BETTER MARKETS

June 21, 2019

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Robert E. Feldman
Executive Secretary
ATTN: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Resolution Plans Required; Board Docket No. R-1660 and RIN 7100-AF47; FDIC RIN 3064-AE93

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the notice of proposed rulemaking captioned above ("Proposal" or "Release"),[2] issued by the Board of Governors of the Federal Reserve System ("Board") and the Federal Deposit Insurance Corporation ("FDIC") (the Board and the FDIC collectively, the "Agencies"). The Proposal would significantly reduce the frequency and required content of resolution plans, i.e. living wills, that covered financial companies are required to submit to the Agencies.

1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

2 84 Fed. Reg. 21,600 (May 14, 2019).

The Proposal is a needless and dangerous weakening of the resolution planning regime that is inconsistent with the spirit and intent of the Dodd Frank Act. It lacks an adequate justification for weakening the current requirements and it relies on considerations that are outside the scope of what Congress instructed the Agencies to consider when implementing resolution planning requirements. It thus weakens one of the core reforms that policymakers wisely determined was necessary just ten years ago to help avoid a recurrence of the devastating financial crash of 2008[3]—or something even worse. Instead of adopting the Proposal, the Agencies should maintain, or even strengthen, the current framework, which is critical to the protection of taxpayers and the financial system.

BACKGROUND AND SUMMARY OF PROPOSAL

The Lehman Bankruptcy: A Paradigm of Disorderly Resolution

One of the most pivotal events during the 2007-2009 financial crisis was the Lehman Brothers declaration of bankruptcy on September 15, 2008, the largest bankruptcy in American history. While it was clear before that day that there was serious instability in the financial system—the government had already taken extraordinary action to arrange a rescue of Bear Stearns by J.P. Morgan Chase to avoid the former's failure—Lehman's collapse on September 15, 2008 arguably marked the point at which profound concerns about the financial system turned into full blown crisis and panic.[4]

Lehman's bankruptcy created a cascading effect that shook the financial system immediately (the Dow Jones dropped more than 500 points that day) and set the course for the crisis. Within days, the government, alarmed by the significant negative impact on markets resulting from the decision to allow Lehman to fail, orchestrated a massive bailout of AIG to prevent it from failing in turn.[5] A leading money market fund, which was experiencing a run as a result of its significant exposures to Lehman, "broke the buck," and the panic spread to other money market funds, resulting in a bailout of the entire $3.7 trillion money market fund industry.[6] Within a month of Lehman's failure, Congress passed the law authorizing TARP.

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3 BETTER MARKETS, THE COST OF THE CRISIS: $20 TRILLION AND COUNTING (July 2015), https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis_1.pdf.

4 FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT 353 (2011) ("September 15, 2008—the date of the bankruptcy of Lehman Brothers and the takeover of Merrill Lynch, followed within 24 hours by the rescue of AIG—marked the beginning of the worst market disruption in postwar American history and an extraordinary rush to the safest possible investments."), https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

5 *Id.*

6 *Id.* at 356.

Simply put, Lehman's bankruptcy sparked chaos in the financial system and, in concert with a torrent of other destabilizing events, brought markets and the entire economy to the brink of collapse. Key problems for regulators were that they did not have adequate insight into the actual financial condition of Lehman, what it would take to save Lehman, and how Lehman's failure would impact other firms—particularly the counterparties to Lehman's over-the-counter derivatives contracts, which were unregulated and opaque. Regulators now have better access to such information under the current resolution planning regime.

From Lehman's perspective, many claim it spent the months, weeks, days, and hours leading up to its bankruptcy filing attempting to prevent it, first by trying to shore up its financial condition and then by trying to convince the government that it simply **could not** be allowed to fail.[7] In other words, while regulators were apparently prepared to follow through on threats to let Lehman fail,[8] for a variety of reasons, they simply did not know what the fallout from that decision might be.[9]

Dodd-Frank Section 165(d) and the Agencies' Resolution Planning Rule

One key reform that emerged to prevent the chaos that Lehman's bankruptcy sparked, and the bailouts that fear of chaos from other Lehman-like bankruptcies precipitated, was to require the largest financial companies to plan in advance for their failure with resolution plans, or "living wills," that would explain how such companies, in the event of financial distress or failure, could be resolved in an **orderly** manner **without** spreading instability throughout the financial system and without requiring the use of taxpayer bailouts.

The living will concept was codified in Section 165(d) of the Dodd-Frank Act, which required that large banking organizations, specifically banking organizations with over $50 billion in assets, as well as non-bank financial companies which the Financial Stability Oversight Council ("FSOC") had designated as systemically significant, periodically submit resolution plans to the Agencies.[10] The Dodd-Frank Act requires that each such company report periodically its plan "for rapid and orderly resolution in the event of material financial distress or failure."[11] The law requires such plans to include

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7 *Id.* at 338.

8 *Cf.* LAURENCE BALL, THE FED AND LEHMAN BROTHERS: SETTING THE RECORD STRAIGHT ON A FINANCIAL DISASTER (2018); ADAM TOOZE, CRASH: HOW A DECADE OF FINANCIAL CRISES CHANGED THE WORLD (2018).

9 *Supra*, note 4, at 329 ("As they now realized, regulators did not know nearly enough about over-the counter derivatives activities at Lehman and other investment banks, which were major OTC derivatives dealers.").

