



FedFin Client Report

Wednesday, March 22, 2023

FedFin Assessment: GSIB Rules Set For Post-CS Rewrite

Client Report: GSIB21

Executive Summary

In this report, we assess the implications of recent events on two assumptions underlying current U.S. and global policy affecting GSIBs and those considered domestic SIBs: first, all are likely to be well insulated from illiquidity and/or insolvency and, when this is not the case, then orderly resolution without taxpayer bailout can be readily deployed. Credit Suisse's failure and subsequent, subsidized acquisition is just one of the "Minsky moments" rattling regulators and other policy-makers, with the conclusions drawn from all of them surely to lead to significant reevaluation of each of these assumptions. To be sure, CS was an outlier in terms of idiosyncratic culture-and-control problems, but the Swiss regulatory and resolution system is considered reasonably robust, thus making the bank's failure a global policy concern. The flood of deposits out of regional banks to the largest U.S. banks also further concentrates the sector, a result the Fed and Department of Justice will view with alarm even though they recognize that recent events are not the fault of the largest banking organizations. In this report, we assess implications for U.S. merger policy, OLA, TLAC, resolution planning, and other standards. See our [Client Report RESOLVE49](#) for a discussion of capital and liquidity standards, [Client Report DEPOSITINSURANCE118](#) for revisions to FDIC thresholds, and [Client Report LIQUIDITY33](#) for run-specific policy actions.

Analysis

Key issues include:

- **Merger Policy:** Unless or until deposits flow back to smaller banks, the nation's largest are now still larger and thus pose still greater concern to those long pushing to contain or even break them up. In the nearest term, we think actions in this arena will focus on the integration of CS and UBS in the U.S. The Fed surely assured Swiss regulators that it would pose no impediments to this integration, but that of separately-incorporated entities will still need to go through not only the Fed-approval process, but also the Department of Justice's. This is likely to allow integration, but perhaps only after specific divestiture commitments. Pending regional deals already facing obstacles (e.g., TD/FH) face still greater hurdles even though some have shrunk under recent stress.

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- **TLAC:** There has been considerable confusion about the loss-absorbing instruments liquidated in the CS resolution. These were so-called alternative Tier 1 (AT1) obligations that, while debt, serve as an equity-equivalent based on terms required by applicable regulators implementing the FSB's TLAC construct ([see FSM Report TLAC7](#)). Swiss rules reportedly required trigger AT1 calls in a supervisory resolution. In contrast, U.S. TLAC rules ([see FSM Report TLAC6](#)) generally do not allow for equity-linked notes, instead requiring GSIBs and FBOs considered GSIBs in the U.S. to meet TLAC via long-term debt creating a private liquidity pool from which at least some of the failed GSIB's obligations can be met at less cost than possible with quasi-equity because equity is likely to have been essentially wiped out ahead of a bankruptcy-like proceedings mandated under OLA ([see FSM Report SYSTEMIC30](#)). Over time, the FSB may return to and rewrite its TLAC standards; in the near term, the U.S. will quickly require GSIBs and large IHCs to demonstrate parent-company resolvability without regard to AT1 or similar obligations. The Fed and FDIC's controversial proposal to require TLAC of large regional banks will also gain new urgency at these agencies.
- **OLA:** As noted in Karen Petrou's March 20 [memo](#), the U.S. is supposed to resolve the largest banking organizations under OLA if bankruptcy does not suffice but has yet to ensure OLA is in fact operational. Robust GSIB living wills are intended to ensure ready resolution and many may well have done so under prior agency assumptions, but we expect the resolution-planning process nonetheless to get a significant revamp leading to considerably more ring-fencing of U.S. operations. If global and/or non-U.S. resolution authorities do the same, as seems likely, much of the cross-border branch structure will be adversely affected.