Regulatory brief

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Resolution: Single point of entry strategy ascends

Overview

The release last week of public summaries of the resolution plans submitted by the 12 largest financial institutions operating in the US reveal more insight into the institutions' resolution strategies than ever before, including the strategy for each of their most important subsidiaries ("material entities").

The considerable additional detail of the 2015 releases displays the structural differences between these institutions – especially between the eight domestic banks and the four foreign banking organizations ("FBOs"). In particular, there is a notable shift toward a Title I single point of entry ("SPOE") strategy among domestic institutions:[1]

- Six of the eight domestic banks have a Title I SPOE strategy
- Two of the eight domestic banks have a Bridge Bank strategy
- All four FBOs describe a *global* SPOE strategy but the strategies for their US operations generally call for a combination of wind-downs and, to a lesser extent, sales (to satisfy the US requirement to provide an alternate strategy for US operations)[2]

2015 is an important year for resolution planning, as the regulators made it very clear in guidance issued last August that the major financial institutions will need to be able to demonstrate more convincingly that they can be resolved without significantly impacting US financial stability – i.e., that they are not "Too Big To Fail."[3] There has long been considerable criticism, especially from members of Congress, that insufficient information exists to demonstrate that the major financial institutions can be effectively resolved. This criticism was no doubt fueled by the lack of detail in public summaries, which have so far provided essentially the minimum possible amount of information to meet regulatory requirements. This year's increased disclosure reflects regulatory guidance as a result of the pressure for greater transparency, based on regulators' review of earlier plan iterations.

Being public summaries, the disclosures do not include substantial sensitive, proprietary details to demonstrate how feasible or executable the strategies are today. Nevertheless, these summaries present the greatest transparency to the public of any major financial institution's resolution plan in any market globally. The US remains unique in requiring firms to prepare resolution strategies and to disclose public summaries covering select key elements.

This **Regulatory brief** provides (a) key background information, (b) an analysis of the disclosed resolution strategies and other important enhanced disclosures, and (c) our view of what happens next.

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Key background

Resolution planning is a critical component of regulators' goal to end "Too Big To Fail." These fourth[4] annual plans, submitted July 1, 2015, are of particular importance because the Federal Reserve Board and the FDIC (together, "the Agencies") will likely be determining (as early as the end of this year) whether each institution has made sufficient progress toward becoming resolvable without having a significant adverse effect on the US financial system. Those that are deemed to have made sufficient progress will avoid a "not credible" determination.

The FDIC indicated last August that it did not find the institutions' 2013 plans to be credible. However, the Federal Reserve simultaneously indicated that it was not yet ready to reach that conclusion because it expected the plans to improve iteratively. The Agencies both expressed concern that the 2013 plans were based on unrealistic and/or inadequately supported assumptions, and articulated necessary improvements for the plans and for the firms themselves, including:[5]

- Reducing legal entity complexity
- Establishing a holding company structure that supports resolvability
- Amending qualified financial contracts to provide for the stay of early termination rights
- Demonstrating the ability to continue shared services to support resolution and certain operational capabilities such as the ability to produce key information needed for resolution

An official finding of "not credible" requires both Agencies to agree. Institutions that are so deemed will be required to submit revised plans that address the deficiencies, in addition to facing potential penalties such as higher capital or liquidity requirements. Furthermore, these banks could eventually be subject to operating restrictions and, in the extreme, forced divestitures.

Of note, in light of extensive new guidance from the FDIC in December 2014 (pertinent to only the covered insured depository institution ("CIDI") entities)[6] the FDIC granted an optional extension for CIDI plans until September 1st. As a result most of this year's public summaries focus exclusively on the bank holding company and its non-CIDI material subsidiaries (governed by Dodd-Frank's section 165(d)).

Resolution strategy disclosures

The resolution strategy section is the area with the most enhanced disclosure in the 2015 public summaries, with many institutions discussing not only their overall approach to resolution but also the specific strategy for each material entity. The below table lists the filers' overall strategic approaches, and is followed by our view of the key takeaways from the strategy sections.