10 12 U.S.C. § 5365(d).

11 12 U.S.C. § 5365(d)(1).

> information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company; (B) full descriptions of the ownership structure, assets, liabilities, and contractual obligations of the company; (C) identification of the cross-guarantees tied to different securities, identification of major counterparties, and a process for determining to whom the collateral of the company is pledged.[12]

Dodd-Frank further provided that if the Agencies notified a company of deficiencies in its resolution plan, and it failed to timely submit a credible revised plan, the Agencies could impose restrictions on the company's activities, including more stringent capital and liquidity requirements, or even break up the company by requiring it to divest assets.[13]

In 2011, the Agencies promulgated a final rule implementing Section 165(d) of the Dodd-Frank Act and requiring covered companies to submit resolution plans ("2011 Final Rule"). Specifically, among other things, the 2011 Final Rule required that covered companies submit resolution plans annually.[14] As the Agencies explained, the "annual filing provides a regular opportunity for firms to update their resolution plans to reflect structural changes, acquisitions, and sales."[15] The Agencies also anticipated that resolution planning would become an iterative process of regular dialog and feedback between companies and the Agencies.[16] As the Agencies explained in 2016, an objective of the resolution planning regime is

> to make resolution planning an ongoing institutional aim. The development of resolution plans compels firms to rationalize their structures, create resolution strategies and mechanisms for their successful implementation, identify and marshal necessary resources, and consider resolvability as part of day-to-day decision-making.[17]

Because the Agencies determined that the annual filing requirement would adequately capture changes at covered companies between filings, they eliminated a proposed provision that would have required that covered companies automatically update resolution plans upon the occurrence of a restructuring, acquisition, or sale.[18] However, the Agencies did require that

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12 *Id.*
13 *Id.*
14 Resolution Plans Required, 76 Fed. Reg. 67,323 (Nov. 1, 2011).
15 2011 Final Rule at 67,330.
16 *Id.* at 67,328.
17 BOARD & FDIC, RESOLUTION PLAN ASSESSMENT FRAMEWORK AND FIRM DETERMINATIONS 5, (2016), https://www.fdic.gov/news/news/press/2016/pr16031a.pdf
18 2011 Final Rule. at 67,330.

companies provide notice upon the occurrence of such events.[19] The 2011 Final Rule also provided further detail about the required content of resolution plans, and provided that banking organizations with less than $100 billion in assets could submit "tailored" plans with less content than full plans.[20]

The Economic Growth, Regulatory Relief and Consumer Protection Act ("S. 2155") weakened a number of the enhanced prudential standards originally included in Section 165 of the Dodd-Frank Act. Among other changes, it eliminated the requirement that banking organizations with less than $100 billion in assets submit resolution plans. It also lifted that requirement for banking organizations with $100 billion to $250 billion in assets, although it gave the Agencies discretion to require those banks to submit resolution plans, upon consideration of certain risk-related factors applicable to those banks.[21]

Incentives to be Too-Big-to-Fail and the Resolution Planning Process to Date

The value of resolution plans depends largely on the willingness of both regulators and companies to meaningfully engage in the process. Here, regulatory oversight plays an especially important role, as companies have no real incentive to plan for their failure in the manner contemplated by Dodd-Frank.[22] Indeed, companies have the **opposite** incentive—if a particular company's failure might plausibly cause the sort of chaos that Lehman's failure did in 2008, the government will almost certainly bail that company out rather than allow it to fail.

Put differently, large, complex banking organizations like Lehman always have an incentive to be too-big-to-fail and, thereby, get bailed out to avoid bankruptcy. This is fundamentally a "put" on the federal government and taxpayers to bail out such firms. This is, to the firm, highly desirable compared to a bankruptcy proceeding which would almost certainly result in catastrophic losses to the executives, including their jobs, wealth, and reputations. All one has to do is compare the outcome of the bankruptcy of Lehman to the bailouts of AIG, Citigroup, Goldman Sachs, Morgan Stanley, and all the other banks and nonbanks that were bailed out.[23]

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19 *Id.*

20 12 C.F.R. § 381.4.

21 Pub. L. No. 115-174.

22 *Cf.* BOARD & FDIC, RESOLUTION PLAN ASSESSMENT FRAMEWORK AND FIRM DETERMINATIONS 3, (2016), https://www.fdic.gov/news/news/press/2016/pr16031a.pdf ("As demonstrated by Lehman Brothers, firms had not been required, nor seen the need, to take specific actions to prepare themselves for resolution under bankruptcy.").

23 This also perversely incentivizes such institutions to take more risk then they otherwise would "since the government will bail them out in an emergency." SIMON JOHNSON & JAMES KWAK, THIRTEEN BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 204 (2011).

Thus, it simply cannot be overstated how critical it is that the resolution planning process include constant oversight by the Agencies, backed up by the credible threat that the Agencies will evaluate plans rigorously and impose meaningful restrictions on companies that fail to cure deficiencies in their plans.[24]

Since the 2011 Final Rule, the Agencies have demonstrated their commitment to holding firms accountable for their responsibility to craft credible resolution plans. In 2014, the Agencies rejected **each** of the eleven resolution plans submitted by the largest banks.[25] In April 2016, the Agencies rejected the resolution plans of five banks, and in December 2016, the Agencies restricted the growth of one of those banks, Wells Fargo, which failed to adequately address the deficiencies identified by the Agencies.[26]

Summary of the Proposal

The Release explains that the Proposal is intended, in part, to "address" the amendments made by S. 2155.[27] **However, it needlessly and dangerously goes far beyond what is required by S. 2155 by significantly reducing the frequency and required content of resolution plans**. The Proposal adheres to the framework that the Agencies and other banking regulators have recently proposed for purposes of tailoring other regulatory requirements: They have divided covered companies into four categories according to asset size and other metrics of complexity and they propose to apply distinct regulatory requirements on each category.

