



Financial Services Management

Living-Will Requirements

Cite

FRB, FDIC; Guide for Resolution Plan Submissions of Domestic/Foreign Triennial Full Filers

Recommended Distribution

Risk Management, Resolution Planning, Policy, Audit/Examination, Legal, Government Relations

Websites

<https://www.fdic.gov/news/board-matters/2023/2023-08-29-notice-dis-c-fr-domestic.pdf>

<https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20230829b2.pdf>

Impact Assessment

- Regional and foreign banks will need to file stringent resolution plans that may lead to structural realignment.
- Some shifts – e.g., heightened FBO reliance on branches – run counter to other regulatory initiatives.
- Severability standards may reduce operating efficiency and have tax consequences.
- MPOE filers may need to restructure plans and perhaps even their strategy to meet MPOE-specific standards, a result also possible if they shift to SPOE plans.
- The ability to count on FHLB advances in resolution planning is unclear. If it is discouraged, then banks may need to realign current plans and develop additional sources of liquidity under stress.
- The extent to which legacy LTD counts for resolution-planning purposes will determine the value of the three-year LTD transition.
- Smaller-bank resolution planning and effective supervision could reduce the risk of regional-bank failures akin to those earlier this year and resulting systemic risk.

Overview

In conjunction with proposing a new long-term debt (LTD) requirement for categories II, III, and IV banks,¹ the Fed and FDIC are pursuing other ways to enhance resolvability. Among these is new guidance for large domestic and foreign banking organizations that requires U.S. banking organizations and foreign banking organization (FBO) intermediate holding companies (IHCs) along with all their insured depositories when any is over \$100 billion to file resolution plans. These are also redesigned to make the plans much closer in substance to those mandated for GSIBs.² However, in a leading indicator of what the FRB is also likely to demand of GSIBs, smaller companies would be required to ensure severability – that is, the ability to cut off a weak limb to save the rest of the banking organization or ensure ready resolution without undue cost to the FDIC or systemic risk. However, easing one aspect of current planning, banking organizations are expressly allowed to count on use of discount-window or other Fed lending facilities to avert failure if – and this is a significant new if – the plan rests atop sound collateral valuation and data-management systems.

¹ See **TLAC9**, *Financial Services Management*, September 6, 2023.

² See **GSIB14**, *Financial Services Management*, January 3, 2019.

Impact

During the lighter-touch phase of bank regulation at the end of the last decade, the Fed and FDIC eased resolution-filing requirements for category II and III banking organizations,³ allowing them to file full plans only every three years. The agencies now view this as insufficient based in part on mid-March bank failures and a newly-harsh view of the last plans filed by regional banks and foreign firms in 2021. The proposed guidance does not alter the current filing schedule, but it expands the number of entities subject to it and imposes new evaluation criteria and high agency expectations in formal guidance. If the agencies are dissatisfied that a firm's living will is credible, they can not only issue enforcement actions, but even mandate significant structural reform (e.g., material divestitures).

Among the express standards included in the new guidance would be that companies plan for seriously-adverse scenarios, with the agencies stating that the 2021 plans were often unduly optimistic. And, while the agencies state that they have no preference between single-point-of-entry (SPOE) and MPOE resolutions, aspects of the guidance appear to favor SPOE evidence by new liquidity and other standards applied to MPOE. If this proves the case, then large regional bank filers – all of which submitted MPOE plans in 2021 – would need to undertake a significant resolution-planning revamp that could force strategic realignment of the company's structure.

As presaged in an advance notice of proposed rulemaking focused on regional-bank resolution,⁴ the new guidance also has considerably more focus on insured depository institution (IDI) resolvability even though the FDIC has separately proposed other standards for large IDIs.⁵ This is particularly true for MPOE filers, which would also come under new standards under this guidance with regard to ensuring IDI resolvability. Much in the guidance tracks the FDIC's IDI-only proposal, making it unclear why it is incorporated also in this guidance unless – unspoken in the proposal – the agencies wish to give the Fed a role enforcing IDI-related resolution requirements via orders to parent holding companies.

Further, plans will now need to include the bank's own estimate of how its strategy complies with the obligation imposed on law by the FDIC to accomplish a resolution at the least cost to the Deposit Insurance Fund (DIF). It is unclear how a filing bank is to put itself in the FDIC's shoes, but the general thrust of this injunction may be to reinforce the warning also included in the guidance that plans for purchase-and-assumption IDI resolutions must be realistic about applicable market circumstances at times of acute stress.

One of the key lessons of the March failures was the extent to which troubled banks were ill-prepared to access the discount window. The new guidance for the first time makes it clear that banks may indeed count on use of Federal Reserve facilities, but only if they demonstrate advance planning ensuring ready collateral access and valuation. The proposal does not make it clear if counting on FHLB advances is included in the "lending facilities" cited in the proposal. If not, then the banking agencies may be seeking to constrain use of these funds given the challenges posed to collateral integrity and broader costs to the FDIC when there are significant outstanding liabilities to the Home Loan Bank System.

As noted, this proposal was issued in concert with new LTD requirements also intended to enhance covered-company resolvability. The agencies note in the resolution release that they intend to make final planning and guidance and the LTD rule "consistent,"

³ See **LIVINGWILL19**, *Financial Services Management*, April 30, 2019.

