FS Regulatory Brief

Domestic SIFIs: Resolution Plan Requirements Final Rule (Approved by FDIC Board 9/13/11)

Significant Changes from Notice of Proposed Rulemaking

Summary

On September 13, 2011, the FDIC approved its final rule regarding resolution plans for systemically important financial institutions (SIFIs) and an interim final rule regarding resolution plans for insured depository institutions (IDIs). This FS Regulatory Brief addresses the changes in the Final SIFI resolution rule from the original joint FDIC and Federal Reserve Notice of Proposed Rulemaking (NPR) on SIFI resolution plans. The interim final rule regarding IDI resolution plans is addressed in a separate Brief.

Changes in the text of the Federal Reserve Board (FRB) and Federal Deposit Insurance Corporation (FDIC) joint Final Rule on resolution plans (RPs) for systemically important financial institutions (SIFIs) reflect more flexibility in requirements than was presented in the agencies' joint Notice of Proposed Rulemaking (NPR) issued on April 22, 2011. These changes include the introduction of staggered filing dates (beginning July 1, 2012) for initial plans based on size of nonbank assets, the provision of definitions for key terms, and a narrowing of the scope of some earlier definitions (e.g., "critical operations"). The Final Rule allows certain companies that have a preponderance of banking assets the option of submitting "tailored" resolution plans, and also limits the strategic analysis of a material entity that is subject to another (non-bankruptcy) insolvency regime to those material entities with more than $50 billion in assets, or that perform a critical operation. The Final Rule also seeks to significantly limit in scope and complexity the resolution plan of a foreign-based company that has limited operations or assets in the United States. (A separate FS Regulatory Brief reviews in more detail the impact of changes on foreign banking organization SIFIs.)

Filing requirements: Submission dates

The NPR contemplated that all "covered companies"[1] would be required to file a RP within 180 days of the issuance of the Final Rule (i.e., by July 12, 2012, based on statutory requirements). For a number of reasons, including a desire to align with forthcoming global SIFI prudential supervision rules as well as with Financial Stability Board (FSB) and other international standards, the Final Rule extends the RP submission due dates for the vast majority of affected institutions:

RP submission due date	
July 1, 2012	Covered companies with nonbank assets[2] >$250B
July 1, 2013	Covered companies with nonbank assets <$250B and >$100B
Dec. 31, 2013	Covered companies with nonbank assets <$100B

[1] Defined as bank holding companies with more than $50 billion in total assets as reported on the FR Y-9C, foreign banks or companies treated as bank holding companies under Section 8(a) of the International Banking Act that had $50 billion or more in worldwide assets, and any nonbank financial company that has been designated by the Financial Stability Oversight Council for supervision by the FRB.

[2] The term "nonbank assets" as used for this tiering is not defined in the final rule, either directly or by reference to an FRB report (such as the FR Y-9C). General regulatory usage would construe the term as assets held by a bank holding company excluding any assets held in insured depository institutions and their subsidiaries; however, that interpretation should be confirmed with regulatory sources.

Note, however, that the FRB and FDIC may jointly determine that a covered company must file its initial plan (or annual plan) on a different date. The definition of "covered company" was clarified to mean a bank holding company that reported average total assets of greater than $50B based on its four most recent FR Y-9C filings. The Final Rule also addressed filing requirements for a newly covered company, stating that such a firm would need to file by July 1 of the year following its becoming "covered," provided that the date is at least 270 days after the date the requirement becomes operational.

A significant change in the Final Rule is the elimination of the RP update requirements contained in the NPR after a significant corporate event (i.e., merger, acquisition, or divestiture) in favor of a notice to the agencies after such an event has occurred. The next annual scheduled RP would then be updated to reflect the corporate event.

Informational requirements

In general, RP informational requirements in the Final Rule remain consistent with the NPR; however, the focus is more clearly placed on institutions with significant nonbank operations. The FDIC concurrently released an Interim Final Rule on RPs for insured depository institutions with assets greater than $50B. One change in the Final Rule provides for the submission of "tailored resolution plans" by US covered companies that have less than $100B in nonbank assets and whose insured depository institutions comprise 85% of consolidated total assets (i.e., the covered companies are thus predominantly engaged in banking activities).

Definitional changes

The Final Rule clarified the meanings of several key terms for RPs.

