that firm, or the assumption of risks by the public authority that would otherwise be borne by the firm and its shareholders, where the value of the funds transferred is not recouped from the firm, its shareholders and unsecured creditors or, if necessary, the financial system more widely, or where the public authority is not compensated for the risks assumed. *See* Financial Stability Board, *Thematic Review on Resolution Regimes: Peer Review Report*, Apr. 11, 2013, at 2.

The FDIC should confirm the SPOE Strategy in as clear and authoritative a manner as possible in order to maximize these benefits.

We are delivering these comments to meet the FDIC's originally announced due-date under the Notice. However, we appreciate that the deadline has been extended and may take advantage of the extension to supplement this letter in response to subsequent developments. As noted below, we intend to address the crucial issues of debt levels at holding companies after we have had the opportunity to review the Federal Reserve's pending proposals. We also intend to comment on the Financial Stability Board's ("FSB") international proposals on the same issue when and as possible.

I. General Comments

These comments are given from an international perspective. It is critical that the international effects of an SPOE resolution be given full consideration by the FDIC during planning and implementation. Consideration of cross-border effects is called for in the *Key Attributes*.[4] The FDIC Notice acknowledges that more work remains at the international level, despite significant progress, and that finalizing these international issues is critical to ensuring that the SPOE Strategy can be implemented successfully; however, recent developments in several countries and, crucially, the EU constitute major advances.

As a general matter, an effective resolution regime minimizes systemic disruption and avoids taxpayer exposure to losses, while protecting the critical economic functions of a firm in resolution and assuring a fair allocation of losses to claimants. The SPOE Strategy, as described, would achieve this. The FDIC's Notice lays out a process that allocates losses to shareholders and unsecured and uninsured creditors, and ensures the continuity of systemically important services. No public solvency support would be required under the model. The SPOE Strategy defines a process that avoids unnecessary destruction of value and minimizes the systemic consequences of a firm's resolution, while allocating losses appropriately.

As Paul Tucker, the then-Chairman of the Financial Stability Board's Resolution Steering Group, said at the 2013 IIF Annual Meeting, the OLA plus the FDIC's SPOE Strategy create the confidence to say that "Too Big To Fail" has been ended for US firms, and that clarity around other details, including completion of the regime in other locations, such as the European Union, Switzerland, and now Hong Kong, will serve to make the resolution process more secure, effective, and confident.[5]

An important step forward in the development of the international framework has been the recent completion of the Bank Recovery and Resolution Directive (the "BRRD"), which will bring the EU in line with the Financial Stability Board's *Key Attributes of Effective Resolution.* The BRRD will give resolution authorities in all EU member states powers that mirror those given to the US authorities under the Dodd-Frank Act, and there will be significant overlap between the US and European frameworks. The BRRD will be implemented in the Eurozone via the planned Single Supervisory Mechanism (the "SSM"), and the Single Resolution Mechanism (the "SRM"), but the essentials are met by finalization of the

---

[4] *See* Key Attributes 2.3(iv); 7.2, Annex I, 3.2.

[5] *See* Paul Tucker, Deputy Governor for Financial Stability, Bank of England, *Solving too big to fail: where do things stand on resolution*, Speech given at the IIF 2013 Annual Membership Meeting (Oct. 12, 2013) (available at http://www.bankofengland.co.uk/publications/Documents/speeches/2013/speech685.pdf). *See also* Wilson Ervin, "Too big to fail: old myths, new realities," Risk (Feb. 2013); *and* Martin J. Gruenberg, Chairman, FDIC, Remarks to the Volcker Alliance (Oct. 13, 2013); *and* Paul Tucker, *Regulatory Reform, Stability, and Central Banking*, Hutchins Center on Fiscal & Monetary Policy at Brookings (Jan. 16, 2014).

BRRD even if the SSM and SRM take a bit longer to complete. The BRRD, together with appropriate completion of the further work being done by the Federal Reserve and the FSB this year on loss-absorbing capacity, and with pending rules in other countries, will provide a basis for robust cooperation going forward.[6]

Importantly, Article 85 of the BRRD (as discussed further below) allows for the European Banking Authority to recognize the resolution proceedings of a third-country institution and for the national authorities to give effect to those proceedings, including the FDIC's SPOE Strategy. Other provisions of the BRRD, including Article 60 (governing the power to request transfer of property located in third countries) and Title VI generally (on relations with third countries), give greater clarity and understanding of the likely international response to implementation of the SPOE Strategy. Similarly, the Swiss authorities have provided clarity about their intentions for an SPOE strategy affecting the foreign operations of banks going through resolution.