The four categories are as follows:

- **Category I:** Firms categorized as globally systemically important banks ("GSIBs") would be subject to Category I standards.

24 The restrictions the Agencies might impose are, of course, not punitive. Instead, they go directly towards reducing the systemic risk of the failure of a large financial company that has failed to adequately plan for its failure.

25 DENNIS KELLEHER & FRANK MEDINA, ENDING TOO-BIG-TO-FAIL BY BREATHING LIFE INTO "LIVING WILLS," BETTER MARKETS POLICY BRIEF (Jan. 2016), https://bettermarkets.com/sites/default/files/Breathing%20Life%20Into%20Living%20Wills_0.pdf.

26 Press Release, Better Markets, Statement on Historic Actions by FDIC and Fed Regarding Wall Street's Proposed Living Wills (Apr. 13, 2016), https://bettermarkets.com/newsroom/better-markets-statement-historic-actions-fdic-and-fed-regarding-wall-street%E2%80%99s-proposed; FDIC & Board, Press Release, Agencies Announce Determinations on October Resolution Plan Submissions of Five Systemically Important Domestic Banking Institutions (Dec. 13, 2016), https://www.fdic.gov/news/news/press/2016/pr16109.html.

27 Release at 21,600.

- **Category II:** Category II standards would apply to banking organizations with $700 billion or more in total consolidated assets or $75 billion or more in "cross-jurisdictional activity," that are not also GSIBs.

- **Category III:** Category III standards would apply to banking organizations with $250 to $700 billion in consolidated assets and to firms with $100 to $250 billion in consolidated assets that also have at least $75 billion in any of the following: (i) nonbank assets; (ii) weighted short-term wholesale funding; or (iii) off-balance sheet exposures.

- **Category IV:** Category IV standards would apply to banking organizations with at least $100 billion in total consolidated assets that do not meet any of the thresholds for Categories I, II or III.

Under the Proposal, even the largest Category I firms—U.S. GSIBs—would only need to file a plan once every two years, instead of annually. In addition, every other filing would be a "targeted plan," which would include only what the Agencies identify as "core elements" and material changes since the filing of the company's most recent full resolution plan.[28] "Targeted plans" would **exclude** key information such as descriptions of the covered company's collateral management processes, practices relating to its derivatives activities, and identification of major counterparties.[29]

In other words, U.S. GSIBs—the largest and most complex banking organizations—would only be required to file a full resolution plan once **every four years.** Category II and III firms would only be required to file a resolution plan once every three years, alternating between full and targeted plans. Thus, these extraordinarily large and complex firms would only be required to file full plans once **every six years**. Finally, Category IV firms would not be subject to any resolution planning requirements at all.[30]

Despite the significant reduction in the frequency of the filing of resolution plans, the Agencies are **not** proposing to require that covered companies automatically update their

28 Release at 21,603.

29 Release at 21,627-28.

30 *Id.* at 21,602. Foreign banking organizations with between $100 billion and $250 billion in assets would be required to file of "reduced" resolution plans every three years. *Id.* at 21,603. These reduced plans would consist solely of a "description of material changes experienced by the covered company since the filing of the covered company's previously submitted resolution plan and changes made to the strategic analysis that was presented in the firm's previously submitted resolution plan in response to these changes and changes made in response to feedback provided by the agencies, guidance issued by the agencies, or legal or regulatory changes." *Id.* at 21,609.

resolution plans upon occurrence of a restructuring, acquisition, or sale. Instead, the Agencies propose to maintain the simple notice requirement upon occurrence of such an event, with the Agencies having the discretionary authority to require that a company file an interim plan.[31] Regarding plan content, in addition to the fact that every other plan submitted by Category I, II, and III firms is a targeted plan with reduced content, the Proposal would also establish a process whereby these firms can seek waiver of the requirement to provide certain content in their **full** plans. Moreover, if the agencies do not **jointly deny a waiver request within 9 months,** the request is deemed granted, which could allow inappropriate waiver requests to be granted by default simply due to the difficulties inherent in coordinating joint agency action.

