First take
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# Ten key points from Agencies' resolution plan feedback

Yesterday, the Federal Reserve and the FDIC (collectively, "Agencies") released their feedback on the resolution plans submitted July 1, 2015 by the eight largest US banking institutions.[1] Five were deemed "not credible," while all eight were found to have "deficiencies" or "shortcomings" (or both). The expected July 1, 2016 plan filing date has been pushed back one year; instead, all eight banks must submit by October 1, 2016 an explanation of how deficiencies have been remedied, a status report on remediation of the shortcomings, and a public section that explains these submissions at a high level. The timeline for remediating some of the cited deficiencies will be very challenging, even considering the relief from the July 1, 2016 filing.[2]

1. **Five plans deemed "not credible" – i.e., the US banks that have become larger, more interconnected since the financial crisis.** The plans of Bank of America, Bank of New York Mellon, JPMorgan Chase, State Street, and Wells Fargo were each deemed to have material "deficiencies" by the Agencies, making them not credible. This result contrasts with the last time that the Agencies provided feedback in August 2014 when only the FDIC found such deficiencies, and is a result we anticipated in a prior *First take* on this topic.[3] The other three US banks avoided this outcome: the Agencies were divided regarding Goldman Sachs's and Morgan Stanley's deficiencies, so neither was deemed not credible, while Citigroup's plan had no deficiencies. Finally, the Agencies indicated that they are still reviewing the four plans submitted by foreign banking organizations last July, and gave no indication as to when that review would be complete.[4]
2. **Plan "shortcomings" cited, in addition to deficiencies.** The Agencies cited numerous "shortcomings" in all but one plan (i.e., Wells Fargo's). Although shortcomings alone do not result in a determination of not credible, shortcomings need to be addressed between now and the next resolution plan filing, now scheduled for July 1, 2017.
3. **Far more public transparency than before.** The Agencies substantially increased the transparency of the feedback provided to the banks. They published redacted versions of the specific feedback letter provided to each bank, together with a summary of this year's review process and results, as well as new guidance for preparation of the 2017 plan ("2017 Guidance"). None of these were provided publicly the last time the Agencies provided feedback.
4. **Muted market reaction.** The release of this feedback occurred simultaneously with the beginning of quarterly earnings releases for these institutions, which makes it difficult to isolate the market reaction. However, the immediate market reaction was not negative, with stock prices of the not-credible banks rising significantly for the day. This rise was driven by J.P.Morgan's positive earnings report, but it is interesting that the bank that had no plan deficiencies experienced the highest stock price gain (i.e., Citigroup).

5. **Agencies clearly laid out their areas of analysis.** The Agencies publicly revealed that they evaluated the plans on six areas that are familiar to the banks:

   - Capital
   - Liquidity
   - Governance mechanisms
   - Operational capabilities (including shared services)
   - Legal entity rationalization (including separability)
   - Derivatives and trading activities

   The Agencies categorized each plan's deficiencies and shortcomings into one or more of these areas and also organized the 2017 Guidance around them. The Agencies also indicated that they considered responsiveness to their prior feedback. While responsiveness is not specifically cited as part of any plan's deficiencies or shortcomings, in our view the Agencies' assessment across the six areas necessarily involves judgment calls which are likely to be much harsher when there is no evidence that prior feedback has been incorporated.

6. **Higher expectations going forward.** Although the Agencies eliminated the July 1, 2016 plan filing, the expectations for deficiency remediation and a plan to address shortcomings by October 1, 2016, and a full resolution plan that addresses all identified shortcomings by July 1, 2017, are ambitious. Further, like the Federal Reserve's annual Comprehensive Capital Analysis and Review ("CCAR"),[5] each year's submission is assessed against rising regulatory expectations, so a bank could be found credible one year and not credible the next. For the July 2017 plan submission, the banks will need to incorporate the 30+ page 2017 Guidance which raises the bar again across all six evaluation areas, arguably very significantly in some cases. For example, the 2017 Guidance requires demonstration of sufficient capital and liquidity for all material entities throughout the resolution process, using a combination of resources held in those entities during business-as-usual and internal total loss absorbing capacity ("internal TLAC").[6] This makes resources far less fungible by effectively ring-fencing resources in specific entities and, by extension, in specific jurisdictions.

