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The Regulatory Trio: Long-Term Debt and Resolution Plan Proposals Signal Need for Greater Clarity and Simplification

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On August 29, 2023, the Board of Governors of the Federal Reserve System (**FRB**), the Office of the Comptroller of the Currency (**OCC**), and the Federal Deposit Insurance Corporation (collectively, **FBAs**) issued requests for comment on:

1. A proposed interagency rule that would require issuance of long-term debt (**LTD**) by certain large bank holding companies and savings and loan holding companies, certain intermediate holding companies of foreign banking organizations (**FBOs**), and large insured depository institutions (**IDIs**) (**LTD NPR**).
   Jump to this section: LTD NPR

2. Proposed FRB and FDIC guidance for resolution planning submissions by large banking organizations (U.S. and FBOs) subject to Section 165(d) of the Dodd-Frank Act (**Title I Guidance Proposal**).
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3. A proposed rule by the Federal Deposit Insurance Corporation (**FDIC**) that would revise its current resolution plan rule (**IDI Rule NPR**).
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All comments are due November 30, 2023, which is the same deadline as the recent interagency regulatory proposal designed to amend the regulatory capital rules (focused on going-concern capital) for large banking organizations and banking organizations with significant trading activity.

The August 29 issuances—referred to here as the "Trio"—are interconnected proposals, each serving to improve resolvability and mitigate financial stability risk in different ways. They are designed to provide regulators with more options to preserve franchise value and mitigate financial stability risk across Category II, III, and IV institutions (**large banks**).[1] They seek to ensure that creditors, not depositors or the Deposit Insurance Fund (**DIF**), bear the risk of loss should any large bank fail. They incorporate historical lessons, ranging from the Global Financial Crisis in 2008 to the recent failures last spring of Silicon Valley Bank, Signature Bank, and First Republic Bank.

The Trio's central theme represents several years of thought that well precedes the recent bank failures. Large banks have changed significantly since the Global Financial Crisis,[2] failure of a large bank has potential systemic impacts,[3] and therefore, in improving the resolvability of large banks, regulators are drawing from their experience regulating the U.S. globally systemically important banks (**GSIBs**).

Each proposal is discussed in relevant detail below, focusing on potential impacts to U.S. banking organizations in Categories II, III, and IV. Certain key issues are identified for further analysis, along with accompanying recommendations designed to clarify and simplify future implementation.[4]

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1. LTD NPR

The LTD NPR would require:

- IDIs with at least $100 billion in total consolidated assets (as well as any IDI affiliates of IDIs with $100 billion in consolidated assets) (**covered IDIs**), to maintain a minimum amount of eligible LTD, akin to the long-term debt rules currently applicable to the GSIBs; [5]

  - Covered IDIs include subsidiaries of covered bank holding companies and savings and loan holding companies.

- "covered entities" (holding companies of such IDIs) to comply with LTD minimums and clean holding company requirements; and
- banking organizations subject to the capital deduction framework contained in the FBAs' capital rule to deduct from regulatory capital external LTD issued by covered entities and externally issuing IDIs to meet the proposal's LTD requirements.

FBA staff estimate that under a zero baseline approach the total principal value of external LTD required, irrespective of existing LTD, would be approximately $250 billion.

- Among Category II and III covered entities, the total requirement would be approximately $130 billion;
- Among Category IV covered entities and externally issuing IDIs, the aggregate requirement is estimated to be approximately $120 billion.[6]

In addition, FBA staff estimate that under a zero baseline approach, based on total eligible external LTD requirement quantities, the LTD NPR would increase pre-tax annual steady-state funding costs by approximately $5.6 billion.[7]

- Among Category II and III covered entities, the estimated pre-tax annual funding cost increase is approximately $2.7 billion, representing a ten-basis point permanent decline in net interest margins (**NIMs**).

- Among Category IV covered entities and externally issuing IDIs, this estimated pre-tax increase in annual funding costs is $2.9 billion, representing a twelve-basis permanent decline in NIMs.

Compliance with the LTD minimums would be phased-in over a three-year period. Twenty-five percent of the LTD requirements would be required within one year after finalization of the rule, fifty percent after two years, and one hundred percent after three years.[8] The FBAs would permit certain "legacy" external debt of covered IDIs, which would not otherwise qualify as eligible LTD, to count toward the minimum requirements during the phase-in period, provided such legacy debt was issued prior to the publication of the final rule in the Federal Register.[9]

Additionally, the FRB has proposed various revisions to the total loss-absorbing capacity (**TLAC**) rules applicable to GSIBs, characterized in the LTD NPR as "primarily technical and harmonizing amendments."[10]

Votes. The LTD NPR received no dissenting votes, although FRB Governors Bowman[11] and Waller,[12] along with FDIC Vice Chairman Hill[13] each expressed some reservations (discussed below).

Rationale. The LTD NPR seeks to increase the resolvability and resiliency of large banks. It would mandate a long-term debt requirement to: (i) give regulators additional gone-concern, loss-absorbing resources to resolve failed banks and prevent contagion; (ii) foster depositor confidence; and (iii) decrease costs to the DIF in the event of a large bank failure.[14] These goals would be accomplished by requiring large banks with total assets of $100 billion or more to maintain a minimum amount of LTD that could be used, in the instance of a bank's failure, to: (i) absorb losses; and (ii) increase options to resolve the failed bank.[15]

- The LTD NPR notes the failures of Silicon Valley Bank, Signature Bank, and First Republic Bank, and states that if the proposed LTD had been in place prior to these failures, each of these IDIs would have had additional loss absorbing capacity which would have mitigated losses to the DIF. In addition, in the FBAs' view, the LTD rules may have provided the FDIC with additional resolution options, and, potentially, reduced the incentives for deposit flight. [16]

Minimum Outstanding Eligible LTD for Covered IDIs. Under the LTD NPR, a covered IDI would be required to maintain outstanding eligible LTD in an amount that is the greater of 6.0 percent of the covered IDI's total risk-weighted assets (**RWAs**), 3.5 percent of its average total consolidated assets, and 2.5 percent of its total leverage exposure if the covered IDI is subject to the supplementary leverage ratio.[17]