To advance the FSB goals of international cooperation and coordination, it is important for the final SPOE Strategy to make clear a parallel commitment on the part of the FDIC as the US resolution authority.

The FDIC's SPOE Strategy will contribute to the development of the vital public understanding of the process for carrying out a US-incorporated global systemically important bank's resolution. Greater certainty will lead to more predictable market responses generally and should reduce the systemic effects of any failure. Greater certainty will also deepen public and market confidence in the efficient and effective administration of the cross-border aspects of a resolution.

The SPOE Strategy should be part of an ongoing process of discussion and disclosure of the FDIC's approach, especially as additional issues are completed. A continuing dialogue with the public and the industry, and with foreign supervisory and resolution authorities, will further solidify market understanding.

The SPOE Strategy considers specifically the SPOE model as described for US bank holding companies, which is probably the most likely one for most major US banking groups. But it needs to be recognized that other approaches may be preferable in some cases, depending on the circumstances, business model, and particular structure of the institution. The SPOE model should not be the exclusive strategy for resolution, as the FSB has recognized.[7] Valid business decisions may cause firms to structure themselves in ways that are more suitable to the MPOE approach. These firms should not be forced to restructure their business lines and operations so that they fit the SPOE model, so long as they are credibly resolvable. Where the United States is the host country, appropriate recognition of "incoming" MPOE firms (and firms with other types of SPOE structures) will be essential. The FDIC, as we believe it

---

[6] *See* European Commission, "A comprehensive EU response to the financial crisis: substantial progress towards a strong financial framework for Europe and a banking union for the Eurozone," MEMO/14/57 (Jan. 24, 2014); *and* Council of the European Union, "Proposal for a Directive Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms," Document 17958/13 (Dec. 18, 2013); *and* European Commission, "Commissioner Barnier welcomes trilogue agreement on the framework for bank recovery and resolution," MEMO/13/1140 (Dec. 12, 2013); *and* FSB, *Progress and Next Steps Towards Ending "Too-Big-To-Fail" (TBTF)* (Sept. 2, 2013) (available at http://www.financialstabilityboard.org/publications/r_130902.pdf); *see generally* FDIC Advisory Committee on Systemic Resolution, "International Coordination" Presentation (Dec. 11, 2013).

[7] *See* FSB, R*ecovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies* (July 16, 2013) (available at http://www.financialstabilityboard.org/publications/r_130716b.pdf).

intends to do, should work closely in advance with the home regulator to come to an understanding about an appropriate resolution plan for those internationally active firms where an MPOE strategy would be the optimal solution.

In addition, allowing for a diversity of business models – in terms of business structures, scale of operations,[8] and other characteristics – will contribute to the overall strength and resiliency of the banking sector. Limiting banks to one type of structure would in all likelihood leave the industry generally more brittle and susceptible to shocks, and diversity with respect to structure should be welcomed.[9]

Regardless of whether SPOE or some other approach is appropriate for a given firm, clarity as to the "preferred path" for each firm would help firms and investors plan effectively. Having a high degree of confidence in how a resolution will likely be carried out should enable the market to respond in ways that minimize value destruction. This is especially important in the absence of actual precedents for resolution under the OLA; without such precedents, there may be a fair degree of uncertainty on how authorities will respond, what events may trigger a resolution proceeding, and so forth. Some form of a "preferred path" would help mitigate that uncertainty. This does not deny the importance of allowing an appropriate degree of discretion for authorities to consider alternative approaches as necessary. However, in the future, it is hoped that the FDIC will continue to deepen its coordination with individual institutions and relevant foreign host regulators so that development of their high-level strategies and contingency planning can be conducted with the highest standards of reliability, transparency and predictability. At a minimum, authorities should disclose to individual firms their expectations for how the "high-level outline of the proposed resolution strategy (for example, SPOE or MPOE)"[10] would unfold in practice. Furthermore, the wider market would benefit if – at an appropriate time – the baseline expected procedures were disclosed more broadly. This would help investors and counterparties alike make informed decisions, and reduce the likelihood of a destabilizing surprise.[11]

