FRB and FDIC Issue Rules on Resolution Plans

On October 17, 2011, the Board of Governors of the Federal Reserve System (FRB) approved a final rule (the "Resolution Plan Rule") requiring certain large bank holding companies, non-US banks with US banking operations, and systemically significant nonbank financial companies to periodically submit to the FRB and the Federal Deposit Insurance Corporation (FDIC) (collectively, the "Agencies") comprehensive plans for the rapid and orderly resolution of the company under the Bankruptcy Code in the event of material financial distress or failure ("Resolution Plans").[1] The FDIC approved the rule on September 13, 2011.[2]

Also on September 13, 2011, the FDIC issued an interim final rule requiring insured depository institutions with $50 billion or more in total assets to submit a plan for the resolution of the institution under the Federal Deposit Insurance Act in the event of the institution's failure (IDI Rule).[3] The interim final IDI Rule attempts to harmonize the IDI requirements with those that will now apply to large bank holding companies under the Resolution Plan Rule.[4] For example, the IDI Rule specifically allows an insured depository institution subject to the rule (a Covered Insured Depository Institution, or "CIDI") to incorporate information from its parent holding company's Resolution Plan under the Resolution Plan Rule.[5]

The Resolution Plan 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 to ensure that the FRB and other US bank regulatory authorities possessed sufficient powers to supervise and establish more stringent prudential standards for large bank holding companies and significant nonbank companies in order to prevent or mitigate risks to the US financial system.[6] Coupled with the Orderly Liquidation Authority (OLA) provided under Title II, federal regulators under the Dodd-Frank Act now possess significantly enhanced authority to supervise large bank holding companies and nonbank financial firms whose failure could impact the stability of the US financial system. In addition, in determining whether to place a financial company into receivership under OLA, federal regulators are required to determine whether the Bankruptcy Code provides an alternative to resolution under OLA. The Resolution Plans thus will provide federal regulators with information that will influence that assessment.

Companies covered under the Resolution Plan Rule include: (i) nonbank financial companies supervised by the FRB and (ii) any bank holding company or non-US bank that is treated as a bank holding company that has $50 billion or more in total consolidated assets on a global basis (the "Covered Companies").[7] In response to the proposed Resolution Plan Rule, commenters argued to exclude non-US Covered Companies with less than $50 billion in US assets. This argument was rejected but, as discussed below, the Resolution Plan Rule does provide for a streamlined process for non-US banking organizations that have small US operations.

Indeed, the preamble to the Resolution Plan Rule acknowledged that "the resolution plan of a foreign-based company that has limited assets or operations in the United States would be significantly limited in its scope and complexity."

Because the statutory $50 billion test applies to all of Section 165, not just the resolution plan requirement of Section 165(d), this broad interpretation of the test in the resolution plan context makes it almost certain that the same global measurement test will be applied for purposes of the other enhanced "prudential standards" for large bank holding companies, including risk-based capital requirements and leverage limits, liquidity requirements, and overall risk management requirements.

Impact of DFA and IDI Rules on Covered Companies

"TAILORED" RESOLUTION PLANS

Compliance with the Resolution Plan Rule will require a comprehensive analysis of a company's operations, overseen by the company's top management officials, and, importantly, approval by the company's board of directors. The development and maintenance of resolution plans are likely to require a substantial investment of time and resources. However, in a significant change from the proposed rule, the Resolution Plan Rule allows smaller Covered Companies and non-US Covered Companies with a small footprint in the United States to submit a "tailored" Resolution Plan focusing on the company's US nonbank operations. A Covered Company may be eligible to file a tailored plan if it (i) has less than $100 billion in total nonbank assets (for non-US Covered Companies, less than $100 billion in nonbank assets in the United States), and (ii) the Covered Company's total insured depository institution assets comprise 85 percent or more of the Covered Company's total consolidated assets (for non-US Covered Companies, the total assets of insured depository institutions and/or US branches and agencies comprise 85 percent or more of the Covered Company's total US consolidated assets).

Covered Companies that believe they qualify for the tailored plan approach must provide the Agencies with 270 days' prior notice of their intention to file a tailored Resolution Plan. Even if a Covered Company qualifies for a tailored plan under the Resolution Plan Rule, the Agencies retain discretion to require a Covered Company to submit a full resolution plan, or to submit additional information under the tailored plan approach.