The Proposal also would formalize a process for identification of "critical operations" by covered companies. Currently, either firms themselves or the Agencies can identify critical operations of specific firms. The Proposal would formalize the process by which critical operations are identified. It would require that the Agencies "review all identified critical operations and the operations of covered companies for consideration as critical operations at least every six years."[32] Moreover, firms that are required to file full plans would be required to have a methodology for identifying "critical operations."[33] However, firms that do not have any currently identified critical operations would be able to apply for a waiver from this requirement.[34]

SUMMARY OF COMMENTS

Each of the elements of the Proposal described above is unnecessary and unjustified, and as a whole, the Proposal, if finalized, would significantly undermine the utility of resolution planning as a safeguard against systemic instability in the U.S. financial system. The Agencies fail to offer sufficient justification for the Proposal. In an attempt to justify the Proposal, the Agencies make the conclusory assertion that "the Rule's annual filing requirement has been a challenging constraint for both the agencies and covered companies and has become less necessary."[35] Similarly, the Release notes that the Proposal is intended to "improve efficiency and balance burden."[36]

However, Dodd-Frank sets forth the factors the Agencies must consider when developing prudential standards—including the resolution plan requirements—and the law does not suggest, much less state, that any such hypothetical "burden" on the either banking organizations or the Agencies would be or should be justification for dramatically weakening a key pillar of the post-crash reforms. Similarly, such considerations appear nowhere in the relevant section of S. 2155,

31 *Id.* at 21,625.
32 *Id.* at 21,611.
33 *Id.* at 21,610.
34 *Id.* at 21,610-611.
35 *Id.* at 21,601.
36 *Id.* at 21,602.

which lists the factors the Board must consider when determining whether to impose resolution planning requirements on banks with between $100 and $250 billion in assets. Rather, in this context, the Dodd-Frank Act and S. 2155 clearly intended the Board to be guided by risk-related factors, not regulatory burdens or related concerns.

In addition, the Agencies do not attempt to detail in the release the purported burden of the annual filing requirement on covered companies, nor do they explain why the difficulties covered companies are supposedly facing due to the annual filing requirement should be solved by reducing the frequency of filings rather than requiring that the companies do what is necessary to comply with their important obligations under Dodd-Frank. Moreover, while the reduced frequency of required filings may decrease the burdens on the resources of the Agencies, the Proposal itself would impose new burdens on the Agencies, such as requiring comprehensive review of waiver requests by covered companies. Thus, it is questionable whether the reduction in frequency and content of resolution plans will actually reduce the burden on Agencies, or whether the burden will simply shift to tasks such as reviewing waiver requests filed by covered companies.

The Proposal would also be dangerous. As described above, under the current resolution planning regime, the Agencies have meaningfully and critically engaged in the process, which in turn has forced covered companies to take the resolution planning requirements seriously. The fact that all eleven initial plans were rejected as inadequate is evidence that these firms did not take their legal responsibilities seriously and only did so after the Agencies proved they were willing to fail the firms and require them to comply with the law.

By significantly reducing both the frequency of the filing requirement and the content of resolution plans, the Proposal is likely to transform resolution planning from an "ongoing institutional aim" that requires each firm to "consider resolvability as part of day-to-day decision-making" to an occasional, outdated, and discrete check-the-box exercise that will result in pro forma submissions and pro forma review by the Agencies. The Proposal is also dangerous because it would altogether eliminate resolution planning requirements for some of the largest banking organizations. Finally, any proposal to relax resolution planning requirements is premature. Notwithstanding the Agencies' experience **reviewing** resolution plans, the adequacy of the current regime cannot be meaningfully assessed until a covered company faces financial stress and a resolution plan is actually triggered and implemented.

In summary, this unwarranted, unwise, and unjustified Proposal is playing with the fire of another crash and imperiling the stability our financial system, the strength of our economy, our citizens' livelihoods, and taxpayers' money.

COMMENTS

I. Reducing the Frequency and Content of Resolution Plans Is Unjustified and Dangerous.

A. The Agencies offer insufficient justification for reducing the frequency and content of resolution plans.

It is a basic tenet of administrative law that when an agency departs from a prior position, it must "display awareness that it *is* changing position" and "must show that there are good reasons for the new policy."[37] Moreover, when a "new policy rests upon factual findings that contradict those which underlay [an agency's] prior policy," the agency must "provide a more detailed justification than what would suffice for a new policy created on a blank slate."[38] This is because, when changing policies, "a reasoned explanation is needed for disregarding facts and circumstances that underlay or were engendered by the prior policy."[39] Here, the Agencies provide an insufficient factual basis to support their primary rationale for weakening the existing resolution planning regime, i.e. reducing burdens on banking organizations and the Agencies. Even worse, the Agencies' focus on burden improperly elevates this factor, which is nowhere to be found in the statutory scheme for developing and applying prudential standards, over the factors Congress explicitly instructed the Agencies to consider relating to financial stability and safety and soundness.

1. *Companies should be expected to continue to devote sufficient resources to meet the annual resolution plan filing requirements.*

One of the most troubling aspects of the financial crisis was that too-big-to-fail Wall Street banks that took huge and unjustified risks were able to internalize the benefits of that excessive risk taking in the form of outsized profits leading up to the crisis, but when the risks they took turned bad, the consequences were externalized, in the form of a near-depression that cost tens of trillions of dollars in lost GDP and inestimable human suffering, much of which continues to this day.[40] On top of that, tens of trillions of dollars were lent, spent, pledged, committed, loaned, guaranteed, and otherwise used or made available to bail out the financial system during the crisis.[41]

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37 *F.C.C. v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (emphasis in original).

38 *Id.*

39 *Id.*

40 BETTER MARKETS, THE COST OF THE CRISIS: $20 TRILLION AND COUNTING (July 2015), https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis_1.pdf.