II. Response to Request for Comment

a. Disparate Treatment

As a general principle, a resolution regime should respect traditional hierarchies of creditor claims but allow for specific differentiation of treatment of creditors when justified by a broader, overarching systemic motivation and subject to clear goals of achieving better economic outcomes for all claimants on the basis of well-understood principles of fairness. A "no creditor worse off than in liquidation" (NCWOL) standard provides a benchmark for measuring the fairness of resolution outcomes.[12] Under the OLA, a creditor would be entitled to a minimum NCWOL recovery right of least as much as it would

---

[8] The notion that a smaller bank would necessarily be more resolvable is misguided, as history has shown; the collapse of a relatively small institution – particularly a mid-sized institution that is too large to be purchased by one of the biggest banks – may end up having devastating systemic consequences, stemming the position it has and its role within the broader market, while the same may not be true for a much larger firm. Size alone cannot be considered an accurate measure or indicator of a firm's resolvability.

[9] As is described later, forced subsidiarization is likely to result in greater balkanization and ring-fencing, which itself will lead to a weaker, more fragile global banking system. By "forced subsidiarization," we mean a statutory or regulatory mandate that an intentional banking organization operate in a host country through a mandated legal-entity structure designed primarily to achieve local resolution goals.

[10] *See* FSB, R*ecovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies*, at 21.

[11] S*ee* IIF, *supra* note 1, at Annex III (discussing investors' perspectives)**.**

[12] *See* Key Attributes 5.1 and 5.2; Dodd-Frank Act, Section 210(a)(7)(B).

have received in liquidation under Chapter 7 of the Bankruptcy Code.[13] The NCWOL standard is well-understood among those who have been working on resolution issues, but perhaps not in the broader community. More discussion of the background, intent and purposes of the NCWOL standard and the ways that it protects formal fairness may be helpful. In addition, more discussion of the advantages of resolution in avoiding the value destruction of a Lehman-type liquidation would be helpful and would foster understanding of the importance of the NCWOL standard. Some of the discussions to date have perhaps tended to overlook avoidance of value destruction and enhancement of recoveries for all as major goals of a bank resolution.[14]

In resolution, the valuation of an entity would be determined through a process managed by the FDIC, as described in the SPOE Strategy, but it is unclear what methodologies are to be used in assessing the liquidation (and therefore minimum recovery) value available to a claimant. The *liquidation* value of a financial institution, particularly in a widespread financial crisis, may be especially low. A more thorough description of procedures for determining liquidation value would help investors better assess the value at risk, and the improvement of outcomes that resolution under the SPOE strategy can be expected to provide.

The FDIC's allowance for possible allocation of stock, options or warrants to creditors and possibly shareholders would appropriately protect investors in relevant cases from initial valuations that may overstate losses, giving them the chance to benefit from a recovery within a reasonable recovery period. In appropriate cases, this would be a way to enhance fairness at a time when current valuations are likely to be volatile and difficult to establish. While the NCWOL standard remains the benchmark against which any resolution should be judged, such provisions also help assure fairness. Further illustrations of how such instruments would be issued, presumably at the conclusion of the bridge process, would help build investor understanding and confidence.

The Notice touches on the possible relationship between disparate treatment on the one hand and, on the other, the absence of a creditors' committee under a Title II resolution and the fact that creditor approval is unnecessary for the FDIC to exercise its powers.[15] Fully developing market confidence about the SPOE Strategy both before and at the time of any resolution will involve the understanding of, and an ongoing role for, creditors to obtain information and provide input during the resolution. While one of the main virtues of the OLA for the resolution of a SIFI is that it gives the ability to act quickly to preserve value and mitigate systemic risks, it is vital, as the FDIC recognizes, that it be implemented in such a way that creditors and other stakeholders are fully informed and can act based on accurate information about the process and its effect on them. During operation of the bridge financial company under FDIC as receiver and closing of the original SIFI, effective communications and consultations with creditors will be part of an effective, fair and efficient resolution.[16] In the meantime, it could be helpful for the FDIC to organize a process to foster greater involvement of the buy-side, to assure that investors are well-informed about the SPOE Strategy and resolution in general, and to meet their concerns about clarity and predictability. Such a process could take the form of a creditors' advisory committee, or perhaps a joint group of the buy side, banks and regulators on the model of the Enhanced Disclosure Task Force that has been inspired at the international level by the FSB.