TIMING

Covered Companies must submit an initial Resolution Plan to the Agencies on a staggered schedule, with the largest and most complex companies required to submit their Resolution Plans first. Specifically, initial Resolution Plans are due on:

- **July 1, 2012** for Covered Companies with total nonbank assets of $250 billion or more (for non-US Covered Companies, $250 billion or more in total US nonbank assets);
- **July 1, 2013** for Covered Companies with total nonbank assets between $100 billion and $250 billion (for non-US Covered Companies, between $100 billion and $250 billion in total US nonbank assets); and
- **December 31, 2013** for Covered Companies with total nonbank assets of less than $100 billion (for non-US Covered Companies, less than $100 billion in total US nonbank assets).

Updated Resolution Plans are due annually on or before the date of a Covered Company's initial submission. If a Covered Company experiences an event that might have a material effect on its Resolution Plan, it must notify the FRB and the FDIC within 45 days after the event.[8]

SCOPE OF RESOLUTION PLANS

Under the Resolution Plan Rule, a US Covered Company will be required to submit information

regarding both its US and non-US operations. However, a non-US Covered Company's plan, including a plan submitted by a Covered Company that does not qualify for the tailored plan approach, would only be required to address its US operations, with an explanation of how the Covered Company integrates its resolution planning for its US operations into its overall contingency planning process and information regarding the interconnections and interdependencies between its US and non-US operations.

As discussed below, the Resolution Plan Rule sets forth the types of information to be included in Resolution Plans. It does not, however, provide guidance on what will constitute a satisfactory Resolution Plan, beyond the requirement that a Plan must be "credible" and able to facilitate an orderly resolution of the Covered Company. In addition, the Agencies retain broad discretion to require additional information as they deem necessary.

While the lack of specificity regarding submission standards potentially increases the burden of the Proposed Rule and creates uncertainty as to the impact Resolution Plans will have on ongoing bank activities, the Resolution Plan Rule emphasizes that the process of creating Resolution Plans is to be "iterative" and will involve an "ongoing dialogue" between Covered Companies and the Agencies. Indeed, although penalties for failure to obtain regulatory approval of a proposed Resolution Plan are potentially harsh (including the imposition of heightened capital, liquidity or leverage requirements, and even forced divestiture of a Covered Company's operations as the Agencies deem necessary), the Agencies have given themselves broad discretion to modify or extend deadlines. Given the Resolution Plan Rule's flexibility and the Agencies' recognition that the process will involve an ongoing dialogue, it seems Covered Companies should be able to avoid disciplinary actions for submissions made in good faith. The FDIC has indicated that it will apply similar flexibility with respect to initial plans submitted under the IDI Rule.

CONFIDENTIALITY OF RESOLUTION PLANS

Although the Resolution Plan Rule provides generally for the confidential treatment of Resolution Plans, the extent of the confidentiality is determined pursuant to the Freedom of Information Act and the implementing regulations of Agencies. Resolution Plan submissions are to be divided into public and confidential sections. The public section must include an executive summary, describing the business of the Covered Company as well as a high-level description of the Covered Company's resolution strategy, and descriptions of core business lines, consolidated financial information, derivatives activities, non-US operations, governance structure, management information systems, and the identities of material supervisory authorities and principal officers. The IDI Rule contains similar confidentiality requirements.

Although confidentiality of Resolution Plans was a concern widely mentioned by commenters on the proposed Resolution Plan Rule, the Agencies did not provide much in the way of additional protections in the final version of the Resolution Plan Rule. For non-US Covered Companies, this presents the possibility that the requirement to submit certain information could be in conflict with the laws of a non-US Covered Company's home country.

Content of Resolution Plans

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

- **Executive Summary.** A summary of the key elements of the strategic plan, any material changes[9] 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.[10] 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,"[11] "critical operations"[12] and "core business lines,"[13] and an analysis of how a Covered Company's key resources (funding, liquidity, support functions, capital) could be leveraged for an orderly resolution, with a focus on the possibility that the resolution may occur during a time of financial distress in the United States.[14] A Covered Company may exclude a material entity subject to an insolvency regime other than the Bankruptcy Code from its strategic analysis if that entity has less than $50 billion in total assets and does not conduct a critical operation. Entities that could be excluded under this test include an insurance subsidiary that is subject to its prudential state regulator's resolution regime and a US branch or agency of a foreign bank. 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[15] 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 for the Covered Company and a consolidating schedule for all material entities subject to consolidation by the Covered Company; (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.[16]
- **Information Regarding Management Information Systems.** This portion of each Resolution 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 its critical operations and core business lines, with a focus on how the Covered Company 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.