41 *See* JAMES ANDREW FELKERSON, A DETAILED LOOK AT THE FED'S CRISIS RESPONSE BY FUNDING FACILITY AND RECIPIENT, PUBLIC POLICY BRIEF NO. 123 4, LEVY ECONOMICS INSTITUTE OF BARD COLLEGE (2012) ("Levy Report"), https://www.econstor.eu/

The Dodd-Frank Act was specifically designed so that systemically important financial companies would fully internalize the costs of their risky activities.[42] In other words, the "burdens" imposed on companies by Dodd-Frank and its implementing regulations, including the resolution planning requirements at issue here, are in fact burdens that Congress determined were properly borne by these companies to ensure that the costs of their activities are not shifted onto innocent taxpayers and others who played no part (and reaped no benefits) from the firms' activities.

In that light, the Agencies' concerns about the burdens of the resolution planning requirements on covered companies are not only baseless, but inconsistent with Congressional intent. This is especially true in light of banks' current record profits.[43] If covered companies are in fact having trouble with the annual filing requirement and the required content of resolution plans, the solution is not for the Agencies to reduce the requirements, but for covered companies to devote more resources to compliance with the law. This is what Dodd-Frank contemplates and requires. The Agencies' attempt to justify weakening regulations by citing the burden on covered companies is contrary to the letter, spirit, and intent of Dodd-Frank.

2. *The Agencies must dedicate themselves to a robust resolution planning framework, and they should not shoulder additional burdens to weaken that framework for the benefit of banks.*

The Agencies also cite the "challenging constraint" of the annual filing requirement on the Agencies themselves as justification for the Proposal.[44] The Release provides no specific detail regarding the magnitude of that "constraint" or burden on the Agencies, but whatever the regulatory challenge may be, the response cannot reasonably be to scale back regulations that are required by law to help avert another financial crisis. Rather, the Agencies must steadfastly continue to implement a robust resolution planning framework. And if additional funding must be dedicated to enable them to discharge that responsibility, so be it: Whatever resources that may

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bitstream/10419/121982/1/689983247.pdf; *see also*, BETTER MARKETS, WALL STREET'S SIX BIGGEST BAILED-OUT BANKS; THEIR RAP SHEETS & THEIR ONGOING CRIME SPREE 1 (Apr. 9, 2019), https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Wall%20Street%27s%20Six%20Biggest%20Bailed-Out%20Banks%20FINAL.pdf.

42 Douglas D. Evanoff & William F. Moeller, *Dodd-Frank: Content, Purpose, Implementation Status, and Issues*, 36 ECON. PERSPECTIVES 75, 77 (2012), https://www.chicagofed.org/publications/economic-perspectives/2012/3q-evanoff-moeller.

43 Sylvan Lane, *Bank Profits Rise 8.7 Percent in First Quarter of 2019*, THE HILL (May 29, 2019), https://thehill.com/policy/finance/446005-bank-profits-rise-87-percent-in-first-quarter-of-2019; *see also* Kate Berry, *Four Myths in the Battle over Dodd-Frank*, AMERICAN BANKER, (Mar. 10, 2017), https://www.americanbanker.com/news/four-myths-in-the-battle-over-dodd-frank.

44 Proposal at 21,601.

require will inevitably pale in comparison to the cost that another financial crisis will inflict on the federal budget, the entire economy, and hardworking Americans across this country.

Finally, if the Agencies are concerned about burden, they should not be proposing regulatory changes that will likely saddle them with significant additional burdens. In particular, under the Proposal, the Agencies would commit to reviewing waiver requests by covered companies seeking to reduce the information they are required to provide in "full" resolution plans. They would also commit to reviewing requests to waive the requirement that a company have a methodology for identifying "critical operations."[45] Essentially, instead of reducing burdens on the Agencies, the Proposal would shift the burden from reviewing resolution plans to reviewing the inevitable torrent of waiver requests.

3. *Burdens on banks or the Agencies is not a consideration under Dodd-Frank for development and application of prudential standards.*

The Dodd-Frank Act clearly sets forth the factors and considerations to be taken into account when developing and applying prudential standards such as resolution planning. When determining which banks should be subject to which enhanced prudential standards, Congress instructed regulators to consider banks' " capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors" deemed appropriate.[46] Congress further provided instruction on the factors to be considered when applying enhanced prudential standards to banking organizations between $100 billion and $250 billion in assets, directing that prudential standards should apply to these organizations when application would "prevent or mitigate risks to the financial stability of the United States" or "promote the safety and soundness" of the banking organization.[47] Notably missing from these lists of statutorily mandated factors is whether adopting prudential standards would impose burdens on banking organizations or the Agencies. Thus, adopting weakened resolution planning requirements, primarily to reduce the burdens of resolution planning on banks and the Agencies, would inappropriately advance a non-statutory factor at the expense of the financial stability of the United States.

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45 *Id.* at 21,610.

46 12 U.S.C. § 5365(a)(2)(A); *see also* 12 U.S.C. § 5365(b)(3) (listing other factors that the Board must consider in when prescribing prudential standards, all of which focus on the attributes of the bank and "other risk-related factors" and none of which refer to regulatory burdens or constraints).

47 12 U.S.C. § 5365(a)(2)(C).

B. Reducing the frequency and content of resolution plans would increase systemic risk.

In the Proposal, the Agencies recognize "that both firms and markets continually evolve and change."[48] However, that correct observation is deployed only in service of proposing formalizing how previously identified "critical operations" can be reconsidered.[49] Instead, the Agencies should recognize that the most obvious policy implication of the ever-changing nature of financial firms and markets is that resolution plans should be continually updated with fulsome information. Unfortunately, the Proposal takes the opposite approach, reducing the frequency with which resolution plans must be filed and reducing the content of most of the plans that do have to be filed. This is dangerous precisely because "both firms and markets continually evolve and change." As we saw in 2007 through 2009, this can happen quickly, unexpectedly, and with devastating consequences.