- ***Methodology.*** The above-noted minimums are based on the same "capital refill" methodology used in the GSIB TLAC rule. Vice Chairman Hill called out this aspect of the proposal in his statement, questioning whether applying the capital refill methodology applicable to GSIBs, which have adopted single point of entry (**SPOE**) resolution strategies, is appropriate for domestic IDIs which generally adopt multiple point of entry resolution strategies, and for which a sale is more likely than a recapitalization.[18]

- ***Haircuts.*** Eligible external LTD due to be paid between one and two years would be subject to a fifty percent haircut and any LTD due to be paid in less than one year is not counted against the LTD minimum (as such debt would likely be paid down in the course of a crisis at the IDI).[19]

- ***Features***. Eligible LTD instruments are required to be "plain vanilla," lacking exotic (or complex) features. Among other requirements, eligible LTD instruments must be unsecured (and subordinate to claims of depositors, general unsecured creditors, and FDIC administrative expenses), not convertible to equity, governed by United States law, and have maturities greater than one year. In addition, certain acceleration clauses and credit-sensitive features are not allowed, and structured notes do not qualify as eligible LTD.[20] The LTD could be left behind in the receivership of a failed IDI—e.g., when the IDI's assets are transferred to a bridge bank. Potential depositor losses would therefore be absorbed by losses to LTD *before* impacting the DIF (effectively meaning the eligible LTD serves as another layer of uninsured depositor protection).[21]

Internal vs. External LTD; Potential Requirements Extend to Holding Companies. Covered IDIs would be required to issue the LTD *internally* to their parents or another entity that consolidates the IDI. IDIs that are not subsidiaries of covered entities would be able to issue LTD (internally) to affiliates *or* (externally) to non-affiliates. The FBAs included various questions about this aspect of the proposal–e.g., whether there might be advantages to allowing IDIs that are otherwise required to issue debt internally to issue debt externally.[22]

The FRB has also proposed that Category II, III, and IV bank holding companies and savings and loan holding companies, and Category II, III, and IV U.S. intermediate holding companies of foreign banking organizations (**FBOs**) that are not GSIBs issue and maintain minimum amounts of LTD.[23]

- The FRB would also subject these holding companies to "clean holding company requirements" akin to those applicable to GSIBs, i.e., prohibiting them from issuing short-term debt to third parties, entering into qualified financial contracts with third parties, having liabilities subject to "upstream guarantees" or contractual offset against amounts owed to subsidiaries, and capping certain of the holding companies' (non-LTD) debt.

- The FDIC's memorandum accompanying the proposed rule indicates that in the FBAs' view, requiring LTD at the holding company level will provide additional optionality for SPOE resolution of the holding company.[24]

  - Vice Chairman Hill called out this aspect of the LTD NPR in his statement noting that "we should consider, and hope we receive comments on, the relative benefits of imposing the long-term debt requirement only at the bank, and not at the holding company, for most of these firms, and allowing the bank to issue externally or internally."

  - FDIC Director McKernan also called out this aspect of the proposal in his statement, noting that the proposal would deny covered IDIs "at least some degree of the flexibility that the U.S. GSIBs have to decide the extent to which resources are prepositioned at their insured depository institutions through the internal issuance of debt by that subsidiary," and expressed reservations that the rules would put covered IDIs at a "competitive disadvantage relative to the U.S. GSIBs."

Reservation of Authority. The LTD NPR includes a reservation of authority provision that would apply to each of the FBAs, and would authorize a covered IDI's applicable FBA regulator to, under certain circumstances, order an IDI to exclude certain debt from the calculation of its outstanding eligible LTD, and "to hold a greater amount of LTD than is otherwise required."[25]

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KEY ISSUE

Should the FBAs require covered, bank-centric institutions to issue LTD at both the bank and holding company level in the final LTD rule?

Large banking organizations are structured differently than GSIBs—the vast majority of their assets and operations are in their IDIs, not across twenty or more material entity subsidiaries. Large bank failure (as currently reflected in the large bank Title I plans) is therefore most likely to result in a failure of the IDI under a multiple point of entry strategy, where the holding company fails in bankruptcy, and the IDI fails under an FDI Act resolution.

At the same time, it is clear the FBAs seek more resolution strategy options for large banking organizations *beyond* FDI Act resolution:[26]

> [T]he separate and related requirement being proposed by the FRB that covered holding companies issue a commensurate amount of LTD provides additional optionality in resolution by supporting the option of a [SPOE] resolution at the holding company, which may be appropriate or necessary in instances in which the failure and resolution of the banking group may present systemic risk to the U.S. economy and where a resolution at the parent level would be most effective in mitigating that risk. "***[W]here conditions for a***

resolution of a banking organization under Title II of the Dodd-Frank Act are met, including that such a resolution would be necessary to mitigate systemic risk to the U.S. economy, the issuance of LTD at the covered holding company, together with the clean holding company provisions proposed by the FRB, would support such a resolution option."[27] Without eligible LTD at the holding company level—and an accompanying SPOE resolution strategy—it is difficult to see how the FDIC could prepare for such a Title II resolution scenario, and how it could maximize the optionality it seeks.[28]

RECOMMENDATION

1. **Should the FBAs require issuance of LTD at the holding company level in the final LTD rule, the FRB and the FDIC should be more explicit in both the final LTD rule and the final Title I Guidance regarding how holding eligible LTD at the holding company level would help facilitate a Title II resolution**, thereby maximizing the potential utility of these large bank Title I plans and clarifying the FBAs' broader policy objectives.

    1. For reasons discussed below in the Part II recommendation section, **the FRB and FDIC should also encourage large bank holding companies' existing Title I MPOE plans (i.e., bridge bank strategies) to *instead* be submitted for purposes of their IDI Rule plan requirement, consistent with the final rule that will stem from the IDI Rule NPR.** If this recommendation were adopted, the FRB and FDIC would receive two resolution strategies as part of two

distinct resolution planning requirements, furthering their objective of maximizing optionality.