7. **Legal entity rationalization is key.** Four of the five not credible plans were cited for deficiencies in legal entity rationalization. In many cases, the Agencies specifically indicated the need for more specific criteria (e.g., around the creation and maintenance of each legal entity and its placement within the organizational structure) and the need to achieve better balance between business-as-usual criteria and resolution concerns, particularly in aligning legal entities to business lines.

8. **Shortcomings should not be overlooked.** Many of the plans' shortcomings derive from insufficient support or analysis for an assertion made within the plan. Although shortcomings are intuitively less serious than deficiencies, the time and resources needed to fully address them is likely to vary considerably. For example, operational shortcomings that were identified by the Agencies range from failure to provide financial statements for non-material entity branches (a problem that could likely be resolved quite quickly) to the need to conduct preparedness testing on the operational ability to execute the plan (a more formidable task). Most liquidity shortcomings pertain to weaknesses in select aspects of the banks' liquidity models which are likely to involve meaningful time and effort to fully address, especially if banks do not have the necessary level of data required to meet the expectations. Similar to liquidity shortcomings, the Agencies identified derivatives and trading shortcomings for four of the eight banks, primarily citing insufficient detail especially with respect to portfolio wind-downs. Shortcomings with respect to governance mechanisms are largely focused on the need for triggers (or more specific triggers) to initiate activities key to the resolution strategy, especially those supporting a single-point-of-entry strategy.

9. **Smaller banks on alert.** Operational capabilities, liquidity, and governance mechanisms were each cited as deficiencies for three not credible plans. Deficiencies in operational capabilities were noted particularly around the identification or continuity of shared services. While banks, including those smaller banks with simpler organizational structures,[7] are tempted to assume that activities performed by their depository institutions (or a subsidiary of the depository institution) are of less concern in resolution, the Agencies clearly stated that "simply indicating that all critical services are provided in the bank chain [i.e., depository institution] does not suffice." Liquidity deficiencies cited were primarily focused on the methods and models used to estimate liquidity needs, and were

silent on the perceived adequacy of the amount of liquidity available. Finally, deficiencies in governance mechanisms included the lack of specific triggers or procedures to escalate problems or to implement actions required to execute the plan. Of note, in one instance, material errors in submitted financial statements were cited as a deficiency in the governance mechanism and the adequacy of internal oversight was questioned.

10. **Agencies quickly address GAO concerns.** The day before the Agencies released their feedback, the Government Accountability Office ("GAO") issued a report finding that the Agencies' process for reviewing resolution plans lacks transparency.[8] The Agencies seem to have gotten the message, given the extensive public feedback they provided yesterday. The GAO also criticized the slow pace of feedback by the Agencies (this is the third time that the Agencies have taken 10 months to provide feedback) and questioned whether annual plan submissions are necessary. The Agencies' one year extension of the deadline for banks' next plans may portend the end of annual submissions and allow the Agencies to provide more timely feedback in the future.

## Endnotes

1. For our prior analysis of the public sections of these plans, see PwC's Regulatory brief, *Resolution: Single point of entry strategy ascends* (July 2015).
2. In addition to identifying deficiencies and shortcomings, the Agencies also acknowledged enhancements made by the banks across several areas – the most common acknowledgements were improved funding structure, compliance with clean holding company guidance, and adherence to the ISDA 2015 Universal Resolution Stay Protocol.
3. See PwC's *First take, Ten key points from regulators' feedback to Wave 1 resolution plan filers* (August 2014) where we indicated that the Federal Reserve would be under considerable pressure this time to join the FDIC by deeming some plans not credible. We detailed this view further in an opinion piece published by Bloomberg Brief (December 23, 2015), stating "while the Fed didn't deem any plans 'not credible' last time around, it more likely to view things differently this time."
4. These four plans by Barclays, Credit Suisse, Deutsche Bank, and UBS are currently still due to be submitted on July 1, 2016.
5. See PwC's *First take, Ten key points from 2015 CCAR* (March 2015).
6. See PwC's *First take, Ten key points from the Fed's TLAC proposal* (November 2015).
7. Banks with fewer than $250 billion in US nonbank assets submitted their most recent resolution plans in December 2015 and have not yet received formal feedback on these plans. See PwC's *Regulatory brief, December resolution plans: Déjà vu all over again* (February 2016).
8. See GAO Report, *Resolution Plans: Regulators Have Refined Their Review Processes but Could Improve Transparency* (April 2016).

# *Additional information*

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