For resolution plans to accomplish their primary goal of providing a path for resolution of firms without impacting financial stability and without requiring taxpayer bailouts, they simply must be actionable, i.e. they must be able to be executed by the **firm** as it exists and in the **environment** in which it exists at the time of failure. If finalized, the Proposal would significantly undermine this goal.

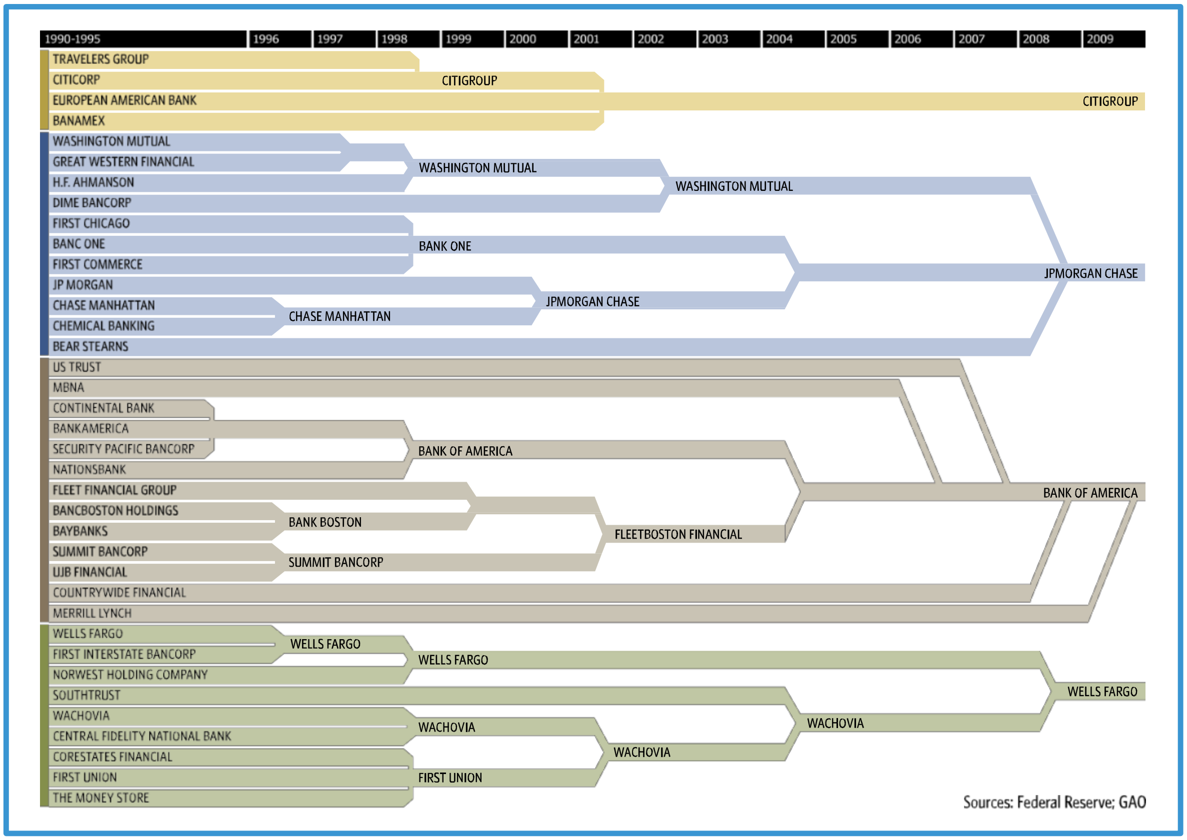
Even for GSIBs, the largest and most complex banking organizations, the information in a resolution plan could be up to **four years old** at the time the plan must be deployed to resolve a failing firm. For other large and complex firms, the information could be up to **six years old**. Even worse, resolution plans might not even account for significant changes that have occurred in the lengthy interval between filings, such as acquisitions or other structural changes. Quite clearly, a resolution plan that includes significantly outdated information is no longer viable and cannot be relied upon when it is actually needed.

One does not have to merely speculate about how dangerous it can be to reduce the frequency and content of resolution plans. Assume for a moment that Lehman Brothers had filed its last full resolution plan on September 15, 2006, two years before it collapsed. As reflected in its 2006 10K, Lehman had $503.5 billion in total assets and $534.5 billion notional outstanding in derivatives contracts.[50] In its final 10-Q before it filed for bankruptcy, less than two years later, Lehman reported $639.4 billion in assets and $729.3 billion notional outstanding in derivatives contracts, a 27% and 36% increase, respectively, reflecting significant changes in Lehman's size and the scope of its derivatives activities in less than two years.[51] Needless to say, a resolution

48 Proposal at 21,610.
49 *Id.*
50 Lehman Brothers Holdings Inc., Annual Report (Form 10-K), at 28, 55 (Feb. 13, 2007).
51 Lehman Brothers Holdings Inc., Quarterly Report (Form 10-Q), at 5, 40 (Jul. 10, 2008).

plan for the 2006 Lehman bank would be virtually irrelevant to the Lehman of 2008, yet that is what is being proposed by the Agencies here.