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2. Title I Guidance Proposal

The Title I Guidance Proposal was issued by the FRB and FDIC and is focused on proposing expectations for resolution plans submitted under Section 165(d) of the Dodd-Frank Act. These are the jointly reviewed resolution plans that describe a bank holding company's strategy for rapid and orderly resolution under the U.S. Bankruptcy Code in the event of material financial distress or failure.

The Title I Guidance Proposal is comprised of two separate notices:

- One concerning the Title I plans submitted by Category II and III U.S. banking organization filers, who submit Title I plans on a triennial cadence (**Domestic Triennial Full Filers)**; and
- The other concerning Title I plans submitted by foreign banking organizations in Category II and III, who also submit Title I plans on a triennial cadence (**Foreign Triennial Full Filers**).

The discussion below focuses on the Domestic Triennial Full Filers, who are receiving Title I guidance for public comment for the first time since the Title I process began following enactment of the Dodd-Frank Act. The Foreign Triennial Full Filers are receiving Title I guidance for public comment for the second time, following issuance of prior final guidance by the FRB and FDIC in 2020.

Votes. The Title I Guidance Proposal received dissenting votes from Governor Bowman and FDIC Vice Chairman Hill. FDIC Board member

McKernan voted in favor of the proposal, resulting in a split vote between FDIC Board Republican appointees.

Rationale. The stated rationale for the Title I Guidance Proposal is that: (i) the Domestic Triennial Full Filer group has never received Title I resolution plan guidance for public comment; (ii) recent plan submissions by this group "revealed significant inconsistencies in the amount and nature of information they provided on critical information elements required by the [Section 165(d) rule]"[29]; and (iii) the FDIC and FRB seek to incorporate learnings from recent bank failures.[30]

SPOE In the Spotlight. The Title I Guidance Proposal focuses principally on the SPOE strategy, adopted today by all GSIBs but not by any Domestic Triennial Full Filers.[31] The MPOE strategy—currently the strategy adopted by all the Domestic Triennial Full Filers—is also discussed, although a large majority of the MPOE portions are replicated in the companion IDI NPR (which focuses exclusively on resolution of the IDI under the FDI Act), NPR 12 CFR 360.10 (FR) (fdic.gov).

The FDIC and FRB's focus on SPOE is unsurprising—even if it is a strategy adopted by a null set of firms in scope for this guidance—because the Title I Guidance Proposal co-exists with the LTD NPR, which anticipates bank holding companies issuing eligible LTD. Indeed the FRB and FDIC state that the LTD NPR "could interact with how the specified firms plan for resolution under the [Section 165(d)] [R]ule, and the agencies anticipate ensuring that the final resolution plan guidance for domestic triennial full filers is consistent with any final long-term debt rule."[32]

Nor is it surprising that the Title I Guidance Proposal repeatedly underscores the FDIC and FRB's longstanding maxim: "[t]he agencies do not prescribe a specific resolution strategy for any covered company, nor do the agencies identify a preferred strategy."[33] As discussed in the recommendation section below, given the possibility that the FBAs may require eligible LTD at the holding company, it seems appropriate for the FDIC and FRB to revisit their historical approach and expressly articulate a SPOE strategy expectation for the next plan submission following the effective date of the final Title I Guidance.

First, since resolution plans have been submitted following the enactment of the Dodd-Frank Act in 2010, only two overarching resolution strategies have emerged: single point of entry and multiple point of entry (with variations in between). While the resolution planning process remains an iterative process for all stakeholders, it is unlikely that firms (or regulators) will come up with a better mousetrap than SPOE or MPOE. Second, clearer direction by the FDIC and FRB would be consistent with recent commentary, including a speech delivered at Wharton in 2022 by Acting Comptroller of the Currency and FDIC Board Director Michael Hsu:

> ***If a large regional adopted SPOE, had sufficient TLAC, and was separable, the government would have more options should the regional fail***. If necessary, we would be able to break the bank up and keep its operations running, while allocating any unexpectedly large losses to private creditors instead of taxpayers. We would not be limited to simply folding it into a GSIB. Today's large regionals are not nearly as complex or global as the GSIBs. The vast majority of their assets are in the insured depository institution (IDI). As such, they do not need to be subject to the full set of resolvability requirements for GSIBs in order to be resolvable. ***The status quo, however, leaves a gap in our financial stability defenses. The failure of a large regional would necessarily lead to a more systemic GSIB and signal that we had not, in fact, ended TBTF, eroding trust in the resolution regime more generally***.[34]

SPOE Proposal Similar to GSIB Guidance. The proposed guidance for firms that adopt an SPOE resolution strategy is "generally based on the 2019 GSIB Guidance, with certain modifications that reflect the specific characteristics of and potential risks posed by the failure of the specified firms."[35] Generally, the Title I Guidance Proposal expects large banks (like GSIBs) to address a set of resolution obstacles, including capital and liquidity measurement and forecasting capabilities; governance mechanisms; payment, clearing and settlement activities; legal entity rationalization and separability; derivatives and trading activity; and more broadly, continuity of critical operations.[36]

Enhanced MPOE Guidance. The proposed guidance for firms that may choose to continue utilizing a MPOE resolution strategy would potentially involve incorporating certain aspects of the 2019 GSIB Guidance that the FDIC and FRB believe are applicable to large banks, with certain modifications. Although the FRB and FDIC's efforts to provide guidance on MPOE strategies for Title I resolution plans is new and notable, this approach risks confusing Domestic Triennial Full Filers by conflating resolution strategies and the underlying purposes of each resolution plan rule. Moreover, the Title I Proposed Guidance's MPOE discussion prompts a number of questions that are better left to the IDI Rule NPR discussion, e.g., demonstrating that a resolution is least costly to the DIF, and analyzing liquidity needs in resolution.[37] As Governor Bowman's statement notes in relation to the Title I Guidance:

> Is there sufficient information available to financial institutions to effectively evaluate whether a proposed resolution plan would satisfy this test? If the agencies expect firms to demonstrate compliance with opaque concepts like the least-cost test, more information about the test and how the FDIC applies this test should be available to firms subject to the guidance.

