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Legal Update
May 2, 2011

US FDIC and Federal Reserve Propose Rule on Resolution Plans and Credit Exposure Reports

The US Federal Deposit Insurance Corporation (FDIC) and the Board of Governors of the Federal Reserve System (FRB) have jointly approved a proposed rule requiring certain companies to periodically submit Resolution Plans (also referred to as "living wills") and Credit Exposure Reports (the "Proposed Rule") to the FRB and FDIC.[1]

The Proposed Rule implements Section 165(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Section 165 was added to the Dodd-Frank Act in reaction to concern that US authorities lacked the ability to address financial problems encountered by systemically significant financial institutions that previously were not subject to comprehensive supervision equivalent to that of bank holding companies, FDIC insured banks, and insurance companies.

Section 165 requires increased supervision, and the establishment of more stringent prudential standards for certain significant companies,[2] in order to prevent or mitigate risks to the US financial system as a result of the financial distress, failure, or ongoing activities of such companies. Coupled with the Orderly Liquidation Authority provided under Title II, federal regulators under the Dodd-Frank Act now possess significantly enhanced authority to supervise nonbank financial firms that could impact the stability of the US financial system. Further, in the event of significant deterioration in the condition of such firms, federal regulators now have the authority to step in and resolve these issues in much the same manner as the FDIC resolves troubled banks. Companies deemed to be systemically significant are defined to include nonbank financial companies designated as such by the FRB, and any bank holding company or non-US bank that is treated as a bank holding company having $50 billion or more in total consolidated assets (the "Covered Companies").[3]

Under the Proposed Rule, a US Covered Company would be required to submit information regarding both its US and non-US operations. A non-US Covered Company would only be required to provide information with respect to its US operations, with an explanation of how the Covered Company integrates its resolution planning for US operations into its overall contingency planning process, as well as information regarding the interconnections and interdependencies between its US and non-US operations (referred to in the Proposed Rule as "mapping").

Impact of Proposed Rule on Covered Companies

Compliance with the Proposed Rule will likely be burdensome, expensive, resource-intensive, and time-consuming. Potentially covered companies should consider taking an active role in the comment process and should carefully review the requirements of the Proposed Rule and what will be required in order to comply with it. The

comment period will end on June 10, 2011. Section 165 of Dodd-Frank requires the FRB and FDIC to issue a final rule by January 21, 2012; the initial Resolution Plan for Covered Companies must be submitted within 180 days of the effective date of the final rule.

The Proposed Rule sets forth the types of information that will need to be included in Resolution Plans and Credit Exposure Reports. It does not, however, define what will constitute satisfactory submissions for Resolution Plans, beyond the requirement that a Resolution Plan must be credible and able to facilitate an orderly resolution of the Covered Company. Indeed, it appears that, after an initial evaluation, Covered Companies may find themselves negotiating with either the FRB or the FDIC over the sufficiency of their Resolution Plans. This lack of specificity increases the potential burden of the Proposed Rule and could create significant uncertainty as to the impact Resolution Plans will have on ongoing bank activities. Failure to obtain regulatory approval of a proposed Resolution Plan within 90 days of being advised by the regulators that a proposed plan is insufficient could result in heightened capital, liquidity or leverage requirements. Failure to reach accord within two years, as explained more fully below, could cause the regulators to move to require divestiture of a Covered Company's operations as the FRB and FDIC deem necessary.

In addition, to the extent the Proposed Rule requires disclosure of confidential information from a home country, non-US banks may find that the interplay between the Proposed Rule, including the vast amount of nonpublic financial information required by it, and similar requirements imposed by home-country regulators could be in conflict. For example, while a Covered Company can request confidential treatment for information submitted in compliance with the Proposed Rule, the determination of what will be accorded such treatment will be made by the FRB and FDIC and may not align with home country requirements.

The Proposed Rule comes at a time when non-US jurisdictions are contemplating similar regulation of systemically significant financial institutions. In January 2011, the European Commission released a consultation paper requesting comment on technical details regarding a proposed framework for crisis management in the financial sector, including resolution planning.[4] The European Commission also intends to adopt a legislative proposal on bank recovery and resolution in June 2011.[5]

In addition, the Financial Stability Board (FSB) stated in a report to G20 finance ministers and central bank governors that it is working on a comprehensive program that will include essential features and tools for a national resolution regime for financial institutions and non-bank financial institutions, and that an FSB Working Group is drafting a list of key attributes of effective resolution regimes, to be released in mid-2011 and finalized by the end of the year.[6]

Overview of Resolution Plans

The Proposed Rule requires each Resolution Plan to contain the following:

- *Executive Summary*—A summary of the key elements of the strategic plan, any material changes[7] that would affect the most recently filed Resolution Plan, and actions taken to improve the plan's effectiveness or remedy any material weakness of the plan.
- *Strategic Analysis*—An analysis/explanation of the Covered Company's plan for a "rapid and orderly resolution." A "rapid and orderly resolution" is defined as a "reorganization or liquidation...under the Bankruptcy Code that can be accomplished within a reasonable period of time and in a manner that substantially mitigates minimizes the risk" of adversely affecting the stability of the US financial markets.[8] The analysis should set forth key assumptions, specific actions to be

taken to facilitate a rapid and orderly resolution of a Covered Company's "material entities,"[9] "critical operations"[10] and "core business lines,"[11] and an analysis of how a Covered Company's key resources (funding, liquidity, support functions, capital) could be leveraged for such orderly resolution, with a focus on the possibility that the resolution may occur during a time of financial distress in the United States. The analysis also is to include a strategy to protect any insured depository institution subsidiary from risks that may arise from the Covered Company's nonbank subsidiaries, including any non-US subsidiaries.

- *Description of Corporate Governance Structure for Resolution Planning*—The corporate governance structure description should identify the senior management official[12] responsible for the Resolution Plan and compliance with the proposed rule, as well as information on how resolution planning is incorporated into the Covered Company's processes and corporate governance structure.
- *Information Regarding Overall Organization Structure*—This information is to include (i) a hierarchical list of material entities, and jurisdictional and ownership information mapped to core business lines and critical operations; (ii) an unconsolidated balance sheet and a schedule that would govern the consolidation of entities that would be subject to consolidation; (iii) information on material assets, liabilities, derivatives, hedges, capital and funding sources, and major counterparties; (iv) an analysis of the effects of a potential bankruptcy of a major counterparty; (v) identification of trading, payment, clearing and settlement systems; and (vi) an explanation of risks related to non-US operations, including the impact of differing national laws, regulations, and policies on the Covered Company's resolution planning.[13]
- *Information Regarding Management Information Systems*—This portion of each Plan should identify the management information systems that support its core business lines and critical operations, including ownership of the systems and related intellectual property, and should address the continued availability of such systems in and outside of the United States.
- *Description of Interconnections and Interdependencies*—A description of interconnections and interdependencies between the Covered Company and its material entities and affiliates, and among the Covered Company's critical operations and core business lines, with a focus on how it will ensure the continuing availability of key services and support to its critical operations and core business lines.
- *Supervisory and Regulatory Information*—Identification of the Covered Company's supervisory authorities and regulators, including non-US regulators with authority over any material non-US subsidiaries or operations.

Review of Resolution Plans

Under the Proposed Rule, within 60 days of submission of a Covered Company's Resolution Plan, the FRB and FDIC will determine whether the plan satisfies certain minimum information requirements. If "informationally complete," the plan will be allowed to move forward to undergo further review; if not, the Covered Company will have 30 days after receiving notice of the plan's deficiencies to resubmit a satisfactory plan.

Once accepted for further review, the FRB and FDIC will evaluate whether a Resolution Plan is "credible" and whether it would facilitate an orderly resolution under the Bankruptcy Code. If after this phase of review, a Resolution Plan is found to be deficient, the FRB and FDIC would jointly notify a Covered Company, identifying the plan's problem areas. A Covered Company would then have 90 days, with the possibility of an extension, from receipt of the notice to resubmit a plan that addresses the deficiencies.

If a Covered Company fails after the 90 day period to cure identified deficiencies in its Resolution Plan submission, the FRB and FDIC may subject the Covered Company or its subsidiaries to more stringent capital, leverage, or liquidity requirements, or restrict its growth, activities or operations. These measures would be imposed until the Covered Company's Resolution Plan is brought in line with supervisory expectations. If a Covered Company has not achieved approval of its Resolution plan after two years, the FRB and FDIC may jointly order the Covered Company to divest certain assets or operations, as necessary to facilitate an orderly resolution of the Covered Company.[14]

Before issuing a notice of deficiencies, imposing more stringent requirements, or ordering a divestiture that will have a significant impact on a functionally regulated subsidiary or depository institution subsidiary, the FRB and FDIC are required to consult with the member of the Financial Stability Oversight Council that primarily supervises the affected subsidiary, and may consult with other US or foreign regulators as the FRB deems appropriate.

Credit Exposure Reports

Starting in 2012, Covered Companies will be required, on a quarterly basis,[15] to report on their credit exposure (including that of subsidiaries) to systemically significant companies. In addition, these credit exposure reports must cover the exposure of systemically significant entities to the Covered Company. The reports must address the following types of exposures:

- Extensions of credit, including intra-day credit, and committed but undrawn lines of credit;
- Deposits and money placements;
- Repurchase and reverse repurchase agreements;
- Securities borrowing and lending transactions;
- Guarantees, acceptances, and letters of credit;
- Purchases of or investments in securities;
- Counterparty credit exposure connected to a derivative transaction; and
- Any other credit exposure the FRB determines to be appropriate.