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[1] Resolution under Title I of Dodd-Frank is conducted as part of the bankruptcy process, as opposed to resolution under Title II which is conducted by the FDIC. Almost all of the public summaries no longer mention Title II resolution, unlike in prior years, in response to the regulators' clear preference that resolution take place in bankruptcy. SPOE resolutions place the bank holding company into bankruptcy.

[2] Once FBOs establish their US intermediate holding companies by July 2016, as required, the FBOs will evaluate a version of the SPOE for their US operations in their subsequent plans. See PwC's *Regulatory brief, Foreign banks: US admission price rising* (July 2014).

[3] See PwC's *First take, Resolution plan guidance to largest firms* (August 2014).

[4] For Wells Fargo, the July 1, 2015 submission was the third submission because Wells Fargo is originally a Wave 2 filer. The regulators initially segmented the more than 130 institutions required to file resolution plans into three categories (or "Waves"). The 11 banking institutions with the largest non-bank operations in the US were initially part of Wave 1 and were the only firms required to file plans in July 2012. The second and third waves of institutions were required to file their first plans in 2013, while select insurance companies and non-bank financial institutions were subsequently required to prepare plans. For 2015, the second Wave, which originally consisted of only four institutions, was split with Wells Fargo remaining on a July submission schedule with the Wave 1 filers and the remaining institutions moving to a December schedule with the Wave 3 filers.

[5] The Agencies have not performed such an assessment of the plans filed in 2014, nor would we expect them to now that the 2015 plans have been filed.

[6] See PwC's *First take, Resolution plan guidance for CIDIs* (December 2014). Most US bank holding companies with more than $50 billion in total assets are subject to both Dodd-Frank's 165(d) resolution rule governing bank holding companies and their material bank and non-bank subsidiaries, and a separate rule governing CIDIs. The CIDI rule includes a somewhat different set of requirements specific to only the insured depository subsidiaries with greater than $50 billion in assets.

Institution	2015 strategy approach	Domestic or Foreign
Bank of America	SPOE	Domestic
Bank of New York Mellon	Bridge Bank	Domestic
Citigroup	SPOE	Domestic
Goldman Sachs	SPOE	Domestic
JPMorgan Chase	SPOE	Domestic
Morgan Stanley	SPOE	Domestic
State Street	SPOE	Domestic
Wells Fargo	Bridge Bank	Domestic
Barclays	US wind down (Global SPOE)	Foreign
Credit Suisse	US wind down (Global SPOE)	Foreign
Deutsche Bank	US wind down, select sales (Global SPOE)	Foreign
UBS	US wind down, select sales (Global SPOE)	Foreign

SPOE gains popularity

The SPOE strategy under Title I requires considerable planning to ensure the material entities under the holding company have access to adequate capital and liquidity to stand on their own (and remain out of bankruptcy or receivership) following the holding company's bankruptcy filing. SPOE generally incorporates the assumption that the holding company will continue to act as a source of strength to its subsidiaries up until the moment it files for Chapter 11 bankruptcy. Therefore, during the "runway" period immediately preceding its bankruptcy, the holding company may fortify the material entities' capital and/or liquidity positions through investments (of cash or assets) or advances.

Once the holding company files for bankruptcy, the material entities would continue to operate as going concerns with a primary goal of executing resolution activities such as the sale, transfer, restructuring or wind down of businesses or operations (including all critical operations)[7] in an orderly manner – all while operating as a going concern and not under the potential structural constraints of a regulatory receivership or similar administrative proceeding. In executing the resolution activities in this manner, more value should be preserved for all stakeholders, including creditors of the holding company which continues to own the equity in all the material entities. Once the resolution activities are carried out, depending on the strategy and nature of activities, the material entities may either re-emerge as new, smaller institutions or, having sold or run-off most assets and businesses, the residual entities (which are no longer systemically important) may wind down under a bankruptcy liquidation (Chapter 11 or 7) or receivership to complete the liquidation of residual assets. To the extent that proceeds from the sales of businesses or assets exceed the material entities' liabilities, the residual proceeds would revert to the holding company (as ultimate owner of the material entities) for the benefit of its stakeholders.

