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### STATEMENT OF JAMES R. WIGAND DIRECTOR OFFICE OF COMPLEX FINANCIAL INSTITUTIONS ON IMPROVING CROSS BORDER RESOLUTION TO BETTER PROTECT TAXPAYERS AND THE ECONOMY

James R. Wigand

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**STATEMENT OF**

**JAMES R. WIGAND  
DIRECTOR  
OFFICE OF COMPLEX FINANCIAL INSTITUTIONS**

**on**

**IMPROVING CROSS BORDER RESOLUTION TO BETTER PROTECT  
TAXPAYERS AND THE ECONOMY**

**SUBCOMMITTEE ON NATIONAL SECURITY  
AND INTERNATIONAL TRADE AND FINANCE  
U.S. SENATE**

**May 15, 2013  
538 Dirksen Senate Office Building**

Chairman Warner, Ranking Member Kirk, and members of the Subcommittee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding our progress in addressing cross-border issues involved in the resolution of a systemically important financial institution (SIFI) with international subsidiaries and affiliates.

The financial crisis that began in late 2007 highlighted the complexity of the international structures of many of these large, complex financial institutions and the need for international cooperation if one of them became financially troubled. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requires the FDIC to coordinate, to the maximum extent possible, with the appropriate foreign regulatory authorities with respect to the resolution of SIFIs having cross-border operations.

Title I and Title II of the Dodd-Frank Act provide significant new authorities to the FDIC and other regulators to address the failure of a SIFI. All large, systemic financial companies covered under Title I must prepare resolution plans, or “living wills”, to demonstrate how the company would be resolved in a rapid and orderly manner under the Bankruptcy Code in the event of the company’s material financial distress or failure. Requiring SIFIs to explain their interactions with foreign authorities during a resolution is a key element of the plans.

While bankruptcy remains the preferred option, Title II provides a back-up authority to place a holding company, affiliates of an FDIC-insured depository institution, or a nonbank financial company into a public receivership process, if no viable private sector alternative is available to prevent the default of the financial company and a resolution through the bankruptcy process would have serious adverse effects on financial stability in the United States. Establishing and maintaining strong working relationship with our cross-border counterparts will be critical, should the Title II authorities ever need to be invoked. The FDIC and other regulators have been actively working with our international counterparts to coordinate resolution strategies for globally active systemically important financial companies (G-SIFIs).

My testimony will provide greater detail about the authorities available to the FDIC to address the failure of a SIFI and how they improve our ability to manage such failures on an international basis. In addition, it will describe the significant progress we have made with our foreign colleagues in one of the most challenging areas of the financial reforms adopted since the recent crisis. Although much has been accomplished, more work remains.

## **Resolving a Systemically Important Financial Firm**

### *Title I – “Living Wills”*

Bankruptcy is the preferred resolution framework in the event of a SIFI’s failure. To make this prospect achievable, Title I of the Dodd-Frank Act requires that all bank holding companies with total consolidated assets of \$50 billion or more, and nonbank

financial companies that the Financial Stability Oversight Council (FSOC) determines could pose a threat to the financial stability of the United States, prepare resolution plans, or “living wills”, to demonstrate how the company could be resolved in a rapid and orderly manner under the Bankruptcy Code in the event of the company’s financial distress or failure. This requirement enables both the firm and the firm’s regulators to understand and address the parts of the business that could create systemic consequences in a bankruptcy. The living will process is a necessary and significant tool in ensuring that large financial institutions can be resolved through the bankruptcy process.

The FDIC and the Federal Reserve Board issued a joint rule to implement Section 165(d) requirements for resolution plans – (the 165(d) Rule) – in November 2011. The plans will detail how each covered company could be resolved under the Bankruptcy Code, including information on their credit exposures, cross guarantees, organizational structures and a strategic analysis describing the company’s plan for rapid and orderly resolution.

In addition to the resolution plan requirements under the Dodd-Frank Act, the FDIC issued a separate rule which requires all insured depository institutions (IDIs) with greater than \$50 billion in assets to submit resolution plans to the FDIC for their orderly resolution through the FDIC’s traditional resolution powers under the Federal Deposit Insurance Act (FDI Act). This rule, promulgated under the FDI Act, complements the joint rule on resolution plans for SIFIs. The 165(d) Rule and the IDI resolution plan rule

are designed to work in tandem by covering the full range of business lines, legal entities and capital-structure combinations within a large financial firm.

