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Regulatory brief

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Resolution planning: FDIC's single point of entry

Overview

The FDIC last week released its long awaited proposal on Single Point of Entry ("SPOE") under Dodd-Frank's Title II resolution framework. Although the proposal contains little new information, its value may be in its utility as a roadmap of outstanding issues, especially because a significant portion of it requests comment for public input.

Since its release, two FDIC board members have highlighted areas that need to be resolved, and key issues were discussed at a recent meeting of the FDIC's Systemic Resolution Advisory Committee. While the FDIC deserves credit for making progress, SPOE as the way forward on resolving G-SIFIs remains far from the goal line.

This **Financial Services Regulatory Brief** updates our previous brief on SPOE[1] with our latest view of the outstanding issues.

Major outstanding issues

Prior to its release, the FDIC's proposal on SPOE had been in development for several years and was previewed by FDIC officials in several earlier presentations and speeches. As a result, the proposal offers little if any new information. However, Dodd-Frank requires the FDIC to be ready to resolve a major financial institution under Title II ("Orderly Liquidation Authority") if resolution under Title I is considered by the authorities (including the Secretary of the Treasury after consultation with the President) to have a serious, adverse impact on US financial stability.

Not surprisingly, SPOE's feasibility hinges on a number of issues on which there remains considerable debate. One of the most important is bail-in debt. The crux of SPOE is that only the holding company "fails," and the interests of the holding company debt holders are converted into equity of a new bridge holding company ("Newco") to which ownership of the operating subsidiaries is transferred. As a result, the success of the SPOE approach hinges on the sufficiency of bail-in debt at the holding company.

However, the proposal says nothing about the amount and composition of bail-in debt which is needed for SPOE to work (in addition to other important terms and conditions such as permitted investors, release triggers, legal entity obligors, etc.). This is because setting a bail-in debt rule is the purview of the Federal Reserve, as the primary supervisor of US bank holding companies. Various Federal Reserve officials have been indicating for a while that the bail-in debt proposed rule will be issued "in the next few months." We believe that we will finally get the proposal in early 2014.

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[11] See PwC's *Financial Services Regulatory Brief, Resolution planning: Bail-in debt rule slowly taking form* (October 2013).

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The following is our view of five other key issues on which the proposal shines a light, even if only by its silence:

- **International cooperation:** SPOE is dependent on international authorities' recognition of, and trust in, the FDIC's ability to manage the resolution of a failing institution. By definition, if Title II is invoked, a systemic threat is present because Title II can only supplant the bankruptcy process if bankruptcy would seriously impact financial stability. Therefore, it is important to have certainty around the cooperation of those international authorities that are the primary supervisors of a failing institution's foreign operations.
- **Cross-default provisions:** SPOE has not solved the issue of cross-default provisions, particularly for contracts governed by non-US law.
- **Moral hazard:** The proposal and subsequent FDIC discussions drive home the issue of potential moral hazard, i.e., the propensity of investors and counterparties to presume that under SPOE the operating subsidiaries that house critical functions will be supported. Under the proposal, creditors of the operating subsidiaries (even those subsidiaries that may have caused the holding company's failure) appear likely to receive "preferential treatment" to holding company creditors, although the FDIC has indicated that creditors of operating subsidiaries could also absorb losses in extreme situations.
- **Funding:** The proposal sets forth the FDIC's expectations that Newco will be able to access funding on its own. However, a limited amount of funding would be available through the Orderly Liquidation Fund ("OLF"), if necessary, prompting a discussion of the appropriate use of tax payer funded OLF.
- **Operating Agreements:** The proposal calls for "operating agreements" which would clarify the respective responsibilities of the FDIC and of Newco's board following the seizure. The agreements would also detail Newco's exit strategy including (i) business or asset sales versus liquidations (along geographic, product, or customer lines), (ii) claim determination, and (iii) a summary timeline of events with key milestones.

What's next?

As of now, the release of the SPOE proposal has no immediate implications for global systemically important institutions. However, the proposal is inextricably linked to the expected Federal Reserve proposal on bail-in debt, which is likely to require near term action.

Firms should prepare by thoroughly understanding their holding company-level debt, including existing investors, investor appetite (or aversion) for various terms and conditions, and related internal funding dependencies (e.g., use of debt to fund subsidiaries, and source of funding for debt servicing). Firms would be particularly wise to follow the SPOE developments closely as the dialogue evolves, especially in light of the EU's upcoming single resolution mechanism ("SRM") regime – the story's next chapter.

Additional information

For additional information about PwC's Financial Services Regulatory Practice and how we can help you, please contact:

Dan Ryan
Financial Services Regulatory Practice Chairman
646 471 8488
daniel.ryan@us.pwc.com

David Sapin
Financial Services Regulatory Practice Leader
646 471 8481
david.sapin@us.pwc.com

Armen Meyer
Director of Regulatory Strategy
646 531 4519
armen.meyer@us.pwc.com

Contributors: Sally Neal and Sharon Haas.

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