⁴ See **RESOLVE48**, *Financial Services Management*, October 21, 2022.

⁵ See forthcoming FedFin Report.

but offer no views as to how this might be done. Instead, comments are welcome on issues that, based on how the agencies resolve inconsistencies, could lead to significant changes to the LTD and/or resolution standards. For example, the agencies ask if the LTD rule's three-year transition could apply to LTD amounts considered for resolvability; if they do not, then firms might need to issue all of their required LTD or even more far more quickly than the LTD rule contemplates.

The proposed resolution standards also interface with the new capital construct under parallel consideration by the Fed, OCC, and FDIC.⁶ Capital expectations for SPOE filers are comparable to those demanded of GSIBs, but the GSIB guidance allows consideration of debt that the banking organization may convert into equity to enhance the chances of continuing as a going concern; the LTD proposal does not contemplate like-kind instruments at either the parent or IDI level, making it unclear how the equity-related requirements would apply. Comment is also sought on this issue, which the agencies appear to recognize as a potential inconsistency that would need to be addressed.

What's Next

The filing guidance was approved on a 4-1 vote by the FDIC and 5-1 Federal Reserve vote on August 29. As with the capital and LTD proposals, comments are due by November 30.

The new round of regional-bank living-will filings from categories II and III companies is due on July 1, 2024, making compliance challenging given the short notice more than likely once the agencies review comments and issue final guidance. The proposal thus says that covered filers are to bring their plans into conformity as quickly as they can, with the agencies also considering a short extension (i.e., less than a year) of the next filing date; comment is sought on this extension, which is likely to be very popular.

Analysis

A. Domestic Companies

The purpose of these standards is to ensure ready resolution under bankruptcy for a parent holding company and IDI resolution at least cost to the FDIC without in either case posing systemic risk. Thus, they allow a parent company to position LTD at the corporate level deemed most important for this approach, a sharp contrast to the proposed TLAC standards for categories II, III, and IV banking organizations which expressly mandate external and internal TLAC.⁷ Much here otherwise resembles the resolution requirements for GSIBs with regard to matters such as intervening companies.⁸ With these requirements varying in numerous ways for SPOE or MPOE resolutions, companies and IDIs would generally need to:

- possess sufficient capital for resolution to meet well-capitalized standards and otherwise suffice throughout the resolution. Material entities not subject to capital standards are to meet investment-grade ratings or independently reviewed;
- meet detailed pre-positioned liquidity standards, assuming ring-fencing at key subsidiaries;

⁶ See *Client Report CAPITAL234*, August 17, 2023.

⁷ See *TLAC7*, *Financial Services Management*, January 11, 2017.

⁸ See *TLAC6*, *Financial Services Management*, December 21, 2016.

- comply with governance standards tailored for SPOE and MPOE resolutions, with triggers defined for board action and legal agreements to accomplish it in SPOE designed to ensure rapid recapitalization of the key subsidiaries, giving consideration to an IHC where appropriate. No similar guidance covers MPOE;
- ensure continuity in key payment, settlement, and clearing functions whether as user or provider, with express standards defined for SPOE playbooks;
- manage collateral exposures, with new provisions here likely intended to avoid the confusions that undermined Signature Bank's resolution;
- map internal liquidity and credit exposures along with the full range of legal commitments;
- anticipate the effect of early-termination and cross-default provisions in QFCs at the parent and material-subsiary levels as well as other QFC obligations and exposures that could affect resolvability;
- ensure the firm's legal structure facilitates holding company, IDI, and other material-subsiary resolution. Issues to be addressed include the extent to which a material IDI subsidiary depends on affiliates that are not within the IDI for shared services. In addition to these legal-entity issues, firms are required to ensure severability under stress, with different standards for doing so set out for SPOE and MPOE plans. Severability plans are to be actionable (e.g., ensure ready divestiture), with impediments identified and potential systemic risks and mitigated ahead of time. Baseline capabilities for ensuring severability are also detailed;
- have and readily populate a data room demonstrating the severability plan's actionability and allowing the FDIC quickly to divest the company in the event of resolution;
- not assume waivers of inter-affiliate transaction restrictions;
- support any assumptions that the firm will have discount-window accessor use any other lending facilities. Numerous details are proposed to ensure ready eligibility and collateral access; and
- if the resolution plan for material IDIs assumes separate IDI resolution, ensure the plan is at the FDIC's least cost and poses no systemic risk.

The proposal also includes extensive detail on standards for the format and structure of SPOE and MPOE plans.

B. Foreign Filers

Much related to foreign filers tracks the proposal for U.S. triennial filers. However, different protocols are specified for foreign firms that do or do not have U.S. SPOE plans, also specifying that the foreign firm must consider its U.S. resolution in light of group-wide priorities and resolution plans.

C. Request for Comment

In addition to the issues noted above, questions posed include:

- the need for additional liquidity standards for MPOE resolutions;
- the need to apply the governance standards applicable to SPOEs to MPOEs;
- the need for additional severability and purchase-transaction considerations requirements in MPOEs;
- the need for guidance on derivatives and trading activities; and
- the need for clarity on the extent to which plans may assume access to the discount window or other lending facilities.