The FDIC and the Federal Reserve review the 165(d) plans and may jointly find that a plan is not credible or would not facilitate an orderly resolution under the Bankruptcy Code. If a plan is found to be deficient and adequate revisions are not made, the FDIC and the Federal Reserve may jointly impose more stringent capital, leverage, or liquidity requirements, or restrictions on growth, activities, or operations of the company, including its subsidiaries. Ultimately, the FDIC and the Federal Reserve, in consultation with the FSOC, can order the company to divest assets or operations to facilitate an orderly resolution under bankruptcy in the event of failure. A SIFI's plan for resolution under bankruptcy also will support the FDIC's planning for the exercise of its Title II resolution powers by providing the FDIC with a better understanding of each SIFI's structure, complexity, and processes.

### *2013 Guidance on Living Wills*

Eleven large, complex financial companies submitted initial 165(d) plans in 2012. Following the review of the initial resolution plans, the agencies developed instructions for the firms to detail what information should be included in their 2013 resolution plan submissions.<sup>1</sup> The agencies identified an initial set of significant obstacles to rapid and orderly resolution which covered companies are expected to address in the plans, including the actions or steps the company has taken or proposes to take to remediate or

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<sup>1</sup> "Guidance for 2013 §165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012."  
<http://www.fdic.gov/regulations/reform/domesticguidance.pdf>.

otherwise mitigate each obstacle and a timeline for any proposed actions. The agencies extended the filing date to October 1, 2013, to give the firms additional time to develop resolution plan submissions that address the instructions.

Resolution plans submitted in 2013 will be subject to informational completeness reviews and reviews for resolvability under the Bankruptcy Code. The agencies established a set of benchmarks for assessing a resolution under bankruptcy, including a benchmark for cross-border cooperation to minimize the risk of ring-fencing or other precipitous actions. Firms will need to provide a jurisdiction-by-jurisdiction analysis of the actions each would need to take in a resolution, as well as the actions to be taken by host authorities, including supervisory and resolution authorities. Other benchmarks expected to be addressed in the plans include: the risk of multiple, competing insolvency proceedings; the continuity of critical operations -- particularly maintaining access to shared services and payment and clearing systems; the potential systemic consequences of counterparty actions; and global liquidity and funding with an emphasis on providing a detailed understanding of the firm's funding operations and cash flows.

As reflected in the Dodd-Frank Act, the preferred option for resolution of a large failed financial firm is for the firm to file for bankruptcy just as any failed private company would, without putting public funds at risk. In certain circumstances, however, resolution under the Bankruptcy Code may result in serious adverse effects on financial stability in the United States. In such cases, the Orderly Liquidation Authority set out in Title II of the Dodd-Frank Act serves as the last resort alternative and could be invoked

pursuant to the statutorily prescribed recommendation, determination and expedited judicial review process.

### *Title II – Orderly Liquidation Authority*

Prior to the recent crisis, the FDIC's receivership authorities were limited to federally insured banks and thrift institutions. The lack of authority to place the holding company or affiliates of an insured depository institution or any other non-bank financial company into an FDIC receivership to avoid systemic consequences severely constrained the ability to resolve a SIFI. Orderly Liquidation Authority permits the FDIC to resolve a failing non-bank financial company in an orderly manner that imposes accountability while mitigating systemic risk.

The FDIC has largely completed the core rulemakings necessary to carry out its systemic resolution responsibilities under Title II of the Dodd-Frank Act. For example, the FDIC approved a final rule implementing the Orderly Liquidation Authority that addressed, among other things, the priority of claims and the treatment of similarly situated creditors.

Key findings and recommendations must be made before the Orderly Liquidation Authority can be considered as an option. These include a determination that the financial company is in default or danger of default, that failure of the financial company and its resolution under applicable Federal or State law, including bankruptcy, would have serious adverse effects on financial stability in the United States and that no viable



private sector alternative is available to prevent the default of the financial company. To invoke Title II, the following would be required:

1. a recommendation addressing the eight criteria set out in the Dodd-Frank Act and approved by two-thirds of the members of the Federal Reserve Board of Governors;
2. a recommendation by either two-thirds of the members of the Securities and Exchange Commission (if the financial company or its largest U.S. subsidiary is a securities broker or dealer), in consultation with the FDIC; or the Director of the Federal Insurance Office (if the financial company or its largest U.S. subsidiary is an insurance company), in consultation with the FDIC; or two-thirds of the members of the FDIC Board of Directors (in the case of all other financial companies) also addressing the eight statutory criteria set out in the Dodd-Frank Act; and
3. a determination by the Secretary of the Treasury, in consultation with the President, covering the seven statutory criteria set forth in section 203(b) of the Dodd-Frank Act.