For those Covered Companies filing a "tailored" Resolution Plan, the plan need address only its nonbank material entities and operations (or, for non-US Covered Companies, US nonbank material operations) in its strategic analysis, corporate governance structure, organizational structure, management information systems, and supervisory and regulatory information. A Covered Company must give a description of interconnections and interdependencies between the Covered Company, its insured depository institutions (for a non-US Covered Company, only US insured depository institutions, branches and agencies), and nonbank material entities and operations. In addition, a non-US Covered Company must give an explanation of how the Covered Company integrates its resolution planning for US operations into its overall contingency planning process.

Review of Resolution Plans and Penalties for Noncompliance

Under the Resolution Plan Rule, within 60 days of submission, the Agencies will jointly determine whether a Covered Company's Resolution Plan satisfies certain minimum information requirements. If "informationally complete," the plan will be allowed to move forward to undergo further review; if incomplete, 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 Agencies will evaluate whether a Resolution Plan is "credible" and would facilitate an orderly resolution under the Bankruptcy Code.[17] If, after this phase of review, a Resolution Plan is found to be deficient, the Agencies will jointly notify the 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 Agencies acting jointly may subject the Covered Company or its subsidiaries to more stringent capital, leverage, or liquidity requirements, or could restrict the Covered Company's growth, activities or operations. These measures would be imposed until the Covered Company's Resolution Plan meets supervisory expectations. If a Covered Company has not achieved approval of its Resolution Plan after two years, the Agencies may jointly order the Covered Company to divest certain assets or operations, as necessary to facilitate an orderly resolution of the Covered Company.[18]

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 Agencies jointly 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 non-US regulators as the FRB deems appropriate. The FDIC employs the same review process for IDI Rule Resolution Plans, but the IDI Rule does not specifically provide for the same penalties as the Resolution Plan Rule. The FDIC may bring an enforcement action for a CIDI's failure to submit a credible Resolution Plan, and could, as appropriate, subject a CIDI to any of the range of penalties at its disposal. Like initial Resolution Plans under the Resolution Plan Rule, the FDIC does not expect that any initial Resolution Plans under the IDI Rule will be found deficient.

Other Resolution Plan Proposals

The Resolution Plan Rule is being adopted at a time when other regulatory authorities are contemplating similar requirements for systemically significant financial institutions. In July 2011, the Financial Stability Board (FSB) released a *Consultative Document on Effective Resolution of Systemically Important Financial Institutions*, which proposed model international

standards and policies for resolution planning for globally significant companies.[19] In it, the FSB sets forth four broad policy recommendations: (i) strengthened national resolution regimes, (ii) cross-border cooperation arrangements, (iii) improved resolution planning by firms and authorities, and (iv) measures to remove obstacles to resolution. The FSB's recommendations regarding effective resolution planning mirror the Resolution Plan Rule and IDI Rule's structure. The FSB emphasized that a resolution authority (here, the FDIC and FRB) should have the legal capacity to coordinate with foreign resolution authorities, and to exchange information. The FDIC and the FRB have moved ahead of the coordinated approach envisioned by the FSB.

The Resolution Plan Rule indicates that in evaluating Resolution Plans, the FRB will give deference to the principle of national treatment and consider the extent to which a non-US Covered Company is subjected on a consolidated basis to home country resolution planning standards, but there is no formal cooperation and coordination mechanism in the Resolution Plan Rule. The extent to which US regulatory authorities will defer to their non-US counterparts remains to be seen.

In August 2011, the United Kingdom's Financial Services Authority (FSA) released its *Consultation Paper on Recovery and Resolution Plans*, which details its proposed Recovery and Resolution Plan (RRP) requirements.[20] The FSA expects to publish final rules regarding RRPs in the first quarter of 2012, and initial RRPs would be submitted in June 2012. 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.[21] The European Commission also intends to adopt a legislative proposal on bank recovery and resolution in 2011.[22]

Endnotes

1 *Resolution Plans Required*, 12 C.F.R. Part 381 (Oct. 17, 2011), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20111017a1.pdf.

2 *Resolution Plans Required*, 12 C.F.R. Part 381 (Sept. 9, 2011), *available at* http://www.fdic.gov/news/board/Sept13no4.pdf.