Timing of Next Submission. Currently, the next resolution plan submission for Domestic Triennial Full Filers is due on or before July 1, 2024. The FDIC and the FRB propose to receive Title I plans incorporating the final version of the proposed guidance as soon as practicable. While the agencies are considering providing "a short extension of the next resolution plan submission date," their expectation is "that these plan submissions would be due *sooner* than one year after the proposed guidance is published in final form."[38] Several points worth noting:

- In 2019, when the FRB and the FDIC amended the Section 165(d) rule, they committed to notice and comment for resolution planning guidance and said they would "endeavor to finalize any such general guidance at least one year prior to the submission date for the first resolution plan submission to which it would apply";
- As noted above, the next resolution plan for Domestic Triennial Full Filers is due on or before July 1, 2024, which is inside the one-year window; and
- By the FDIC and FRB's own impact analysis, the "estimated hours per response for a domestic SPOE triennial full filer would be 11,235 hours"[39]—a timeframe well exceeding one year. It is also conceivable that "response" hours are limited to the hours associated with a filer producing the plan submission, not the additional hours that potentially would be spent simultaneously ensuring readiness for capabilities testing.

Format and Structure of Plans; Assumptions.

The proposed format, structure, and assumptions expected for Domestic Triennial Full Filers' Title I plans are generally similar to those in the 2019 GSIB Guidance, except that the proposed guidance reflects the expectation that a firm should support any assumptions that it will have access to the Discount Window and/or other borrowings during the period immediately prior to entering bankruptcy.[40] The Title I Proposed Guidance also seeks to clarify expectations around certain assumptions, including that firms should not assume the use of the systemic risk exception to the least-cost test in the event of a failure of an IDI requiring resolution under the FDI Act.[41]

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KEY ISSUES

While the Section 165(d) rule and the IDI Rule[42] are separate rules (i) requiring separate resolution plans; (ii) with different "goals," "expected content,"[43] and baseline resolution regimes, the Title I Proposed Guidance demonstrates the potential for significant overlap in content between a Title I MPOE Plan and an IDI bridge bank plan (e.g., least-cost test analysis).

Given the FBAs' stated goal of obtaining greater optionality across resolution strategies for Domestic Triennial Full Filers and the possibility that the FBAs may require eligible LTD to be issued at the holding company level, to what extent could (or should) the FDIC and the FRB understand the broader goals of Section 165(d) and the IDI Rule more harmoniously?[44]

Could a more "holistic" approach across both resolution plan rules result in two overarching resolution strategies for each Domestic Triennial Full Filer, thereby simplifying the resolution planning

process and increasing resolution readiness under both the Bankruptcy Code and the FDI Act?[45]

As noted in Vice Chairman Hill's statement:

> [M]ost of the provisions are focused on SPOE firms. At the same time, we are also proposing a rule that would require long-term debt to be issued from the holding company at each of these firms. Given that not a single domestic firm in scope has adopted an SPOE strategy, it would be natural to wonder if the agencies intend to push Category II and III firms to an SPOE strategy. After more than a decade into resolution planning, it is worth considering whether the FDIC, as the entity ultimately responsible for determining how a bank will be resolved, along with the Federal Reserve, should decide in a clear and transparent manner whether and when institutions need to adopt an SPOE strategy. [ ] Conversely, what the agencies should not do is spend more than a decade approving an MPOE strategy for each of these firms, put out guidance that expressly states the agencies do not have a preferred strategy, and then without warning find the plans not credible because of doubts about the MPOE strategy.

RECOMMENDATIONS

1. **FDIC and FRB should favor transparency and clarity over strategy agnosticism.** The broader purposes of the Section 165(d) and IDI Rule are to make resolution work in a rapid and orderly way, mitigate financial stability risk, and help ensure costs are not borne by taxpayers, depositors, or the DIF. The FDIC and FRB should consider including an explicit SPOE strategy expectation for the next Title I plan submission following the effective date of the final Title I Guidance. Such clarity would not

only maximize the optionality desired by regulators, but also—as discussed below—reduce the likelihood that the FRB and FDIC could potentially reach diverging credibility determinations for the same bridge bank strategy submitted under different resolution plan rules.

2. **Honor the endeavor: give filers at least one year to prepare their next plan submissions.** Domestic Triennial Full Filers should have at least one year to prepare their next resolution plan, irrespective of whether that resolution plan includes an SPOE or enhanced MPOE strategy.

    1. While the recent delay in issuing the Title I Proposed Guidance is understandable given the 2023 bank failures, Domestic Triennial Full Filers would be shortchanged in terms of their ability to thoughtfully and comprehensively incorporate the final Title I Guidance (which could potentially mean pivoting to a new SPOE strategy).
    2. In considering the timeline for the next large bank Title I plan submissions, the FDIC and FRB should be mindful of the existing and future IDI Plan filing requirements for these large banks, ideally avoiding a competing (or near competing) deadline for multiple resolution plans under different resolution plan rules.[46] While this calculus is never easy or perfect, the recommendation to align the plans is offered both for the sake of the large banks producing these plans, as well as the staffs who review them and are tasked with providing individualized firm feedback.

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3. IDI Rule NPR

The IDI Rule, originally issued in 2012, currently requires each covered IDI periodically to submit a resolution plan that, in the event of its failure should enable the FDIC to resolve the IDI under the FDI Act. The IDI Rule is intended to ensure that the FDIC has access to all of the material information it needs to efficiently resolve a covered IDI in the event of its failure.

As discussed above, plans submitted under the IDI Rule NPR are distinct from those submitted under Section 165(d) of the Dodd-Frank Act, which requires plans for a covered company's resolution under the U.S. Bankruptcy Code in a manner that substantially mitigates the risk that the failure of the covered company would have serious adverse effects on financial stability in the United States.

The IDI NPR is a wholesale revision of the IDI Rule. If finalized as proposed, the IDI plan moratorium currently in place for IDIs between $50-$100 billion in total assets would expire, and a new group of institutions would be required to file resolution plans for the first time.