Since the SPOE structure relies heavily on strong and detailed liquidity and capital management – at each material entity as well as at the holding company – SPOE links resolvability to other regulatory initiatives including: CLAR (Comprehensive Liquidity Analysis and Review), CCAR (Comprehensive Capital Analysis and Review),[8] and TLAC (Total Loss Absorbing Capital).[9] The SPOE strategy also underscores the importance of the holding company being "clean" – i.e., not conducting operating activities or critical operations itself, and not being guaranteed by operating subsidiaries.

[7] "Critical operations" according to Dodd-Frank are "operations of the covered company [a defined term that includes consolidated banking organizations with $50 billion in assets or more], including associated services, functions and support, the failure or discontinuance of which, in the view of the covered company or as jointly directed by the Federal Reserve Board and the FDIC, would pose a threat to the financial stability of the United States." Examples of the types of activities that fall into this category are operations that facilitate the movement or management of funds, such as payment, clearing and settling activities, custody activities, or management of money market mutual funds.

[8] See PwC's *First take, Ten key points from the 2015 Comprehensive Capital Analysis and Review* (March 2015).

[9] See PwC's *First take, Ten key points from the FSB's TLAC ratio* (November 2014).

Bridge Bank approach embraced by institutions with key activities centralized in the bank

In a Bridge Bank strategy, the Bank (i.e., insured depository) is closed by its primary regulator and the FDIC is appointed receiver. The FDIC then divides the assets and liabilities between those that will be left in the receivership and those that will be transferred to a Bridge Bank, which is a newly chartered Bank operated by the FDIC. As in SPOE, in a Bridge Bank resolution strategy, the holding company files Chapter 11 bankruptcy. Depending on various factors including capital and liquidity resources sufficient to operate as standalone entities, holding company material entities that are outside of the insured depository may either continue as going concerns or also be placed in bankruptcy or the applicable resolution regime (e.g., a receivership for a broker-dealer).

The Bridge Bank structure allows for the continuance of most operating activities, including servicing deposit accounts, provided that the relevant assets and access to resources critical to conduct operations (such as personnel, office and data center facilities, systems, and other shared services) are transferred to the Bridge Bank. For institutions that are structured such that the insured depository houses most critical operations and resources critical during business as usual, the Bridge Bank is a way to continue operations much like a going concern. It will have the primary goal of executing the resolution activities and sustaining critical operations until they can be transferred, spun off, or wound down in an orderly manner. Bridge Banks are intended to have a limited life (an initial duration of up to two years, with the possibility of up to three one-year extensions for a total of five years). The firms using a Bridge Bank strategy provide for the sale or wind down of entities outside the insured depository and for a significant reduction in the scope of the Bridge Bank as compared to the failed insured depository such that, at the end of the Bridge Bank's life, the remaining smaller institution can be sold or otherwise privatized.

The ISDA resolution stay protocol, which key subsidiaries of Wave 1 firms adopted in late 2014, addressed several previous challenges associated with early termination rights embedded in many derivative and other qualified financial contracts ("QFCs"), and certain cross-default provisions triggered by the bankruptcy filing of a US holding company. Parties to the protocol, which became effective in many jurisdictions in January 2015, agreed to temporary stays of their early termination rights with respect to contracts with other adhering parties in participating jurisdictions (paving the way to transfer many global QFCs into a Bridge Bank), and agreed to the stay of cross-default provisions in certain circumstances. The protocol thus eliminates a considerable portion of the potential asset fire-sales that could result from terms imbedded in QFC agreements.[10]

FBOs wind down US operations, for now

The FBOs' 2015 strategies for their US operations are designed to be used if, for some reason, the global SPOE strategies of their parent organizations were not executable for the US operations. The FBOs' US strategies consist of the wind down of US material entities and, in some cases, the sale of select US material entities.

Each of the FBOs has indicated the intent to review a SPOE model for future plans, once their intermediate holding companies ("IHCs") are established. This may be a considerable benefit of the IHC structure, potentially mitigating some of the costs and capital requirements that necessarily accompany such a change. However, any US branches of the FBO will not be part of the IHC by definition, so FBOs will likely need a hybrid strategy to accommodate this legal entity structure.

