

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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Date: October 7, 2022  
To: Board of Governors  
From: Staff<sup>1</sup>  
Subject: Advance notice of proposed rulemaking on resolution-related resource requirements for certain large banking organizations

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**ACTIONS REQUESTED:** Approval of the attached draft advance notice of proposed rulemaking (ANPR), which staff have developed jointly with staff of the Federal Deposit Insurance Corporation (FDIC), to solicit public input on potential changes to the resolution-related standards applicable to large banking organizations (LBOs) that are not global systemically important bank holding companies (GSIBs). Staff also requests authority to make technical, non-substantive changes to the attached materials prior to publication in the Federal Register.

**EXECUTIVE SUMMARY:**

- The U.S. banking system continues to evolve and large banking organizations, in particular, have experienced noteworthy increases in size. Specifically, Category III firms<sup>2</sup> had an average of approximately \$413 billion in total consolidated assets in December 2019. By December 2021, the same group of large banking organizations had grown to an average size of approximately \$554 billion in total consolidated assets through organic growth and mergers. While important distinctions remain between non-GSIB LBOs and GSIBs, including in how they are expected to go through resolution, their larger size combined with sizable uninsured deposit funding, may narrow resolution options in the event of their material failure or distress.

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<sup>2</sup> Category III banking organizations have between \$250 billion and \$700 billion in average total consolidated assets or at least \$75 billion in off-balance sheet exposures, nonbank assets, or short-term wholesale funding.

- Further, there is a significant difference in the resolution-related standards applicable to non-GSIB large banking organizations in Categories II<sup>3</sup> and III relative to GSIBs, despite the fact large banking organizations, particularly those in Category II, could have very large or complex operations.
- Given these differences and the increase in merger activity among large banking organizations, the draft ANPR would assist the Board and the FDIC in evaluating whether any modifications should be made to the set of resolution-related standards that apply to LBOs to promote optionality in resolution and limit the effects of an LBO's failure on financial stability.
- The draft ANPR would broadly solicit comments and pose specific questions on whether, in appropriately tiered form, certain resolvability-related requirements such as a long-term debt requirement, would be effective in strengthening the resolvability of LBOs and addressing financial stability risks posed by an LBO's material distress or failure.
- The draft ANPR would also seek comment on the costs associated with such a proposal for large banking organizations and their customers.
- The draft ANPR would also solicit comments on whether additional resolution-related standards, such as guidance on separability,<sup>4</sup> would be useful for enhancing optionality in the resolvability of LBOs.

## **DISCUSSION:**

### **A. Background**

Over the past decade, the Board and FDIC have promulgated rules and guidance, both jointly and individually, to support the orderly resolution of large banking organizations.<sup>5</sup> These rules and related guidance are tiered based on the complexity and risks of different banking

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<sup>3</sup> Category II banking organizations have over \$700 billion in total assets, or \$75 billion in cross jurisdictional activity, but are not U.S. GSIBs.

<sup>4</sup> Separability refers to a banking organization's ability to sell, transfer, or dispose of significant assets, portfolios, legal entities, or business lines on a discrete product line or regional basis to a third party in the event of internal or external stresses.

<sup>5</sup> *E.g.*, Regulation QQ, 12 CFR part 243 (joint resolution planning rule); Regulation YY, 12 CFR part 252 (Board's enhanced prudential standards, including TLAC).

organizations: the most stringent rules apply only to GSIBs and include requirements to submit a resolution plan every two years, follow a “clean holding company” requirement,<sup>6</sup> adopt resolution-related stay provisions in qualified financial contracts,<sup>7</sup> and maintain minimum outstanding amounts of total loss-absorbing capacity (TLAC) and long-term debt, which is used to recapitalize the firm in the event of failure.<sup>8</sup> The Board also has issued supervisory guidance on recovery planning that applies to GSIBs. By contrast, LBOs are generally not subject to TLAC or long-term debt requirements, clean holding company requirements, rules related to qualified financial contract stay provisions in resolution, or Board guidance on recovery planning. Further, LBOs’ resolution planning requirements apply at a reduced frequency.<sup>9</sup>

In recent years, merger activity and organic growth have increased the size of LBOs, particularly those in Category III. While most of these firms’ overall business remains concentrated in traditional banking activities, and their proportion of total banking sector assets has remained relatively constant, their larger size heightens the potential impact of a disorderly resolution, if one were to occur. In addition, certain LBOs have increased their reliance on uninsured deposits to fund their operations over the past decade. Relative to insured deposits, uninsured deposits may be less stable under conditions of firm-specific stress and resolution. Large proportions of uninsured deposits could limit the FDIC’s resolution options for a failing LBO because any costs associated with assuming those deposits would need to be accounted for in the FDIC’s conclusion that their chosen resolution strategy is the least costly to the Deposit Insurance Fund.