Rationale. In developing the IDI NPR, FDIC staff "incorporated the FDIC's more than a decade of experience implementing the IDI Rule, the guidance and feedback provided to [covered IDIs] **CIDIs**, the [IDI Rule] content that has proven most useful to the FDIC in developing resolution strategies, and lessons learned from the recent" bank failures.[47]

Voting. The IDI NPR received two dissenting votes from Vice Chairman Hill and Director McKernan. Selected excerpts are discussed below.

Scope and Plan Submission Frequency. The IDI NPR would currently apply to 45 IDIs, divided into the following two groups:

- Group A: 31 IDIs with $100 billion or more in total assets (**Group A IDIs**). These IDIs would be required to file resolution plans every two years. In off years when not filing resolution plans, the Group A IDIs would be required to file an "interim supplement" updating certain information included in the prior year's plan.
  - Filings would be staggered filings across this cohort. "Like characteristics" will be grouped together to "support horizontal analysis across the submission cohort."[48]
- Group B: Fourteen IDIs with total assets of $50 billion or more but less than $100 billion (**Group B IDIs**) would be required to make biennial "informational filings," which the IDI NPR describes as different from a Group A IDI plan in that it "would not be required to include an identified strategy and apply that strategy to a failure scenario, or be subject to review of the credibility of the identified strategy. In addition, an informational filing would not be required to include valuation to facilitate FDIC's assessment of least-costly resolution method."[49]

Working Assumption. The IDI Rule NPR is premised on several assumptions: (i) that as IDIs increase in size, the likelihood of a timely sale to a single acquirer diminishes; and (ii) the availability of a closing weekend sale of the whole institution "cannot be assumed given a CIDI's significant size, complexity, and potential speed of failure."[50] Covered IDIs would not be permitted to assume a closing weekend sale of the franchise to one or more acquirers.[51]

The IDI NPR represents a marked pivot from the FDIC's Statement on Resolution Plans for Insured Depository Institutions (fdic.gov) in 2021 (**IDI Statement**), which sought to streamline content requirements and emphasize periodic engagement. The IDI Statement notes that the "key goal is to assist the FDIC in preparing to meet the operational challenges of resolving a specified CIDI, particularly those that must be addressed during the resolution weekend and, if applicable, to initiate operations in a bridge depository institution (**BDI**) in a way that best preserves value and minimizes disruption."[52]

Plan Content. Group A CIDIs would be required to submit complete resolution plans containing all content elements described in the Proposal, including two specific items:

- A resolution strategy appropriate for the CIDI's orderly and efficient resolution under the FDI Act; and
    - The "identified strategy" would be required to describe the resolution from the point of failure through sale or disposition of the Group A IDI's franchise (meeting the credibility standard described below). The default identified strategy is one that would provide for the establishment and stabilization of a [BDI] and an exit strategy from the BDI.[53]
- A demonstration of the capabilities testing necessary to produce valuations that the FDIC could use to conduct the statutorily required least-cost analysis at the time of an actual failure.

Group B CIDIs' "informational filing" would not be required to include a resolution strategy or valuation capabilities.

While some of the proposed plan content is new, most of it already exists in the IDI Rule or prior IDI Rule guidance (e.g., franchise components, key personnel, and communications capabilities). Some content is proposed to be eliminated following the express exemption of certain plan content detailed in the IDI Statement (e.g., disaster recovery or other back-up plans); however, most of the content requirements exempted in the IDI Statement would be continued to be required in the final IDI NPR rule.[54]

- New Content on Key Depositors. The IDI NPR includes several new potential requirements, including a mandate for IDIs to identify their "key depositors," defined as those depositors that control the largest deposits that are collectively material to one or more business lines. Each key depositor must be identified by name, line of business, and geographic location, where that information is known.[55]

- New Content on Digital Services. The IDI NPR also incorporates a potential requirement for all covered IDIs to include information about digital services and electronic platforms offered to depositors to support banking transactions for business customers, given their recent "dramatic" proliferation since the IDI Rule was adopted.[56] It is intended that this plan content will "enhance the FDIC's understanding of the value of these services, their impact on customer relationships, and the potential challenges to continuing or winding down those services in resolution."[57]

Enhancement of Engagement and Capabilities Testing. The FDIC would conduct enhanced engagement and "capabilities testing" with individual Group A and Group B IDIs as a means of "enhancing the usefulness of both exercises to the FDIC's resolution planning."[58] These processes would proceed as follows:

- **Engagement** between each covered IDI (**CIDI**) and the FDIC may be required at any time. Each CIDI would be required to provide the FDIC with information and access to such personnel of the

CIDI as the FDIC in its discretion determines is relevant. Personnel made available to the FDIC staff would need to have sufficient expertise and responsibility to address the informational and data requirements of the engagement.

- Engagement may include the FDIC requiring the CIDI to provide information or data to support certain content items, or other information related to a Group A CIDI's identified strategy, or, for any CIDI, other resolution options being considered by the FDIC. Among other topics, the FDIC may seek information from a Group A CIDI on the impact to the identified strategy of a change in economic assumptions or CIDI-specific scenario assumptions.[59]

- The proposed frequency of engagement for:
  - Group A IDIs would occur "on a selective basis"[60] but in theory not more than once in a two-year cycle.

  - Group B IDIs would occur in each two-year cycle. The FDIC expects engagement with Group B IDIs to "be a key component of its resolution planning for such firms."[61]

- ***Capabilities testing*** *would occur at* the FDIC's discretion; the FDIC may require any CIDI to demonstrate the CIDI's capabilities described or required to be described, in their resolution plan, including the ability to provide the information, data and analysis underlying the resolution submission. The FDIC may seek information from a CIDI on the impact on identified capabilities of a change in economic assumptions or CIDI-specific scenario assumptions, if applicable. The CIDI would be required to perform such capabilities testing promptly and provide the results in a time frame and format acceptable to the FDIC. Capabilities testing may be included in connection with any engagement.