---

[13] *See* Dodd-Frank Act, Section 210(a)(7)(B).
[14] While much of the discussion to date has been framed in terms of minimizing value destruction, the IIF would welcome a statement from the FDIC expressing its aim to *maximize* the value to be recovered by creditors in a Title II resolution. That could be helpful in guiding decisions when time is short, and could help reduce systemic stress at the same time.
[15] 78 Fed. Reg. at 76,622.
[16] S*ee* IIF, *supra* note 11, at Annex III**.**

Properly understood, the OLA also protects the interests of creditors; it should have the result of reducing value destruction compared to liquidation, and thus improving outcomes for creditors. That said, it may be worth looking into how creditors' views could be taken into account, perhaps during the six to nine months during which a resolution might be expected to last; however, that is an issue that can be debated over time and perhaps addressed at a future stage, once the critical definition of how the OLA would be used is clearly established.

It appears highly unlikely, given the structure of US holding companies and the nature of their liabilities, that there would be any need for the FDIC to use its discretion to treat similarly situated creditors differently under the SPOE strategy. A US holding company typically has limited amounts of operating liabilities that could potentially run, and the Net Stable Funding Ratio will help ensure that this is true. In this context, it is difficult to imagine any significant need for differential treatment among similarly situated creditors, although the option remains open in cases where it might be necessary given the facts and circumstances of a given resolution. The same should be true of a well-designed MPOE strategy or a well-designed SPOE strategy or other corporate structure in other countries.

Any differentiated treatment within traditional hierarchies (and subject to the protections of NCWOL, which avoid results fundamentally at odds with the legal hierarchies) is likely to be with respect to claims that are different in kind from a business point of view. Although creditors may have equal formal ranking in the traditional scheme, they are likely to represent different types of claims (e.g., "financing liabilities" versus "operating liabilities"). In such cases, the selection of certain claims for continuation or transfer is likely to be economically justifiable, so long as the NCWOL standard is met. However, any classes of claims that may receive differential treatment in resolution should be well understood in advance. It should be noted as well that, as the FDIC's Notice itself demonstrates, this does not imply giving arbitrary or unrestrained discretion to the FDIC or any other resolution authority.[17] The strong presumption should be that similarly situated creditors will be treated equally and that any deviation from this will be justified only on the basis of preventing unnecessary value destruction or systemic harm.

b. **Use of the Orderly Liquidation Fund**

Bail-in on the SPOE model under the OLA gives the FDIC a powerful tool to resolve and reorganize a firm-in-resolution without exposing taxpayers to losses. The SPOE Strategy provides quick access to substantial internal resources, which would enable the essential functions of a firm to be continued and supported by a sound capital structure. While a return to solvency should give a firm a strong basis to restore private-sector liquidity, liquidity is often subject to its own dynamics. This would be particularly true in a systemic crisis, when other market participants may be under stress and credit generally may be less available. Strong liquidity options to overcome the near- and medium-term constraints or market uncertainty about a solvent successor firm in a resolution will be helpful in restoring the confidence of counterparties and clients.

There are other potential sources of funding for a firm in resolution besides direct lending from the OLF. A bank in resolution may seek debtor-in-possession ("DIP") financing from private-sector sources, and the OLF may facilitate this through guarantees.[18] With assurances of loss absorbing capacity ("LAC") at the top-company level, and once the Basel liquidity rules are fully implemented, there should be sufficient eligible collateral for the firm-in-resolution (or, as necessary, subsidiary banks) to make use of

[17] 78 Fed. Reg. at 76,622.
[18] *Id*. at 76,616; see also IIF, *supra* note 1.

the traditional central-bank discount window lender-of-last resort facility for a portion of its needs. As a result, the combination of DIP-like, private-sector solutions when possible; the effective use of guarantees where necessary; and access to lender-of-last-resort facilities should considerably reduce the need for any direct OLF outlays. However, having available strong OLF powers in the early days of a resolution makes the resolution regime more credible, and would help reassure markets.