Following the culmination of the expedited judicial review process specified in section 202(a) of the Dodd-Frank Act, the FDIC is appointed receiver under Title II. If, however, the covered financial company is itself an insurance company, the resolution is conducted under applicable state law and the FDIC has backup authority to stand in the place of the appropriate state regulatory agency.

### *Single Point-of-Entry Strategy*

To implement its authority under Title II of the Dodd-Frank Act, the FDIC has developed a strategic approach to resolving a SIFI which is referred to as Single Point-of-Entry. In a Single Point-of-Entry resolution, the FDIC would be appointed as receiver of the top-tier parent holding company of the financial group following the company's failure and the completion of the recommendation, determination and expedited judicial review process set forth in Title II of the Dodd-Frank Act. Shareholders would be wiped out, unsecured debt holders would have their claims written down to reflect any losses that shareholders cannot cover, and culpable senior management would be replaced.

The FDIC would organize a bridge financial company into which the FDIC would transfer assets from the receivership estate, including the failed holding company's investments in and loans to subsidiaries. Equity, subordinated debt, and senior unsecured debt of the failed company would likely remain in the receivership and be converted into claims. Losses would be apportioned to the claims of former equity holders and unsecured creditors according to their order of statutory priority. Remaining claims would be converted, in part, into equity that will serve to capitalize the new operations, or into new debt instruments. This newly formed bridge financial company would continue to operate the systemically important functions of the failed financial company, thereby minimizing disruptions to the financial system and the risk of spillover effects to counterparties.

The healthy subsidiaries of the financial company would remain open and operating, allowing them to continue business and avoid the disruption that would likely accompany their closings. Critical operations for the financial system would be maintained. Because these subsidiaries would remain open and operating as going-concerns, counterparties to most of the financial company's derivative contracts would have neither a legal right nor a financial motivation to terminate and net out their contracts.

However, creditors at the subsidiary level should not assume that they avoid risk of loss. For example, if the losses at the financial company are so large that the holding company's shareholders and creditors cannot absorb them, then the subsidiaries with the greatest losses will have to be placed into resolution, exposing those subsidiary creditors to loss.

Under the Dodd-Frank Act, officers and directors responsible for the failure cannot be retained and would be replaced. The FDIC would appoint a new Chief Executive Officer and Board of Directors from the private sector to run the bridge holding company under the FDIC's oversight during the first step of the process.

During the resolution process, restructuring measures would be taken to address the problems that led to the company's failure. These could include changes in the company's businesses, shrinking those businesses, breaking them into smaller entities, and/or liquidating certain assets or closing certain operations. The FDIC also would

likely require the restructuring of the firm into one or more smaller non-systemic firms that could be resolved under bankruptcy.

The FDIC expects the well-capitalized bridge financial company and its subsidiaries to borrow in the private markets and from customary sources of liquidity. The new resolution authority under the Dodd- Frank Act provides a back-up source for liquidity support, the Orderly Liquidation Fund (OLF). If it is needed at all, the FDIC anticipates that this liquidity facility would only be required during the initial stage of the resolution process, until private funding sources can be arranged or accessed. Much like debtor-in-possession financing in a bankruptcy, the OLF can only be used for liquidity and would only be available on an over-collateralized fully-secured basis. If any OLF funds are provided, the OLF must be repaid either from recoveries on the assets of the failed firm or, in the unlikely event of a loss on the collateralized borrowings, from assessments against the largest, most complex financial companies. The law expressly prohibits taxpayer losses from the use of Title II authority.

In our view, the Single Point-of-Entry strategy holds the best promise of achieving Title II's goals of holding shareholders, creditors and management of the failed firm accountable for the company's losses and maintaining financial stability.

### **Cross-border Issues**

Addressing the issues associated with the resolution of G-SIFIs is challenging. Advance planning and cross border coordination will be critical to minimizing

disruptions to global financial markets. Recognizing that G-SIFIs create complex international legal and operational concerns, the FDIC is actively reaching out to foreign host regulators to engage in dialogue concerning matters of mutual concern and to enter into bilateral Memoranda of Understanding in order to address issues associated with cross-border regulatory requirements, to gain an in-depth understanding of foreign resolution regimes, and to establish frameworks for robust cross-border cooperation and the basis for confidential information-sharing, among other initiatives.