Of note, all strategies are contemplated under Title I, incorporate no government or taxpayer assistance, and incorporate certain assumptions provided by the Agencies designed to ensure at least a base level of conservatism. The strategies also reflect the possibility that a resolution could occur in a baseline, adverse or, importantly, a severely adverse economic environment.

Other important disclosures

Beyond the details that this year's public plans provide with respect to institutions' strategies, most filers also included the following enhancements to their 2014 public sections:

- High level indication of the institutions' "end state" following resolution
- More comprehensive discussion of structural and other changes made (or in progress) to reduce organizational complexity and improve resolvability
- Additional discussion of resolution planning governance
- High level financial metrics (although mostly drawn from public reports) and more robust descriptions of each material entity
- Description of inter-affiliate dependencies

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[10] See PwC's *Regulatory brief, Resolution preparedness: Do you know where your QFCs are?* (March 2015).

The end state

A notable addition to this year's public sections is the description of what the resulting organization would look like upon completion of the resolution process. Filers provide a range of detail in describing their potential end-states, with some domestic banks planning for no resulting organization at the conclusion of the resolution process (primarily as a result of wind down or third-party sales), while some FBOs indicate a substantially reduced presence through a local branch only.

For institutions contemplating a surviving organization, their public sections provide a high-level description of the overall size and, in some cases, the primary businesses emerging from resolution. Some plans provide a more detailed discussion of the expected impact on customers and product offerings. Typically, these banks discuss maintaining a portion of their respective core banking franchises, while winding down or selling other parts of their operations such as investment banking, sales and trading, and other capital markets businesses.

Structural changes to improve resolvability

All filers included a robust discussion of the changes they have made in the past few years to improve their resolvability. Many of the changes included speak to enhanced resiliency (e.g., stronger capital and liquidity) which reduces the probability that the firm will find it necessary to execute its resolution strategy.

However, the Agencies have made it clear that they desire, and in some cases require, actual change in how firms are structured and in the robustness of their management tools. As such, most of the filers also included considerable discussion of changes that have been made (or are in progress) to facilitate resolvability, most commonly including:

- Reduction and/or rationalization of the number of legal entity subsidiaries and their structures
- Modification of inter-affiliate service agreements governing the provision of shared services
- Establishment of a "clean" holding company structure
- Adoption of ISDA's resolution stay protocol
- Infrastructure changes to ensure access to shared services in resolution
- Enhanced liquidity management and simulation tools to facilitate determination of liquidity needs in resolution

Governance

The substantive changes that regulators are calling for necessitate executive and board-level support, resulting in enhanced governance requirements. Each institution discussed the governance structure used to create and approve not only the resolution plans, but also the integration of resolvability goals into business as usual processes. Many firms also highlighted governance enhancements such as expansion of oversight committee membership to include broader executive management representation across different areas and activities within the firm and the establishment of separate committee or executive oversight of resolution planning at the material entity and/or core business line level.

Financial metrics and descriptions for material entities

Whereas in prior public summaries, most banks included only consolidated financial statements from their Annual Report, the 2015 summaries include additional financial metrics on many (or in some cases all) material entities. Many institutions limited the additional information to metrics that are part of other public reporting (e.g., balance sheet metrics that are included in annual required broker-dealer SEC filings), while some firms included a few key metrics (e.g., assets, liabilities, equity, revenue, net income) on material entities that have no public filing requirements, such as affiliates with no third party creditors that may own real estate or manage technology services. All firms also provided a more robust, albeit still high level, description of each material entity's activities.

Inter-affiliate dependencies

Shedding light on the complexity of institutions' existing legal entity structure, many banks provided a high level description of the types of dependencies between their material entities. Acknowledging regulators' concerns, many also included a description of how they are reducing their interconnectivity or otherwise managing it to ensure continuity of shared services in resolution. At a high level, firms generally discussed inter-affiliate interconnections and dependencies in terms of either financial dependencies, such as capital and inter-company funding, or operational dependencies, such as reliance on personnel employed by subsidiaries or office space leased or owned by affiliates. Some firms appear to have relied on standardized business process classifications which, in cases where provided at too high a level, may have actually somewhat muddied the waters as it sometimes appears that material entities are providing the same services to each other.

