Banking and Finance Law Daily Wrap
Up, TOP STORY—Big banks’ living wills have deficiencies, weaknesses, and shortcomings, (Apr. 13, 2016)

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The Federal Deposit Insurance Corporation and the Federal Reserve Board have jointly announced determinations and provided firm-specific feedback on the 2015 resolution plans of eight systemically important, domestic banking institutions. These banking institutions are also referred to as global systemically important banks or GSIBs.

Under the Dodd-Frank Act, bank holding companies with total consolidated assets of $50 billion or more and nonbank financial companies designated by the Financial Stability Oversight Council as systemically important periodically are required to submit resolution plans, commonly referred to as “living wills,” to the FDIC and the Fed. Each plan must describe the company’s strategy for rapid and orderly resolution under the U.S. Bankruptcy Code or other applicable insolvency regime in the event of material financial distress or failure of the company. Regulations implementing the requirements of section 165(d) of the Dodd-Frank Act were issued by the FDIC and Fed in November 2011 and are codified at 12 C.F.R. Part 243 and Part 381.

The agencies issued “Resolution Plan Assessment Framework and Firm Determinations (2016),” which explained the resolution planning requirement, and provided further information on the determinations and the agencies’ processes for reviewing the plans.

**Deficiencies.** The agencies jointly determined deficiencies in the 2015 plans of Bank of America, Bank of New York Mellon, JP Morgan Chase, State Street, and Wells Fargo. The agencies have issued feedback letters to these five firms (Bank of America, Bank of New York Mellon, JP Morgan Chase, State Street, and Wells Fargo) detailing the deficiencies in their plans and the actions the firms must take to address them, as required by the Dodd-Frank Act and the agencies’ rule. The nature, rather than the number, of deficiencies identified in a firm’s plan reflects the extent of the required remediation.

Each firm must remediate its deficiencies by Oct. 1, 2016, as specified in the feedback letters; and provide a targeted submission addressing their deficiencies by that date. The agencies will review each submission and consider whether the firm has adequately remediated its deficiencies.

Finally, the agencies found that, with the exception of Wells Fargo, the other four firms also have shortcomings, which must be addressed by the submission of their July 2017 resolution plans.
Weaknesses. The agencies jointly identified weaknesses with regard to the 2015 plans of Goldman Sachs and Morgan Stanley; however, the FDIC and Fed did not make any joint determinations regarding the two plans and their deficiencies.

Commenting on Goldman Sachs’ resolution plan, the FDIC found that the plan was not credible or would not facilitate an orderly resolution under the Bankruptcy Code and identified deficiencies. Specifically, the FDIC found that Goldman Sachs “exhibited particular weaknesses” related to post-resolution derivatives and liquidity methodology.

The Fed identified a deficiency in Morgan Stanley’s plan and found that the plan was not credible or would not facilitate an orderly resolution under the Bankruptcy Code. The Fed faulted Morgan Stanley’s resolution-related liquidity position.

Since the agencies did not make joint findings regarding the plans and their deficiencies, the identified weaknesses constitute shortcomings required to be addressed in their July 2017 resolution plans.

Shortcomings. The agencies jointly identified shortcomings in Citigroup’s 2015 plan, particularly with regards to governance triggers; however, neither agency identified deficiencies. The shortcomings must be addressed in the firm’s July 2017 plan.

Foreign banks. In a press release, the Fed and FDIC noted that they are continuing to assess the plans for the four foreign banking organizations that filed resolution plans on July 1, 2015—Barclays PLC, Credit Suisse Group, Deutsche Bank AG, and UBS.

Guidance for 2017 plans. To assist the eight banking institutions in drafting their 2017 resolution plans, the Fed and FDIC also released guidance that describes the agencies’ expectations for these plans. The document highlights specific areas where additional detail should be provided and where certain capabilities or optionality should be developed to demonstrate that each firm has considered fully, and is able to mitigate, obstacles to the successful implementation of their preferred resolution strategies.

Significant step forward. Following release of the agencies’ determinations and feedback, FDIC Chairman Martin J. Gruenberg called the agencies’ actions “a significant step forward in the use of living will authority.” He added, “The FDIC and Federal Reserve are committed to carrying out the statutory mandate that systemically important financial institutions demonstrate a clear path to an orderly failure under bankruptcy at no cost to taxpayers.”

Hoenig concerns. On the other hand, FDIC Vice Chairman Thomas M. Hoenig had a number of concerns. He noted that, while having a credible living will is essential to supervision of these largest banking institutions, it unfortunately is not sufficient to assure an orderly bankruptcy since the living wills are based on an unrealistic assumption that individual GSIBs would be able to withstand the systemic shock arising from the failure of another GSIB.

Hoenig was also concerned that most of these plans are reliant on the single point of entry strategy which emphasizes dependence on the long-term debt component of total loss absorption.
capacity. He was of the opinion that this dependence on long-term debt serves as a justification for holding less equity capital and makes the financial system more vulnerable to financial shocks.

“Fix this broken process”. Commenting for the U.S. Chamber of Commerce Center for Capital Markets Competitiveness, David Hirschmann, the CCMC’s president and CEO, stated, “If living wills are to be a productive tool for financial stability, regulators must fix this broken process and markets need to know how those systems will improve the allocation of capital. Contradictory outcomes through different tools such as stress tests and living wills harm the ability of regulators to achieve financial stability and for market participants to understand what regulators are doing.”

Continuing to learn. Rob Nichols, president and CEO, of the American Bankers Association said, “Today’s results show that both banks and regulators continue to learn from the living wills process. Banks have made tremendous strides in adding hundreds of billions of dollars in additional capital, improving liquidity and better managing risk since the financial crisis. These efforts ensure the industry is well equipped to handle any economic circumstance that could arise.

He added, “While issues remain, we’re confident that they can be resolved as part of the ongoing dialogue of the supervisory process. Each iteration brings more value for both the regulators and the institutions they supervise, and provides an important roadmap for further work that needs to be done.”

Companies: American Bankers Association Bank of America; Bank of New York Mellon; Barclays PLC; Center for Capital Markets Competitiveness; Credit Suisse Group; Deutsche Bank AG; JP Morgan Chase; State Street; UBS; U.S. Chamber of Commerce; Wells Fargo

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