- The FDIC expects that capabilities testing "for each Group A and Group B CIDI will occur no more than once per two-year cycle."[62]

- New Valuation Capabilities for Least-Cost Test; Continued Emphasis on Franchise Components. The IDI NPR proposes that instead of including the least-cost test as an informational content requirement, Group A IDIs would be required to "produce valuations that the FDIC can use to conduct the statutorily required least-cost analysis at the time of an actual failure."[63] The FDIC contends that while these valuation capabilities would be "evaluated under the second prong of the credibility standard" (described below), the FDIC would not make a credibility determination as to the identified strategy based on the valuation information provided.[64]

- In addition, the IDI NPR would require covered IDIs to be able to demonstrate they have the capabilities necessary to support the information and analysis provided in the plan and the capabilities necessary to ensure continuity of critical services. CIDIs would also have to show that their franchise components are separable and marketable, including a description of "current capabilities and processes to provide access to or establish a virtual data room promptly in the run-up to or upon failure of the bank."[65]

FDIC Enforcement Power "Clarification." The IDI NPR clarifies that if a CIDI fails to resubmit an IDI plan within the prescribed timeline or if a resubmission fails to adequately address identified weaknesses, the CIDI could be subject to enforcement action. Any violation of the IDI final rule may, at the FDIC's discretion, subject a CIDI to enforcement action under section 8 of the FDI Act, including backup enforcement action pursuant to section 8(t).[66]

Section 8 of the FDI Act provides the FDIC's Board of Directors with broad enforcement powers, including the power to (i) terminate deposit insurance; (ii) issue cease-and-desist orders; and (iii) remove institution-affiliated parties or prohibit their participation in bank affairs. Section 3(u) of the FDI Act defines "institution affiliated parties" to include the controlling stockholder of an IDI, or any shareholder or person who participates in the conduct of the affairs of an IDI, or any independent contractor who participates in certain acts that significantly adversely affect an IDI.

New Credibility Standard. The IDI NPR introduces a new credibility standard, not dissimilar in concept from the credibility standard contained in the Section 165(d) rule. Like the enforcement power provisions described above, this aspect of the proposal illustrates a clear desire for the amended IDI Rule to have more impact and to potentially be a rule that causes IDIs to change their organizational structures. The credibility standard would have two prongs:

- Prong one has four separate subprongs and applies only to the "identified strategy," submitted by Group A IDIs. It provides that a submission is not credible if its identified strategy would not:

- provide timely access to insured deposits;
- maximize value from the sale or disposition of assets;
- minimize any losses realized by creditors of the CIDI in resolution; and
- address potential risks of adverse effects on U.S. economic conditions or financial stability.

- Prong two would apply to both Group A IDIs and Group B IDIs. Under prong two, a submission is not credible if the information and analysis in it are not supported with observable and verifiable capabilities and data, and reasonable projections, or if the covered IDI fails to comply "in any material respect with the requirements of the Proposal."[67]

If, after consultation with the appropriate federal banking agency for a covered IDI, the FDIC determines that the resolution plan is not credible, the FDIC must notify the IDI in writing of such determination, and such a writing "must include a description of the weaknesses in the resolution submission identified by the FDIC that resulted in the determination that the resolution submission is not credible."[68] There is currently no language in the IDI Rule NPR envisioning that such a writing would be publicly available (as Title I Plan feedback letters are on the FRB's website).

Proposed Transition Period. Certain Group A CIDIs have been directed to submit their IDI Rule plans in December of 2023, 2024, or 2025. IDI Rule plans due in 2023 will be evaluated under the IDI Rule, although feedback on those submissions will focus on IDI Rule provisions "that would remain relevant under the [IDI Rule] as amended if the Proposal is adopted as a final rule."[69] No engagement or capabilities testing is expected on plans due in 2023.

Group B CIDIs (most of which have never filed any resolution plan) would be required to submit their first informational filings on a date stated by the FDIC that would be at least 270 days from the effective date of the final amended rule.

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KEY ISSUES

Does the IDI NPR strike the appropriate balance between plan submission and capabilities testing and engagement? Is it tipped more towards IDIs producing "reams of paper"[70] instead of engagement and capabilities testing focused on the readiness of the IDI to produce—within 24 hours—the detailed content a proposed bidder would need to submit a qualified bid over resolution weekend?

Recent bank failures demonstrated that once a bridge bank opens, the franchise value of the institution can deteriorate quickly. Helping ensure covered IDIs can, in near real time, demonstrate how their franchise components are separable and marketable by populating relevant information using a virtual data room is the most practicable and sensible proposal embedded in the IDI Rule NPR. Having this ongoing capability maximizes the likelihood of a resolution weekend sale, thereby reducing costs to depositors and the DIF. A weekend sale in the case of SVB would have eliminated the need to invoke the systemic risk exception and losses to the DIF of approximately $20 billion. As noted by Acting Comptroller and FDIC Board Member Michael Hsu:

> If SVB had held sufficient capital and been separable, its failure would likely have been far less chaotic. Its loss-absorbing capital — including its LTD — would have ensured that the vast majority of losses would have been borne by the bank's investors, not the FDIC's deposit insurance fund. ***Quickly and systematically selling or breaking up SVB, the first of these banks to fail, would have minimized uncertainty for the entire banking sector. . . . Doing this work ahead of time can mitigate such risk.***[71]

Is the IDI NPR plan submission structure for both Group A IDIs and Group B IDIs workable from an administrative perspective given the number of CIDIs, concurrent Section 165(d) plan reviews, ongoing engagement, capabilities testing, individual feedback letters, and review of informational filings and interim supplements? Will the FDIC need additional time to thoroughly review submissions and provide feedback and will CIDIs have sufficient time to incorporate the FDIC's feedback into their next resolution plan?

Does the proposed multi-pronged and "enhanced" credibility standard give Domestic Triennial Full Filers sufficient information to produce a credible IDI plan? For Domestic Triennial Full Filers that also file Title I plans, could the application of the credibility standard under the final amended rule in any future IDI Rule conflict with a plan review finding on a bridge bank strategy submitted under Title I?

RECOMMENDATIONS

1. **Building on the lessons learned from recent failures, the FDIC should be more focused on maximizing the likelihood of a resolution weekend sale (realizing that there will always be obstacles given a CIDI's size, operations, geographical**

footprint, etc.). The FDIC could accomplish this by placing more emphasis on the real-time capability for IDIs to produce —within 24 hours—all the necessary information potential buyers would need to submit a qualified bid for all or a portion of the IDIs assets, thereby reducing the risk of loss to depositors and the DIF.