Additional disclosure observations

Some institutions' public summaries offer brief discussions of the level of effort put forth to improve their resolvability. Although a few actually quantify the number of staff involved in resolution planning and the associated costs, all plans indicate that considerable (and increasing) attention has been devoted to resolution planning and achieving resolvability.

In addition, in light of the Agencies' August 2014 criticism of the assumptions underlying prior plans, most filers indicated that the 2015 plans incorporate conservative and required assumptions. The Agencies have also repeatedly expressed concerns around certain issues shared almost universally among the largest financial institutions. Among these are institutions' ability to:

- Ensure continuity of access to financial market utilities[11]
- Produce timely and robust information around many activities, operations, exposures, or assets such as collateral value, location and availability
- Access shared services such as personnel, office and data center facilities, technology, systems, applications and data, and other critical support functions, particularly in light of complex interconnectivity common among major financial institutions

Not surprisingly, discussion of these complex issues in the public summaries is generally limited, with most filers acknowledging the issues at a very high level, and stating that improvements have been made and continue.

What's next?

With the release of these more detailed public sections, the next major action is likely to come from Congress. As in the past, Congress is likely to question the Agencies in public hearings regarding the efficacy of the recently submitted plans. Some members, including Senator Elizabeth Warren, will almost certainly express their view that the Agencies should make joint credibility determinations without further delay.

For the Agencies' part, they will rely on the plans' enhanced public disclosures to help explain to Congress and other critics the progress that has thus far been made. For this reason, the new disclosures have caused some trepidation among the stakeholders at the institutions (especially regarding resolution strategies and hypothetical failure scenarios) due to the potential for misinterpretation and unintended consequences.

But the real action will be behind the scenes – the Agencies will no doubt be working to provide their plan assessments faster than ever before. It took about ten months for institutions to receive formal feedback to their 2013 plans (in the form of the August 2014 guidance), and the institutions have not received formal feedback to their 2014 plans (and we do not expect that they will at this point).

The Agencies will be focused on making credibility determinations for the 2015 plans, and we believe they will provide feedback as early as the fourth quarter of this year. Although we would not expect them to deem plans to be "credible," we would not be at all surprised if the Agencies ultimately deem several plans as not credible.

[11] See PwC's *A closer look, Financial market utilities: Is the system safer?* (February 2015).

Appendix

Below is an analysis of some of the quantitative attributes of the institutions' public summaries. As we have noted in prior briefs, banks have consistently taken somewhat different approaches (given the wide latitude allowed) to how they decompose their businesses for resolution planning, such that the number of core business lines ("CBLs") is not a comparable measure across firms.

In comparing each institution's public summary information to that same firm's public summary from the prior year, a few trends can be noted, with the most obvious being that all public summaries increased in length, doubling on average. Furthermore, two firms had more CBLs, while one firm had fewer. With respect to material entities ("MEs"), and perhaps reflecting some of the firms' efforts to reduce legal entity complexity, four firms had fewer MEs (reducing the number of MEs by a range of two to six entities) while two increased MEs (by two or three).

	# of pages		# of CBLs		# of MEs	
	2014	2015	2014	2015	2014	2015
US banking companies						
Bank of America	37	63	15	17	22	17
Bank of NY Mellon	24	68	4	4	15	15
Citigroup	32	102	12	12	27	29
Goldman Sachs	31	86	10	10	24	18
JPMorgan Chase	36	53	26	26	35	33
Morgan Stanley	21	60	3	3	17	17
State Street	25	55	2	2	16	16
Wells Fargo	27	38	5	5	7	5
FBOs						
Barclays	23	43	5	4	9	9
Credit Suisse	17	27	12	12	22	25
Deutsche Bank	37	55	9	11	8	8
UBS	30	37	5	5	10	10

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