If the FDIC does provide direct liquidity under the OLF, it of course would do so on a temporary, super-senior, secured basis. If recoveries from the disposition of assets are insufficient to repay amounts owed, there would be a subsequent assessment on other creditors and the industry to repay any excess under the Dodd-Frank Act. There is therefore no legitimate basis for equating use of the OLF with a taxpayer-funded bail-out.

In essence, the OLF should function similarly to other lender-of-last-resort facilities, where temporary liquidity is provided on a fully collateralized basis. The rationale for these types of facilities is well-understood and has been broadly accepted since the Nineteenth Century. There is no basis for characterizing these facilities as any form of taxpayer bail-out.

c. **Alleged Funding Advantage of SIFIs**

Research on the funding of systemically important financial institutions ("SIFIs") points in a number of directions. Some studies show that SIFIs have no funding advantage. More recent studies find there were such benefits historically, but that they are diminishing over time or have substantially disappeared or even reversed. Studies that do purport to find a funding advantage tend to be inconclusive on the cause or sources of that advantage. Economies of scale and scope provide a strong explanation, given that firms enjoy a funding advantage over their smaller peers across a wide range of industries.[19]

If a funding advantage is assumed, and it is assumed, as well, to be caused by the "TBTF effect", the most effective way to correct for this is through the continued development and communication of the SPOE Strategy. As confidence in the Strategy builds, any remaining funding advantage tied to the TBTF notion will wane (and of course there are strong arguments that it has already been eliminated). Both Standard & Poor's and Moody's have lowered the credit ratings of the largest banking groups on the basis that these groups will no longer receive government support; [20] this reflects growing confidence in and the credibility of the US resolution framework. The relevant comparison for the OLA and the OLF is the preexisting TBTF effect that applied in the absence of any effective resolution process for SIFIs. Without the OLF and the OLA, there would be much better argument for a funding advantage for SIFIs because the market would assume (as it previously did assume) that a bail-*out* would be required. The OLA changed that calculus. Indeed, clear and reliable statements from the FDIC as to its intentions under OLF will reinforce the market's perception of the change that has occurred.

---

[19] *See, e.g.*, Randall Kroszner, "A Review of Bank Funding Cost Differentials" (Nov. 16, 2013); *and* Steve Strongin, Amanda Hindlian, Sandra Lawson, Jorge Murillo, Koby Sadan, and Balakrishna Subramanian, "Measuring the TBTF Effect on Bond Pricing," The Goldman Sachs Group, Inc. Global Markets Institute Working Paper (2013); *and* Michel Araten and Christopher Turner, "Understanding the Funding Cost Different Between Global Systemically Important Banks (G-SIBs) and non-G-SIBs in the United States," 6 Journal of Risk Management in Financial Institutions 387 (2013); *and* John Giodano and Dennis Hannan, "Regulatory Reform Impact on Bank Credit Spreads," Credit Suisse (July 2013) (available at https://www.credit-suisse.com/governance/doc/us_bank_spread_analysis_retail.pdf).

[20] *See, e.g.*, Standard & Poor's, "Standard & Poor's Applies Its Revised Bank Criteria To 37 Of The Largest Rated Banks And Certain Subsidiaries" (Nov. 29, 2011); *and* Moody's Investors Service, "Rating Action: Moody's concludes review of eight large US banks" (Nov. 14, 2013).

We cannot see any convincing basis for the argument that potential use of the OLF would give some sort of funding advantage to SIFIs. The OLF procedure effectively translates to holding-company level resolution processes that have long been available at the bank level. It in some ways can also be seen as bringing to the financial sector benefits similar to those of Chapter XI for industrial companies.[21]

Although the OLA would have the advantage of conserving more value than liquidation in most cases, this does not insulate shareholders or management from losses, nor does it absolve creditors from the need to exercise market discipline. The OLA will help mitigate potential systemic risk, but the shareholders and creditors of the failed SIFI will bear all the losses incurred during the resolution and the operation of the bridge company. For smaller financial companies, the traditional combination of resolution at the bank level plus bankruptcy at the holding-company level is not likely to be substantially disadvantageous or to make an appreciable difference in their position in the market, given the very different funding structures of those smaller companies. In a sense, the SPOE resolution process may help level the playing field between smaller firms and larger firms: smaller firms have the benefit of being able to preserve going-concern value via purchase and assumption arrangements, an option that is not readily available to large, SIFI institutions.