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<sup>6</sup> The “clean-holding company” requirement prohibits top-tier U.S. holding companies from entering certain financial arrangements (such as short-term borrowings or derivatives contracts) that might impede orderly resolution.

<sup>7</sup> Examples of such resolution-related stay provisions include establishing a set period of time during which a party to a qualified financial contract is restricted from terminating, liquidating, or netting such contract in the event of resolution.

<sup>8</sup> See 12 FR 8266 (Jan. 24, 2017); 82 FR 42882 (Sept. 12, 2017).

<sup>9</sup> Category II and Category III large banking organizations file resolution plans on a triennial cycle, alternating between submission of full and targeted resolution plans.

The draft ANPR would explain how the availability of long-term debt could be helpful to the FDIC if the resolution of an LBO were necessary.<sup>10</sup> Generally speaking, the broader the range of feasible options available to the FDIC as it undertakes resolution of a large bank, the greater the chance that resolution can be conducted in an orderly manner with minimal impact to financial stability. Currently, there are two generally recognized approaches to resolution – the single-point-of-entry (SPOE) approach used currently by the U.S. GSIBs and the multiple-point-of-entry (MPOE) approach used by the LBOs. For banking organizations following an SPOE resolution approach, these resources would support a “bail-in” recapitalization strategy,<sup>11</sup> where the resources would be converted to capital to support continuous operation of material subsidiaries of the banking organization. The requirement that such firms maintain greater loss-absorbing capacity that could be used to effectuate recapitalization after failure helps to ensure that sufficient resources are available to maintain continuous operations. For large banking organizations following the MPOE resolution approach, loss-absorbing resources could be useful in keeping various options open for the FDIC when resolving a subsidiary insured depository institution, thereby reducing the likelihood of a sale of the institution to another large banking organization or GSIB. The draft ANPR would also seek comment on potential associated costs for large banking organizations and their customers if increased resolution-related standards are imposed, including any potential impact on credit cost and availability.

## **B. Draft ANPR**

The draft ANPR would seek public input on the potential costs and benefits of additional resolution-related standards for LBOs. These would include whether LBOs should be required to maintain loss-absorbing capacity in the form of long-term debt that meets certain specified characteristics, and whether any requirements for the issuance and maintenance of such resources should apply at the level of the bank holding company or the insured depository institution subsidiary. In addition, the proposed ANPR would seek comment on whether to apply to LBOs appropriately adapted forms of the clean holding company requirements,

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<sup>10</sup> In resolution, long term debt that meets certain criteria can be converted to equity, creating an additional layer of loss absorbing capacity.

<sup>11</sup> Under an SPOE “bail-in” resolution strategy, prior to resolution, the top-tier holding company would downstream all available resources to operating subsidiaries. Upon exhaustion of the remaining holding company resources, the holding company would enter resolution while the subsidiaries continue operating.

recovery planning guidance, and disclosure requirements currently applicable to U.S. GSIBs.<sup>12</sup> Lastly, the proposed ANPR poses questions about whether establishing separability requirements for all or some LBOs in the recovery or resolution contexts would be appropriate.

**RECOMMENDATIONS:**

Staff recommends that the Board approve the attached draft advance notice of proposed rulemaking. Staff also recommends that the Board authorize staff to make technical, non-substantive changes to the attached materials prior to publication in the Federal Register.

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<sup>12</sup> Under the TLAC rule applicable to GSIBs, firms are required to provide the LTD debtholders a description of the financial consequences that could occur if the GSIB entered into a resolution proceeding as well as a summary table of the location of the disclosures (e.g., on the GSIB's website, in public financial reports, or public regulatory reports).