2. The FDIC should reconsider rebalancing the production and frequency of paper across 45 covered IDIs (e.g., plans, information supplements, and information filings) with the resources spent on engagement and capabilities testing (in particular, the real-time capability to produce relevant and reliable detailed data for a virtual data room).
3. Any credibility standard is necessarily subjective. For the benefit of all CIDIs potentially subject to a credibility standard and consistent with the FRB's practice for Title I feedback letters, the FDIC should commit to publishing all future amended IDI Rule feedback letters (with confidential supervisory information redacted), including any that describe weaknesses resulting in a noncredible determination.[72]

There are also potential benefits to providing depositors and the general public with an understanding of how CIDIs would fare under the amended IDI Rule. Without disclosure, CIDIs will lack the information they could use to assess and improve their IDI plans. This is especially important given the potential consequences that would flow from proposed enforcement provisions, and the broad enforcement powers granted to the FDIC Board under Section 8 of the FDI Act.

Transparency could also strengthen public and market confidence in IDI plans. "For important policy choices affecting economic and

social conditions, the tilt should be toward transparency."[73]

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Conclusion

Striking the right balance in improving firm resolvability is a never-ending, time-consuming, and complex process that occurs within a broader landscape of evolving prudential regulation. Complexity not only poses challenges to the FBAs charged with rulemaking, guidance-writing, capabilities testing, and plan review—it also presents challenges to the wide range of firms that are required to implement these requirements and meet expectations, and that sometimes lack the clear direction they need to effectively do so.

The recommendations offered above recognize these inherent challenges as well as a simple truth: rulemaking and guidance issuance is never perfect. Like music, dissonance and consonance co-exist; harmony and clarity of sound are ideal.

Footnotes

[1] Category II institutions include U.S. banking organizations that have: (1) at least $700 billion in total consolidated assets; or (2) at least $75 billion in cross-jurisdictional activity and at least $100 billion in total consolidated assets. Category III institutions include U.S. banking organizations that have: (1) at least $250 billion in average total consolidated assets; or (2) at least $100 billion in average total consolidated assets and at least $75 billion in average total nonbank assets, average weighted short-term wholesale funding, or average off-balance sheet exposure. *Category IV institutions include* U.S. banking organizations with *total* consolidated assets of $100 billion or more that

do not meet the thresholds for one of the other three categories. Depository institution subsidiaries of Category II, III, or IV institutions are considered Category II, Category III, or Category IV institutions, respectively. 12 CFR § 252.5 Categorization of banking organizations - Code of Federal Regulations (ecfr.io)

[2]See, e.g., Martin J. Gruenberg, Member, FDIC Board of Directors, *An Underappreciated Risk: The Resolution of Large Regional Banks in the United States* (Oct. 16, 2019), at 5, Gruenberg-Remarks.pdf (brookings.edu) ("First, even though regional banks generally do not have the extensive international operations and diversified nonbank business lines that characterize the Global Systemically Important Banks, many nevertheless have large branch networks, substantial IT systems, and millions of account holders. This complexity, certainly as compared to smaller banks, would make the management of a bridge bank a significant operational challenge for the FDIC."); Acting Comptroller of the Currency Michael J. Hsu Remarks before the Wharton Financial Regulation Conference 2022 on Financial Stability and Large Bank Resolvability (occ.gov) (Apr. 1, 2022), at 5 ("Large regionals today do not have SPOE resolution strategies, are not subject to the TLAC minimum long-term debt requirement, and are not separable. This is not their fault. When the Title I framework was being developed, it made sense to focus it just on the GSIBs. The large regionals were significantly smaller and less complex then. For instance, in 2011 the largest non GSIB bank had approximately $330 billion of total consolidated assets. Today, however, that bank has $550 billion (which is not too much smaller than Lehman when it failed). Pending mergers would push that number even higher.").

[3]See *The resolution of large regional banks and lessons learned with Martin Gruenberg* (Aug. 14, 2023), at 3, es_20230815_gruenberg_regional_banks_transcript.pdf (brookings.edu),

("[W]hile regional banks may not be as large and complex and internationally active as the so-called global, systemically important banks that – the GSIBs – they would pose distinct and significant challenges in resolution that could raise serious financial stability risks.").

[4] Views and recommendations are informed by prior regulatory experience at the FDIC and resolution plan work. All or portions of this post are intended to be submitted as a comment for public record.

[5] IDIs consolidated under GSIBs would not be subject to the new LTD proposal because their parent holding companies are already subject to the LTD requirements under the FRB's TLAC rule. Federal Register :: Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations

[6] Id. at 107.

[7] LTD NPR at 112.

[8] Id. at 84.

[9] Id. at 65-66.

[10]See id. at 126 (citing Section X). The proposed amendments to the TLAC rules are issued exclusively by the FRB. The primary changes to the GSIB TLAC rules are: (1) to cut the amount of eligible one to two year LTD that counts toward the TLAC requirement to fifty percent; (2) to require minimum denominations of LTD; (3) to amend the clean holding company requirements to permit certain agreements that would have been prohibited by the QFC rules; (4) to require holding companies to make certain disclosures; and (5) to reserve authority for the Federal

Reserve Board to require TLAC companies to maintain greater or lesser amounts of LTD or TLAC instruments. See id. Section IX.

[11]Federal Reserve Board - Statement by Governor Michelle W. Bowman on the Proposed Long-term Debt Requirements and Proposed Guidance for Resolution Plan Submissions of Domestic Triennial Full Filers.

[12]Federal Reserve Board - Statement by Governor Christopher J. Waller on the Long-Term Debt Requirement Proposal

[13]FDIC: Speeches, Statements & Testimonies - 08/29/2023 - Statement by Vice Chairman Travis Hill on the Proposed Long-term Debt Requirements for Large Banks

[14]Fact Sheet on Proposed Rule to Require Large Banks to Maintain Long-Term Debt to Improve Financial Stability and Resolution (federalreserve.gov)

[15] Id.

[16] LTD NPR at 13-14.

[17] Id. at 37.

