Clients&FriendsMemo

Living Wills: FDIC Modifies, Finalizes Rules

September 22, 2011

On September 13, 2011, the Federal Deposit Insurance Corporation approved the final rule governing the implementation of the "living will" provision found in the Dodd-Frank Wall Street Reform and Consumer Protection Act. The rule continues to require covered companies to submit to the Board of Governors of the Federal Reserve System, the FDIC and the Financial Stability Oversight Counsel annual plans for the rapid and orderly resolution of their business in the event of material financial distress. The rule must still be approved by the Federal Reserve (which is expected to approve the rule shortly). It will then become effective 30 days after its publication in the Federal Register.

The final rule modifies the prior proposed rule that was the subject of a Client and Friends Memorandum dated June 13, 2011 in a number of ways and generally reduces the burden on financial institutions – though the burden remains significant.

Most significantly, the rule now staggers the implementation by requiring only covered companies with $250 billion or more in nonbank assets to file their plan by July 1, 2012, with smaller institutions' deadlines to follow. The rule also permits certain smaller covered companies that operate primarily through an insured depository institution to file a more limited "tailored" resolution plan. The rule eliminates the requirement that a covered company file an updated resolution plan following each material event and replaces it with a notice requirement. The rule also removes the credit exposure report component which will be covered by a separate rulemaking. Finally, the rule sets forth more detailed confidentiality provisions, and clarifies a number of additional provisions.

On the same day, the FDIC also approved an interim final rule that requires insured depository institutions with $50 billion or more in nonbank assets to submit a resolution plan under the FDIA for resolution of the insured depository institution in the event of its failure.

Below please find a detailed description of each of the changes to the prior version of the rule as compared with the final rule adopted by the FDIC.

Staggered Implementation

The final rule provides for staggered submission of resolution plans. The previous version of the rule required all covered companies with $50 billion or more in nonbank assets to submit plans by July 1, 2012. Now, only covered companies with $250 billion or more in total nonbank assets (or, in the case of a foreign-based covered company, in total U.S. nonbank assets) must file initial plans by July 1, 2012. covered companies with nonbank assets between $100-$250 billion must file their initial plans by July 1, 2013. The remaining covered companies have until December 31, 2013, to file their initial resolution plan.

"Nonbank Assets" is not defined in the regulation. We understand the regulators intended the phrase to encompass a bank holding company's consolidated assets not held by its insured depository institution (or operating subsidiary thereof) or, in the case of a foreign bank by its uninsured U.S. branch.

After its initial filing, each covered company is required to submit a resolution plan to the Federal Reserve and the FDIC on or before the anniversary date of its initial plan. The FDIC and the Federal Reserve retain the right to require a covered company to submit its initial resolution plan earlier or later than the relevant timeframe set forth in the final rule.

Tailored Plans Permitted for Certain Institutions

The final rule acknowledges the challenge certain institutions faced in developing a plan under the Bankruptcy Code when it primarily operates through an insured depository institution. The final rule permits two groups of covered companies to file a "tailored" resolution plan that focuses on the institution's nonbanking operations and business lines. The two groups are (1) institutions with less than $100 billion in total nonbank assets and whose insured depository institution assets comprise at least 85 percent of its total consolidated assets and (2) foreign-based covered companies with less than $100 billion in total U.S. nonbank assets and whose U.S. insured depository institution comprises 85 percent or more of the covered company's U.S. total consolidated assets.

A tailored resolution plan focuses only on the relationship between the covered company and its nonbanking material entities and operations – except with respect to a description of interconnections and interdependencies.

No Interim Plans Following a Material Change

The final rule also lessens the burden on a covered company that experiences a material event after the filing of its resolution plan by no longer requiring the covered company to file an updated

resolution plan to be filed within 45 days after the occurrence of such event. The final rule instead requires a covered company to submit a notice of a material event within 45 days of the event. The notice is only required if the material event is significant enough to merit a modification of the resolution plan and should describe the event and explain why the event may require changes to the resolution plan. The company need not file a new plan until it would otherwise be scheduled to file a revised plan. No notice is required if the covered company is required to submit its annual resolution plan within 90 days. The firm must then revise its next annual resolution plan to account for the material event.

Confidentiality Protections

Dodd-Frank requires the Federal Reserve and the FDIC to assess the confidentiality of the resolution plans and related material in accordance with applicable exemptions under the Freedom of Information Act. The FDIC expects that large portions of the submissions will qualify for exemptions under such rules.