Critics have also suggested the SPOE Strategy protects the creditors of the operating entities and, in doing so, reduces market discipline. We agree with the FDIC's analysis that this is incorrect.[22] First, structural subordination – with reinforced source-of-strength principles – provides those creditors with a more senior position in the normal course of business; in exchange, they will presumably accept smaller compensation for the relatively reduced risk they bear. To the extent that creditors of downstream subsidiaries benefit from structural subordination, the holding company pays the cost. Second, the creditors of operating subsidiaries are not shielded entirely from losses. Losses that overwhelm the capital of the top-level holding company or that force the firm into an MPOE resolution may eventually fall to the creditors of the operating subsidiaries. No guarantees are made that these creditors will be spared or made whole. We consider the argument that creditors of subsidiaries somehow benefit from a new form of moral hazard does not reflect a realistic corporate-finance analysis of the financing structures thus created.

d. **Capital and Debt Levels at the Holding Company**

A discussion of the quantity and location of a holding company's equity and unsecured debt is difficult in the absence of specific regulatory guidance. We expect to give comments on these issues after the release of, and in response to, the proposed requirements under development[23] by the Board of Governors of the Federal Reserve System. We will also comment on the proposals expected at the international level from the FSB.

---

[21] While the OLF structure appears to have these benefits for a resolution under Title II of the Dodd-Frank Act, further development of the proposed Chapter XIV of the Bankruptcy Code may allow direct use of Chapter XI pursuant to the expedited procedures that are essential for financial-institution resolution.
[22] 78 Fed. Reg. at 76,623.
[23] Daniel K. Tarullo, Member of the Board of Governors of the Federal Reserve System, *Toward Building a More Effective Resolution Regime: Progress and Challenges*, Remarks at the Federal Reserve Board and Federal Reserve Bank of Richmond Conference, "Planning for the Orderly Resolution of a Globally Systemically Important Bank," Washington, D.C., Oct, 18, 2013.

e. **Treatment of Foreign Operations of the Bridge Financial Company**

Financial institutions have chosen a variety of organizational structures for their overseas operations. The choice made by some firms to operate mainly through subsidiaries (which may not always be fully owned by the parent), as opposed to through branches, has worked well for certain business models. However, a requirement mandating that all banks adopt a certain structure would be ill-advised; this would result in reduced flexibility for a firm to adapt to its needs and the circumstances it faces. Such a requirement would reduce the role of the global group in the recovery and resolution process, putting much greater focus on local supervision, capital and resources. The ability of firms to redirect capital and liquidity to affiliated entities under stress would be greatly reduced, and the result, potentially, would be a group structure more brittle and susceptible to adverse market conditions.[24] It would be important before embarking on any program mandating new structural changes for firms to have a close analysis and broad stakeholder consultation on the potential impacts on both US and global markets.

Forced subsidiarization could create uncertainty about the commitment to following the SPOE Strategy. Forced subsidiarization would in some cases increase the mechanistic ability of local authorities to execute a local resolution; but that, in turn, may contribute to a greater uncertainty about the likelihood of a coordinated resolution which, in turn, would create an increased burden on the US authorities to manage relationships. While a forced subsidiary structure need not necessarily thwart the SPOE Strategy, it lessens the chance of its success, especially if accompanied by preemptive ring-fencing of excessive assets in specific jurisdictions, thereby discouraging cross-border cooperation, lessening the incentives to local authorities to cooperate and, importantly, reducing the ability of the group to use its source of strength in an agile and responsive manner. Furthermore, the feedback effects between home and host supervisors of forced subsidiarization tactics are not well understood at this stage, but certainly increasing the chances of go-it-alone actions by individual jurisdictions increases the risk of market disruption. Dealing with these warrants a strong commitment to cooperation as well as a high degree of trust among the home and host regulators and authorities, rather than relying on forced subsidiarization.