The scope of these significant changes is not limited to Lehman. For example, over the course of a relatively short period of time there was incredible change in the composition of the banking industry, as shown by the following chart, which reflects the consolidation of **44 banks into just 4** over the course of a decade:



Under the Proposal, which does not require an update of resolution plan upon completion of a merger or other consolidation, many of the transactions reflected in this chart would not have been reflected in the bank's current resolution plan.

The Proposal also sends a troubling signal about the importance placed on resolution plans. One reason for the annual filing requirement was that it would result in firms integrating "resolution planning into their business operations."[52] As the Agencies noted as recently as 2016, the resolution planning

52 2011 Final Rule at 67,330.

> process works largely by requiring firms to make resolution planning an **ongoing institutional aim**…The development of resolution plans compels firms to rationalize their structures, create resolution strategies and mechanisms for their successful implementation, identify and marshal necessary resources, and consider resolvability as part of day-to-day decision-making.[53]

In other words, resolution planning is supposed to be front-of-mind for covered companies. The annual filing requirement is key to ensuring that resolution planning remains on ongoing consideration for covered companies, because it essentially means there will be constant government oversight of their resolution plans. If covered companies only have to file a plan for government review **every two to three years—and only have to file a full plan once every four to six years**—then resolution planning would no longer be an "ongoing institutional aim" or a "part of day-to-day decision-making," but would instead be an occasional, out of date, discrete check-the-box exercise. This would be especially dangerous, as the existence of pro forma resolution plans **on paper** that do not reflect or integrate the actual condition of the firm or the day-to-day activities of the covered company in roughly real-time would create a false sense of security.

The Proposal is also dangerous because it would **entirely eliminate** resolution planning requirements for some of the largest banking organizations. A banking organization with between \$100 billion and \$250 billion in assets is significant, and often complex, notwithstanding that it may not be as large or complex as some other massive banking organizations. Experience has shown that failure of such organizations can cause major disruption to the financial system.[54] Given these facts, it is extraordinarily unwise for the Agencies to eliminate entirely the resolution planning requirement for many banks within this group of large institutions. S. 2155 gave the Agencies discretion to continue to require resolution planning for banking organizations with \$100 billion to \$250 billion in assets, and the Agencies should exercise that discretion by continuing to require that all of these firms submit credible resolution plans, tailored to their risk, complexity, activities, and related relevant characteristics.

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53 BOARD & FDIC, RESOLUTION PLAN ASSESSMENT FRAMEWORK AND FIRM DETERMINATIONS 5, (2016), https://www.fdic.gov/news/news/press/2016/pr16031a.pdf.

54 Lael Brainard, Member of the Board of Governors of the Federal Reserve, Statement on Proposals to Modify Enhanced Prudential Standards for Large Banking Organizations (Apr. 8, 2019) https://www.federalreserve.gov/newsevents/pressreleases/3B1F641BEB4A485B994EBC38165F0F3B.htm ("During the crisis, the failures of large banks in the \$100 to \$250 billion asset size range necessitated distress acquisitions, and the failure of a large banking organization with roughly \$300 billion in assets triggered substantial spillovers. These episodes would have led to rapid depletion of the deposit insurance fund had the institutions not been acquired in distress—an avenue that is less likely to be available today than in the crisis.").

II. It Is Premature to Weaken Resolution Planning Requirements that Have Not Been Tested.

The Agencies cannot assess the adequacy of the current resolution planning regime because no firm subject to resolution planning requirements has actually had to implement its resolution plan. Accordingly, it is premature to consider weakening those requirements.

America is currently in the midst of one of the longest economic expansions on record.[55] That expansion has seen banks become more profitable than ever[56] even as they have become safer than ever—2018 was the first year since the financial crisis, and only the third year since 1933, in which not a single bank failed.[57] While these facts certainly speak to the wisdom and efficacy of Dodd-Frank and many of the regulatory reforms put in place since the financial crisis (and also as a rebuke to the deregulatory claims made by financial institutions and their allies), this state of affairs cannot last forever.

When the next economic downturn occurs—likely sooner rather than later given the length of the current expansion, among other factors—robust and credible resolution plans will be a critical tool in ensuring that the downturn does not turn into another Great Recession or worse. Most importantly, credible and up-to-date plans will provide a blueprint for how large and complex firms can be resolved without threatening financial stability and without requiring a government bailout. The plans will also provide policymakers and the public with key information about the operational and financial aspects of large and complex companies.

Whether the current framework is sufficiently robust to ensure that resolution plans perform these key functions adequately cannot be known with any reasonable certainty before any company has had to use its resolution plan, and especially before the plans have been through the stresses of an economic downturn, cyclical or otherwise. At this point in the business cycle, the Agencies should be reviewing the resolution planning regime to ensure it is sufficiently strong and robust, not proposing to weaken it so that resolution plans are likely to be of little use when actually needed.

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55 Catherine Rampell, Opinion, *Happy 10th Birthday to the Economic Expansion. Don't Count on an 11th*, WASH. POST (June 3, 2019), https://www.washingtonpost.com/opinions/happy-10th-birthday-to-the-economic-expansion-dont-count-on-an-11th/2019/06/03/5b1ecfe6-863b-11e9-a870-b9c411dc4312_story.html?utm_term=.6be85856f36e.