To address this issue, the final rule requires each resolution plan to be divided into two portions—a public section and a confidential section. The public section should consist of an executive summary describing the business of the covered company and include (1) the names of the material entities; (2) a description of the core business lines; (3) consolidated or segment financial information regarding assets, liabilities, capital and major funding sources; (4) a description of derivative activities and hedging activities; (5) a list of memberships in material payment, clearing and settlement systems; (6) a description of foreign operations; (7) the identities of material supervisory authorities; (8) the identities of the principal officers; (9) a description of the corporate governance structure and processes related to resolution planning; (10) a description of material management information systems; and (11) a description, at a high level, of the covered company's resolution strategy, covering such items as the range of potential purchasers of the covered company, its material entities and core business lines.

The covered company may request confidential treatment of the information set forth in the remainder of the resolution plan in accordance with the Freedom of Information Act. Further, the final rule provides that the submission of any nonpublic data or information shall not constitute a waiver of, or otherwise affect, any privilege arising under Federal or state law (including the rules of any Federal or state court).

Delayed Implementation of Credit Exposure Reports

Under the proposed rule, each "covered company" was required to submit a quarterly credit exposure report. Various parties expressed a number of concerns regarding the clarity and scope of these provisions and suggested that this requirement should be considered in conjunction with

the Dodd-Frank single-counterparty single exposure limit. The FDIC final rule on living wills indicated that the credit exposure reporting requirement will be covered by a separate rulemaking.

Clarification of Key Provisions

- The FDIC and Federal Reserve clarified which entities are covered by the rule. Both the FDIC and the Federal Reserve interpret the plain meaning of section 165 of Dodd-Frank to require the eligibility threshold to be calculated based on a firm's worldwide consolidated assets, rather than only its U.S. assets. A bank holding company or a systemically significant nonbank financial company is a "covered company" if its consolidated worldwide assets are $50 billion or more. It will remain a covered company subject to the requirements of the rule until its consolidated assets drop below $45 billion. A newly eligible firm must file an initial report no later than the next July 1, provided that such date is at least 270 days after it became eligible.

- The FDIC recognized that certain material subsidiaries of a covered company may be subject to an insolvency regime other than the Bankruptcy Code. For those subsidiaries, the final rule only requires a covered company to analyze it if the subsidiary's total assets are $50 billion or more or if it conducts a critical operation. Any such analysis should include a reference to the applicable insolvency regime.

- In preparing its plan for rapid and orderly resolution, the final rule requires a covered company to consider its material financial distress under the baseline scenario provided to the covered company by the Federal Reserve in connection with its annual stress test pursuant to Section 165(i) of Dodd-Frank. For all future plans, the final rule requires the covered company to take into account such material financial distress under each of the baseline, adverse and severely adverse economic conditions provided in connection with its annual stress test.

- The final rule allows the FDIC to extend deadlines set forth in the rule either on their own initiative or upon request. Any extension request should be supported by a written statement describing the basis and justification for the request.

- Prior to issuing a notice of deficiency or otherwise restricting a covered company, the final rule requires the FDIC to consult with each member of the Financial Stability Oversight Counsel that primarily supervises such subsidiary and permits the FDIC to consult with any other Federal, state, or foreign supervisor as appropriate.

- The FDIC recognized that the resolution plan of a foreign-based company that has limited assets or operations in the United States will be limited in scope and complexity and that the most important in the review of such plans will be a close analysis of how the resolution plan fits within the firm's overall resolution or contingency planning process.

- The FDIC also recognized that the content of a resolution plan will vary from company to company and acknowledged that it will take into account such variances in its review of a resolution plan. To the extent a required information element is not applicable to a covered

company, then the FDIC stated that it should indicate this in its resolution plan.

Interim FDIC Rule Regarding Insured Depository Institutions

On the same day, the FDIC also approved an interim final rule requiring an insured depository institution with $50 billion or more in total nonbank assets to submit its own separate resolution plan under the FDIA. The purpose of this resolution plan is to enable the FDIC, as receiver, to (i) ensure the institution's depositors receive access to their insured deposits within one business day of the institution's failure, (ii) maximize the value realized from the sale or disposition of the institution's assets, and (iii) minimize the losses by the institution's creditors. This interim rule is currently subject to a 60-day comment period and expected to become effective no later than January 1, 2012.

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Please feel free to contact any of the following Cadwalader attorneys if you have any questions about this memorandum.

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