"Critical operations," previously defined in the NPR as "operations . . . upon a failure of, or discontinuance of such operations, would <u>likely result in a disruption to the US economy or financial markets</u>" are defined in the Final Rule as "operations . . . the failure or discontinuance of which . . . would pose a <u>threat to the financial stability of the United States</u>." Additional context for the definition of "critical operations" is provided in the Rule preamble, which notes that the change in definition was intended to clarify the threshold for designation of an activity as "critical," and cites examples of critical operations such as "a clearing, payment or settlement system, which plays a role in financial markets for which other firms lack the expertise or capacity to provide a ready substitute." This change formally introduces the concept of substitutability and significantly raises the bar for a "critical operation."

The stress scenario requirement for RPs is also clarified to allow firms to use the economic stress testing scenarios to be utilized by the FRB for purposes of Dodd-Frank Section 165(i)(1) rather than having to develop their own scenarios. The NPR required that in its RP, a covered company "take into account that such material financial distress or failure of the Covered Company may occur at a time when financial markets, or other significant companies, are also under stress and that the material financial distress of the Covered Company may be the result of a range of stresses experienced by the covered company . . ." The Final Rule provides that in preparing its RP, the covered company "[t]ake into account that such material financial distress or failure of the covered company may occur under the baseline, adverse and severely adverse economic conditions provided to the covered company by the Board pursuant to 12 U.S.C. 5365(i)(1)(B); provided, however, a covered company may submit its initial resolution plan assuming the baseline conditions only, or, if a baseline scenario is not then available, a reasonable substitute developed by the covered company. . ."

Other key definitions for terms such as "core business lines" and "material entity" remain consistent with the NPR.

Recovery plans

While the Final Rule does not *require* the preparation of recovery plans, it is clear that a strong regulatory recommendation to commence such a process may be anticipated. The discussion of RP requirements for the second group of filers (i.e., those with nonbank assets between $100B and $250B) contains the following language: "A recovery planning process, such as that proposed by the Financial Stability Board in its recently published consultative document [footnote deleted], can be useful towards developing a robust resolution plan. *Therefore, the Board and Corporation encourage covered companies to fully consider the recommendations of the Financial Stability Board regarding effective recovery planning*."[3] (Emphasis added.)

Regulatory RP reviews

The regulators went to great pains to allay industry concerns regarding the acceptability of RPs and convey a desire for more of an iterative process. The preamble to the Final Rule states that the regulators desire to "work closely with covered companies" in the development of their RPs, "and are dedicating staff for that purpose." They "expect the review process to evolve as covered companies gain more experience in preparing" RPs. The FRB and FDIC recognize that RPs will "vary by company and, in their evaluation of plans, will take into account variances among companies in their core business lines, critical operations, domestic and foreign operations, capital structure, risk, complexity, financial activities (including the financial activities of their subsidiaries), size and other relevant factors. . . . There is no expectation by the Board and the Corporation that the initial resolution plan iterations submitted after this rule takes effect will be found to be deficient, but rather the initial resolution plans will provide the foundation for developing more robust annual resolution plans over the next few years following that initial period."

RP confidentiality

The Final Rule provides that resolution plans should be divided into two parts: a public section and a confidential section. The public section would consist of an executive summary that would detail a high-level description of the firm, its core businesses, and its critical operations, and give a summary of the firm's resolution strategy. A covered company may submit a "properly substantiated request" for confidential treatment of any details in the confidential section that it believes are subject to withholding under Exemption 4 of the Freedom of Information Act (trade secrets and privileged or confidential commercial or financial information). The FRB and FDIC note that they "expect" large portions of the information to be confidential under Exemption 4 or Exemption 8 for examination and other reports prepared for a financial regulatory agency.

Material entities subject to other resolution regimes

The Final Rule includes a new provision which is intended to recognize that some material entities of a covered company may be subject to insolvency regimes other than the Bankruptcy Code, such as the FDIC for insured depository institutions.

The preamble to the Final Rule indicates that a covered company may limit its strategic analysis with respect to a material entity that is subject to an insolvency regime other than the Bankruptcy Code to those material entities that either have $50 billion or more in total assets or conduct a critical operation. The covered company should provide its strategy and the actions it will take to prevent and to mitigate any adverse effects of such failure on the financial stability of the United States. If the material subsidiary has less than $50 billion in assets and conducts no critical operation, the covered company need not address such failure in its strategy.

[3] FDIC Final Rule (text format) September 9. 2011 at 21. http://www.fdic.gov/news/board/Sept13no4

Additional information

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