[18]"For most of these institutions, a sale of the failed bank franchise is a much more likely resolution outcome than a recapitalization, as was the case in the three failures earlier this year. As a result, I question whether the capital refill framework is the right approach." FDIC: Speeches, Statements & Testimonies - 08/29/2023 - Statement by Vice Chairman Travis Hill on the Proposed Long-term Debt Requirements for Large Banks

[19] LTD NPR at 50.

[20] Id. at 45-50.

[21] Relatedly, if eligible LTD effectively serves as another layer of deposit insurance--thereby maximizing the likelihood of meeting the least cost test--presumably the amount of uninsured deposits at any CIDI should impact the amount of eligible LTD a CIDI is required to hold.

[22] LTD NPR at 34, question 11.

[23] Id. at 9.

[24] See Memorandum from James McGraw to FDIC Board of Directors, Publication of *Federal Register* Notice Regarding Long-Term Debt for Certain Depository Institutions (Aug. 29, 2023) ("FDIC LTR NPR Memo, Long-Term Debt (BC) (fdic.gov)," at 4.

[25] Id. at 8.

[26] See comment of Randy Guynn, Banks offer muted criticism of long-term debt and resolution plan proposals | American Banker ("They're not saying that the regional banks have to change their strategy from what's called a bridge bank strategy to a single-point-of-entry strategy, but they're saying they would like to have the option to be able to execute one and this will help them do it," Mr. Guynn said, adding that the move "could well push the regional banks toward the single point of entry strategy.")

[27] See FDIC LTR NPR Memo, Long-Term Debt (BC) (fdic.gov), at 4, 6 (emphasis added).

[28] See FDIC Vice Chairman Travis Hill on recent bank failures and the path ahead - YouTube, discussion with Margaret Tahyar and Karen Petrou, at 58:30.

[29] FDIC LTR NPR Memo, Long-Term Debt (BC) (fdic.gov), at 6.

[30] Id.

[31] See Title I Guidance Proposal at 27 (noting "[t]here are currently no domestic triennial full filers utilizing a SPOE strategy."), Federal Register notice: Guidance for Resolution Plan Submissions of Domestic Triennial Full Filers (federalreserve.gov).

[32] Id. at 8.

[33] Id. at 7.

[34]Acting Comptroller of the Currency Michael J. Hsu Remarks before the Wharton Financial Regulation Conference 2022 on Financial Stability and Large Bank Resolvability (occ.gov), at 5-6 (emphasis added).

[35] See Title I Guidance Proposal at 9.

[36] Id. at 29-56.

[37] Id. at 57-58. Specific assumptions and expectations for each resolution strategy are detailed extensively in the Title I Guidance Proposal.

[38] Id. at 11 (emphasis added).

[39] Id. at 27.

[40] Id. at 22, 61-62.

[41] Id. at 22, 60.

[42] 12 C.F.R. § 360.10 (**IDI Rule**).

[43] Title I Guidance Proposal at 16 n.16.

[44] See remarks of FDIC Director Rohit Chopra, FDIC Board of Directors Meeting, Aug. 29, 2023, at 1:17:10 in support of the proposition that, "It is right for us to be thinking about how we compare it [the resolution planning rules]").

[45] *Compare* divestiture options under the Title I Proposed Guidance separability expectations (i.e., "options contemplating the sale, transfer, or disposal of significant assets, portfolios, legal entities or business lines... Options that may permanently change the firm's structure or business strategy") at 54, *with* "franchise components" under the IDI NPR ("a business segment, regional branch network, major asset or asset pool, or other key component of the IDI franchise that currently can be separated and marketed in a timely manner. . . franchise components should be those that can be separated based upon the organizational structure and capabilities of the firm . . ."), at 61.

[46] See generally Bank Reg Blog, Three Notes on the FDIC's IDI Resolution Plan Proposal (substack.com) (Aug. 30, 2023) (citing potential future cadence of IDI plan submissions and astutely noting, " [m]eanwhile, while all this is going on, the FDIC along with the [FRB] will also be reviewing 165(d) resolution plans, which under current rules are required every two years from the U.S. GSIBs and every three years from a number of other firms.").

[47] Memorandum from James McGraw and Maureen Sweeney to FDIC Board of Directors Regarding Amendments to 12 C.F.R. § 360.10 — Notice of Proposed Rulemaking (Aug. 29, 2023) ("FDIC IDI NPR Memo"), at 4.

[48] IDI NPR at 26.

[49] Id. at 140-41.

[50] FDIC IDI NPR Memo at 5.

[51] Id. at 12.

[52] IDI Statement at 1.

[53] FDIC IDI NPR Memo at 11.

[54] Id. at 17.

[55] Id. at 16.

[56] IDI NPR at 82.

[57] FDIC IDI NPR Memo at 17.

[58] Id. at 7.

[59] IDI NPR at 106.

[60] Id. at 107.

[61] Id.

[62] Id.

[63] FDIC IDI NPR Memo at 14.

[64] Id.

[65] Id. at 15.

[66] FDIC IDI NPR Memo at 8.

[67] Id. at 10.

[68] IDI NPR at 193-94.

[69] FDIC IDI NPR Memo at 18.

[70] See remarks of FDIC Director Rohit Chopra, *supra* note 44, at 1:14:38 ("I think we[] all as regulators have dealt with the reams of paper before. We cannot have reams of paper...we need actual plans that have some reality to them...I see this capabilities testing as directly related to that.").

[71] Michael J. Hsu, *Megabanks Have Living Wills. Regional Banks Need Them Too.*, Bloomberg (Aug. 29, 2023) (emphasis added).

[72] See Resolution Plans: Regulators Have Refined Their Review Processes but Could Improve Transparency and Timeliness | U.S. GAO (Apr. 2016) (recommending, in the Title I resolution plan context, that the "FDIC and the Federal Reserve publicly disclose information about their assessment frameworks and reduced plan criteria for smaller companies and revise the annual filing requirement.")

[73] Margaret E. Tahyar, *Are Banking Regulators Special?*, Davis Polk & Wardell, at 29, tch_banking_perspectives_-_are_banking_regulators_special.pdf (davispolk.com).

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