56 Sylvan Lane, *Bank Profits Rise 8.7 Percent in First Quarter of 2019*, THE HILL (May 29, 2019), https://thehill.com/policy/finance/446005-bank-profits-rise-87-percent-in-first-quarter-of-2019.

57 Hugh Son, *For the First Time Since 2006, Not a Single U.S. Bank Failed Last Year*, CNBC (Jan. 10, 2019), https://www.cnbc.com/2019/01/09/for-the-first-time-since-2006-not-a-single-us-bank-failed-last-year.html?__source=sharebar%7Ctwitter&par=sharebar.

III. NO INDUSTRY EVIL REQUIRED; JUST THE SIREN SONG OF COMPETITIVE PRESSURES

Importantly, the sort of excessive risk-taking that can lead to financial crisis, and which resolution plans are intended to identify and mitigate, does not require evil actors or motives in the industry. It is the nature of markets and financial firms, individually and collectively, to take on risk in pursuit of higher short-term profits. This impulse is especially powerful where the cost of failure is likely to be externalized if, for example, there is an expectation that failing firms will be bailed out by taxpayers. That is the unsettling, but undeniable, truth behind former Citigroup Chief Executive Officer Chuck Prince's infamous and much misunderstood quote in July 2007:

> When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing.[58]

Translation: When a financial institution and its peer group are making lots of money doing roughly the same thing (**meaning**, the market "music" is playing), they have to keep doing the same thing ("dancing") or their revenues, profits, bonuses, and stock will go down **relative** to their peer group.

While doing otherwise may be tolerated by a board and stockholders for a short time, it will not last long as revenues, profits, and share prices drop relative to their peers. That is why Mr. Prince was right: "as long as the music is playing, you've got to get up and dance" or you will be replaced with someone who will.

That is the (oversimplified) history of Morgan Stanley in the 2000s. John Mack was CEO until ousted in 2001, when Paul Purcell was appointed CEO. Morgan Stanley then pursued a business diversification strategy, seeking relatively stable revenues and profits from a broad mix of businesses that avoided the high-risk, high leverage and high return trading gambling that was taking off at its rivals. As its revenues, profits, bonuses, and share prices lagged its rivals, the board ousted Mr. Purcell and in June 2005, brought back Mr. Mack as CEO, clearly with the mandate to catch up with its rivals by doing what they were doing.

As the Siren Song of deregulatory music played, Mr. Mack got Morgan Stanley up and dancing to the tune of big proprietary trading, structured products, and subprime mortgage activities. However, just a little over two years later in the fall of 2007, Morgan Stanley was forced to begin recognizing gigantic proprietary trading losses at the same time it was forced to take substantial subprime-related write downs, which eventually were cumulatively so crippling that

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58 *See* Michiyo Nakamoto and David Wighton, *Citigroup chief stays bullish on buy-outs*, FIN. TIMES (July 9, 2007), https://www.ft.com/content/80e2987a-2e50-11dc-821c-0000779fd2ac.

Morgan Stanley was on the verge of failure in the days following Lehman's bankruptcy and required a bailout by the Board to survive.[59]

To his credit, Mr. Mack recognized what had happened and in 2009, embraced financial reform, regulation, and regulators. In fact, he went so far as to say

> [**w]e cannot control ourselves**. You [lawmakers and regulators] have to step in and control the Street. Regulators? We just love them.[60]

This cautionary tale and the broader history before, during, and after the 2008 crash demonstrate why banking regulators and supervisors as well as oversight, regulation, and enforcement generally are so critically important. Put differently, they have to step in and slow the tune if not change the song or stop the "music" altogether, regardless of how much "dancing" the private sector is doing or wants to do.

Without regulators taking such independent and, at times, unpopular actions (unpopular at least among the regulated industry), the public interest is subordinated and exposed to the erratic and volatile dynamics of the marketplace, with devastating crashes the inevitable result.

CONCLUSION

The Proposal is inconsistent with the letter, spirit, and intent of the Dodd Frank Act and lacks a credible justification for weakening the current resolution planning regime. Reducing the frequency and content of resolution plans will make the plans less useful and less credible, undermining the entire purpose of the resolution planning requirement. It risks breathing new life into too-big-to-fail and making systemic risk and contagion more likely. The Agencies should not adopt these unnecessary proposals. We hope you find these comments helpful.

Sincerely,

[redacted]

59 An internal Board email from September 20, 2008, shows that Morgan Stanley indicated they could not open the following Monday, and that Goldman Sachs, hearing this news, admitted that it was "toast" unless it could convert to a bank holding company. Better Markets Press Release, Email Shows Goldman Admitted It Was "Toast," (Sept. 21, 2018), https://bettermarkets.com/newsroom/email-shows-goldman-admitted-it-was-toast.

60 *Regulators? We Just Love 'em, says John Mack*, THE EVENING STANDARD (Nov. 19, 2009), https://www.standard.co.uk/business/regulators-we-just-love-em-says-john-mack-6744822.html (quoting John Mack) ("We cannot control ourselves. You have to step in and control the Street. Regulators? We just love them."); *see also* Dealbook, *Morgan Stanley's Mack: 'We Cannot Control Ourselves,'* N.Y. TIMES (Nov. 19, 2009) (same), https://dealbook.nytimes.com/2009/11/19/morgan-stanleys-mack-we-cannot-control-ourselves.

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