The FDIC asks whether a US subsidiarization requirement would reduce the likelihood of ring-fencing and improve the resolvability of a firm with foreign operations. The opposite is the case. There is a risk that forcing subsidiarization would accelerate a trend that is already apparent toward fragmentation of markets and ring-fencing of resources, with a net loss of efficiency in the overall system. As set out above, forced subsidiarization trades arguable improvement of mechanistic resolvability in the local market for possible *complication* of group resolution. Furthermore, material changes to the ability of firms to deploy capital and liquidity to stress points in other jurisdictions will substantially change some of the burdens and stresses on the global financial system, both as between countries and between the private and public sectors, particularly in relation to liquidity provision. Unless this is managed very well, it may create inefficiencies that would tend to undermine the benefits that integrated, wholesale global finance can provide.

Forced subsidiarization would make it much more difficult to realize the benefits many groups aim to achieve, especially diversification and capital and liquidity flexibility (and here such a structure needs to be differentiated from a decentralized or archipelago structure relying more on local funding and dispersed business models). Interfering with the efficiency benefits of integrated groups increases the probability of default for the individual firm, while on an aggregated scale, it would create a pattern of more brittle and less diverse financial firms in the market and thus increase systemic risks and the vulnerability of the system at large.

---

[24] *See* Committee on the Global Financial System, *Funding Patterns and Liquidity Management of Internationally Active Banks*, CGFS Papers No. 39 (May 2010).

Resiliency of SIFIs in a world that reflects the implementation of the G20 global financial reform program has already been and will continue to be substantially increased over what was known before the crisis. The FSB resolution program – which can be implemented by a number of robust options depending on national choices and corporate structures – is an essential part of those reforms. However, forced subsidiarization will impair both resiliency and the ability to achieve a seamless and relatively non-disruptive resolution. In fact the conceptual support for mandatory subsidiarization (and associated excessive ring-fencing of capital and liquidity) ignores both the new sources of resilience in the system and the feedback loops that a "Maginot Line" subsidiarization approach implies, resulting in structures that are less resilient as well as less efficient in the interconnected but efficient and well-regulated global system that the G20 set out to foster.

f. **Cross-Border Cooperation**

The *Key Attributes* has identified the need for cross-border cooperation between jurisdictions and makes suggestions for forms of cooperation, such as firm-specific cooperation agreements (so-called "COAGs") and Crisis Management Groups as well as broader MOUs among regulators.[25] The FDIC, for its part, has made significant progress in establishing bilateral agreements and partnerships with foreign regulatory authorities. Notable examples of such cooperation and partnerships include the joint paper with the Bank of England[26] and the recent letter to ISDA signed by the FDIC, the Bank of England, the Federal Financial Supervisory Authority ("BaFin"), and the Swiss Financial Market Supervisory Authority ("FINMA").[27] Clarity on the SPOE Strategy will reinforce the trust and confidence that is being built up through these relationships.

We believe that other activities that the FDIC and other agencies have engaged in with their foreign counterparts are also contributing significantly to the development of a common understanding for cross-border resolution. The table-top simulation exercises that the FDIC has done with the UK authorities;[28] the FDIC-European Commission joint working group on resolution and deposit insurance; and the various engagements with the Swiss, German, Japanese and other authorities; the various MOUs, Crisis Management Groups; and , of course, the bilateral cooperation agreements are all noteworthy.

In addition to the FDIC's work in this area, other jurisdictions, such as Hong Kong and Switzerland, are bringing their resolution regimes closer to the FSB standard. The BRRD in Europe, as described previously, demonstrates a commitment by the EU to cross-border cooperation that will provide all the legal necessary tools to EU authorities to cooperate in the resolution of a US firm led by the FDIC (including the power to override cross-defaults) and should provide substantial assurances that the SPOE Strategy could and would be recognized in the EU. Legal provisions such as Article 85 of the BRRD, allowing for the recognition of third country resolution proceedings, help establish a basis of confidence

[25] *See*, *e.g.*, Key Attributes 7.1 – 7.7, 9.1 – 9.2

[26] FDIC and Bank of England, Joint Paper, *Resolving Globally Active, Systemically Important, Financial Institutions* (Dec. 10, 2012).