3 *Resolution Plans Required for Insured Depository Institutions with $50 Billion Or More in Total Assets*, 76 Fed. Reg. 58379 (Sept. 21, 2011).

4 Prior to the enactment of the Dodd-Frank Act, the FDIC had released a proposed IDI Rule. *See Special Reporting, Analysis and Contingent Resolution Plans at Certain Large Insured Depository Institutions*, 75 Fed. Reg. 27464 (May 17, 2010). Written comments on the IDI Rule are due on November 21, 2011.

5 Under the IDI Rule, each CIDI must submit a Resolution Plan that would enable the FDIC to resolve the CIDI in the event of its insolvency in a manner that (i) ensures that depositors may access their insured deposits within one business day of the CIDI's failure (if the failure occurs on a day other than Friday, depositors must be able to access their insured deposits within two business days); (ii) maximizes the net present value return from the sale or disposition of its assets and (iii) minimizes the losses to the institution's creditors. The timing of submission for Resolution Plans under the IDI Rule is harmonized with the Resolution Plan Rule; that is, a CIDI must file its Resolution Plan at the same time as its parent holding company must file its plan under the Resolution Plan Rule. The IDI Rule tracks the requirements of the Resolution Plan Rule in both form and content.

6 Earlier this year, the FRB issued a proposed rule that would define what constitutes a "significant" nonbank financial company and bank holding company for purposes of Section 113 of the Dodd-Frank Act. 76 Fed. Reg. 7731 (Feb. 11, 2011). On October 11, 2011, the Financial Stability Oversight Council (FSOC) released a proposed rule seeking comment on the specific criteria and analytic framework the FSOC intended to apply in determining significant nonbank companies. *See Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 12 C.F.R. Part 1310, *available at* http://www.treasury.gov/initiatives/fsoc/Pages/notices-of-proposed-rulemaking.aspx. This proposed rule supplements an earlier proposal issued by FSOC in January 2011. *Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies*, 76 Fed. Reg. 4555 (Jan. 26, 2011).

[7] Total consolidated assets would be calculated based on the average of the four most recent Form FR Y-9C filings for a US bank holding company, and on the most recent annual (or, if applicable, the average of the four most recent quarterly) Form FR Y-7Q filings for a non-US bank or non-US company that is treated as a bank holding company. Thus, for instance, a non-US bank with a small New York branch would nevertheless have to comply with the Rule if the worldwide assets of the non-US bank exceed $50 billion.

[8] In the Resolution Plan Rule as initially proposed, Covered Companies would have had to submit a revised resolution plan in the event of such an event.

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

We note that the Resolution Plan Rule uses the modifier "material" throughout, and only defines it in a few instances. This lack of clarity could add to the difficulty of compliance with the Resolution Plan Rule, and give additional latitude to the Agencies to require revisions.

[10] 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 certain non-bank systemically important financial institutions). However, a Covered Company's Resolution Plan may be used to determine whether the Bankruptcy Code provides an appropriate alternative to resolution under the OLA.

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

[12] "Critical operations" include operations that upon failure or discontinuation would result in a disruption to the US economy or financial markets. In the IDI Rule, the term "critical services" is not tied to US economic or market disruption, but is instead defined as "services and operations of the CIDI, such as servicing, information technology support and operations, human resources and personnel that are necessary to continue the day-to-day operations of the CIDI."

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

[14] For a Covered Company's initial plan, however, the Resolution Plan Rule allows the Covered Company to assume a baseline (non-distressed) scenario only.

[15] 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.

[16] 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.

[17] One significant difference between the Resolution Plan Rule and the IDI Rule is that the IDI Rule defines a plan as "credible" if "its strategies for resolving the CIDI, and the detailed information required by this section, are well-founded and based on information and data related to the CIDI that are observable or otherwise verifiable and employ reasonable projections from current and historical conditions within the broader financial markets."

[18] We note that because the Resolution Plan 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 banking presence is a US branch that is not FDIC insured.

[19] *The Consultative Document on Effective Resolution of Systemically Important Financial Institutions* is available at http://www.financialstabilityboard.org/publications/r_110719.pdf.

[20] The August 2011 *Consultative Document on Effective Resolution of Systemically Important Financial Institutions* is available at http://www.fsa.gov.uk/pubs/cp/cp11_16.pdf.

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

[22] *Id.*

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