Other Provisions

The Proposed Rule also provides that it is non-binding on a bankruptcy proceeding or orderly liquidation under Title II of the Dodd-Frank Act, and clarifies that it provides no private right of action based on a Resolution Plan or any action taken by the FRB or FDIC in connection with a Resolution Plan. These provisions are also contained in Section 165(d) of the Dodd-Frank Act.

Endnotes

[1] The full text of the FDIC's Proposed Rule, issued on March 29, 2011, is available at http://www.fdic.gov/news/board/29Marchno4.pdf.

On April 12, 2011, the FRB also approved the proposed rule. The FDIC and FRB proposals are materially the same; *see* 76 Fed. Reg. 22648 (April 22, 2011), available at http://edocket.access.gpo.gov/2011/pdf/2011-9357.pdf.

In May 2010, prior to the enactment of the Dodd-Frank Act, the FDIC issued a similar "living will" Proposed Rule that would have required certain large insured depository institutions to submit a "contingent resolution plan" describing how the institution could be effectively separated from its parent companies and/or affiliates in the event of the institution's failure or the bankruptcy of the parent company or any key affiliate. *See* 75 Fed. Reg. 27464 (May 17, 2010).

[2] Earlier this year, the FRB issued a proposed rule that would define what constitutes a "significant" nonbank financial company and bank holding company. 76 Fed. Reg. 7731 (Feb. 11, 2011).

[3] Based on the FRB proposal that was published on February, 11, 2011, for purposes of that proposal and thus the Proposed Rule, total consolidated assets would be calculated by the average of the four most recent Form FR Y-9C filings for a US bank holding company, and by the most recent annual or, as applicable, the average of the four most recent quarterly Form FR Y-7Q filings for a non-US bank or company that is treated as a bank holding company. This means that, for instance, a non-US bank with a small New York branch operation would, nevertheless, have to comply with the Proposed Rule, if the

worldwide assets of the non-US bank exceed $50 billion, regardless of the size of the US branch operations.

[4] European Commission Consultation IP/11/10 is available at: http://ec.europa.eu/internal_market/consultations/docs/2011/crisis_management/consultation_paper_en.pdf.

[5] *Id.*

[6] *Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability*, Report of the Financial Stability Board to G20 Finance Ministers and Central Bank Governors (February 15, 2011), available at: http://www.financialstabilityboard.org/publications/r_110219.pdf.

[7] A "material change" includes: significant acquisition, sale, discontinuation of a business, dissipation of assets, bankruptcy, material reorganization, and other events.

We note that the Proposed Rule uses the modifier "material" throughout, and only defines it in a few instances. For example, "material loss of revenue, profit, or franchise value," "material reorganization," "material license," "material weakness," "material components of the liabilities," "material off-balance sheet exposures," "material hedges," "material number," and "materially affect" are used without definition. This lack of clarity could add to the difficulty of compliance with the Proposed Rule, and give additional latitude to the FRB and FDIC to require revisions.

[8] The definition of "rapid and orderly resolution" contemplates resolution only in the context of the Bankruptcy Code, and does not address other applicable resolution regimes (in particular, the Orderly Liquidation Authority under Title II of Dodd-Frank Act that would apply to non-bank systemically important financial institutions).

[9] A "material entity" is a subsidiary or foreign office that is significant to the activities of a critical operation or core business line.

[10] "Critical operations" include operations that upon failure or discontinuation would result in a disruption to the US economy or financial markets.

[11] "Core business lines" include business lines, services, and functions that upon failure would result in a material loss of revenue, profit, or franchise value.

[12] A US-based Covered Company's board of directors must approve the initial Resolution Plan and each plan filed annually. A delegee may approve any updates. For a non-US Covered Company, a delegee of the board of directors, presumably the head of US operations, may approve the initial and annual Resolution Plans as well as any updates.

[13] This section will require a Covered Company with non-US operations to map its core business lines and critical operations to non-US entities or entities with assets, liabilities, operations or service providers located outside the US, and track the ability to maintain the core business lines and critical operations during material financial stress or insolvency proceedings.

[14] Although remote, we note that because the Proposed Rule contemplates joint enforcement by the FDIC and FRB, there exists the possibility that the FDIC, for the first time, could be involved in regulating a Covered Company whose only US presence is a US branch that is not FDIC insured.

[15] Section 165(d) of the Dodd-Frank Act only requires "periodic," not "quarterly," reports. If a potentially Covered Company finds this overly burdensome, the statutory language of the Dodd-Frank Act could provide a basis for comment that the reports should be less frequent.

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