[27] Joint Letter dated Nov. 5, 2013 from the FDIC, the Bank of England, the German BaFin and the Swiss FINMA to the International Swaps and Derivatives Association

[28] Reports suggest the US and UK authorities have developed a particularly strong working relationship, as evidenced by the commitment made, in principle, by the Bank of England to stand aside and allow the UK subsidiaries of a US firm to be resolved as part of firm-wide resolution. *See* Paul Tucker, *Solving too big to fail: where do things stand on resolution*, IIF 2013 Annual Membership Meeting. For purposes of strengthening cross-border cooperation, the US authorities should consider making a reciprocal commitment with the UK, or other, authorities, in the event of a proper foreign resolution that respected legitimate US interests (*i.e.*, assuming that the capital at the operating-company level was maintained at adequate levels).

and certainty in the market that a cross-border resolution can and will be carried out smoothly. These constructive developments lay the foundation for further understanding and trust, and overcome some of the prior hurdles to cross-border cooperation.

Bilateral agreements and the overall framework provided by the FSB's *Key Attributes* are effective steps forward and do establish a strong foundation; they contribute to a consistent global culture of expectations for the resolution process. The IIF has advocated consideration of an international Convention that would create a formal, multilateral mechanism for conducting a cross-border resolution.[29] Such a Convention would be worth considering to ratify and formalize the arrangements now being developed, but, given the strong incentives to cooperation possible with the current framework, it would be a desirable medium-term goal and not a necessity at this time, given the amount of progress that has been made on resolution regimes.

Regardless of whether a Convention is eventually adopted, it is important that resolution authorities take all possible steps to increase the levels of understanding as to the potential outcome of a resolution. In particular, the likely response of host-country authorities to a home-country proceeding should be well understood by market participants in advance of a resolution. Clarity on the preferred path, good planning, robust bilateral agreements among authorities, and clear resolution plans should help assure that a resolution would be carried out to the benefit of all participants and other stakeholders. The ability of the FDIC to avoid the value destruction of a failure and outright liquidation by use of the SPOE Strategy will give clear incentives to cooperation to all the resolution agencies that would be involved in a US firm's resolution. Continued work is needed, but an end state can be created where all major jurisdictions concerned have the incentive of getting the best possible outcomes for their claimants through maximizing cooperation if a US-led resolution is carried out.

Regular public disclosure of basic information about the types of arrangements the FDIC has entered into with foreign regulatory authorities would strengthen confidence in the SPOE Strategy. For example, the presentations made to the FDIC's Systemic Resolution Advisory Committee on this subject have provided useful insights thus far. To the extent it can, the FDIC should continue making these types of disclosures.

g. Conclusions

We applaud the FDIC for developing this Strategy and look forward to a continued dialogue on it. We believe the case can be made even more strongly in the final version of the SPOE Strategy and that the reservations about which comment is appropriately solicited will not distract from the essential robustness of the Strategy in a global context where other jurisdictions are committed to the FSB *Key Attributes* and are moving toward adoption of the resolution regime it mandates.

As mentioned earlier, a well-understood resolution framework will be essential to minimizing market uncertainty before and during a Title II resolution proceeding, and this process of describing the steps that will be taken helps achieve this goal of improved understanding. Clear affirmation of the SPOE Strategy, including fair treatment of both domestic and foreign creditors and support for critical activities internationally, is essential to maintaining the confidence of foreign authorities that the US would act on the SPOE Strategy in a fair way. This would allow them to rely upon the value-conserving incentives created by SPOE, support international cooperation, and avoid the balkanization and value-destroying local ring-fencing that would otherwise occur. The US financial system will benefit from clarity and fairness on these issues.

[29] *See* IIF, *supra* note 1, at Annex I.

The purpose of this letter is to address, from an international perspective, some of the more conceptual topics raised in the Notice. Many important issues fall outside the scope of this letter and are not covered, including issues relating to US law; on technical matters, we refer to the views given in the comment letter submitted by The Clearing House, the Securities Industry and Financial Markets Associations, the American Bankers Association, and the Financial Services Roundtable.

Should you have any questions or would like to pursue discussions of issues raised in this letter, please contact the undersigned at any time.

Very truly yours,