*Coordination with the United Kingdom, the European Union, Switzerland & Japan*

As part of our bilateral efforts, the FDIC and the Bank of England, in conjunction with the prudential regulators in our respective jurisdictions, have been working to develop contingency plans for the failure of G-SIFIs that have operations in both the U.S. and the U.K. Of the 28 G-SIFIs designated by the Financial Stability Board (FSB)<sup>2</sup> of the G-20 countries, four are headquartered in the U.K, and another eight are headquartered in the U.S. Moreover, approximately 70 percent of the reported foreign activities of the eight U.S. G-SIFIs emanates from the U.K. The magnitude of these financial relationships makes the U.S.-U.K. bilateral relationship by far the most significant with regard to the resolution of G-SIFIs. As a result, our two countries have a strong mutual interest in ensuring that, if such an institution should fail, it can be resolved at no cost to taxpayers and without placing the financial system at risk. An indication of the close working relationship between the FDIC and U.K authorities is the joint paper on

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<sup>2</sup> The Financial Stability Board is an international member organization established in 2009 to develop and promote the implementation of effective regulatory and supervisory policies.

resolution strategies that the FDIC and the Bank of England released in December 2012.<sup>3</sup> This joint paper focuses on the application of “top-down” resolution strategies for a U.S. or a U.K. financial group in a cross-border context and addressed several common considerations to these resolution strategies.

In addition to the close working relationship with the U.K., the FDIC is coordinating with representatives from other European regulatory bodies to discuss issues of mutual interest including the resolution of European G-SIFIs. The FDIC and the European Commission (E.C.) have established a joint Working Group comprised of senior executives from the FDIC and the E.C. The Working Group convenes formally twice a year -- once in Washington, once in Brussels -- with on-going collaboration continuing in between the formal sessions. The first of these formal meetings took place in February 2013. Among the topics discussed at this meeting was the E.C.’s proposed Recovery and Resolution Directive, which would establish a framework for dealing with failed and failing financial institutions and which is expected to be finalized this spring. The overall authorities outlined in that document have a number of parallels to the SIFI resolution authorities provided here in the U.S. under the Dodd-Frank Act. The next meeting of the Working Group will take place in Brussels later this year.

The FDIC also has engaged with Swiss regulatory authorities on a bilateral and trilateral (including the U.K.) basis. Through these meetings, the FDIC has further developed its understanding of the Swiss resolution regime for G-SIFIs, including an in-

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<sup>3</sup> "Resolving Globally Active, Systemically Important, Financial Institutions."  
<http://www.fdic.gov/about/srac/2012/gsifi.pdf>.

depth examination of the two Swiss-based G-SIFIs with significant operations in the U.S. We have made substantial progress in establishing a strong framework for the sharing of information and for coordination with respect to the resolution of G-SIFIs operating in our respective jurisdictions.

The FDIC has had bilateral meetings with Japanese authorities. In March 2013, FDIC staff attended meetings hosted by the Deposit Insurance Corporation of Japan to discuss the FDIC's resolution strategy under the Orderly Liquidation Authority and the treatment of qualified financial contracts under the Dodd-Frank Act. That same month, the FDIC hosted a meeting with representatives of the Japan Financial Services Agency (JFSA) to discuss our respective resolution regimes. Representatives of the JFSA provided a detailed description of the current legislative proposal to amend Japan's existing resolution regime to enhance authorities' ability to resolve SIFIs. These bilateral meetings, including an expected principal level meeting later this year, are part of our continued effort to work with Japanese authorities to develop a solid framework for coordination and information-sharing with respect to resolution, including through the identification of potential impediments to the resolution of G-SIFIs with significant operations in both jurisdictions.

To place these working relationships in perspective, the U.S., the U.K., the European Union, Switzerland and Japan account for the home jurisdictions of 27 of the 28 G-SIFIs designated by the FSB and the Basel Committee on Banking Supervision in

November 2012. Progress in these cross-border relationships is thus critical to addressing the international dimension of SIFI resolutions.

### *Multilateral Initiatives*

The FDIC also has been active in multilateral initiatives promoting international financial stability through the FSB – and in particular its efforts to establish greater cross-border resolution coordination -- through the Resolution Steering Group, the Cross-border Crisis Management Group and a number of technical working groups. Additionally, the FDIC has been the co-chair of the Cross-border Bank Resolution Group of the Basel Committee on Banking Supervision since its inception in 2007.

Resolution regimes have been identified as a priority area by the FSB. In April 2013, the FSB published the findings of the first Peer Review on Resolution Regimes.<sup>4</sup> The review, which was conducted by a team led by the FDIC, focused on compliance with international financial principles developed by the FSB and endorsed by the G-20 for the key attributes of resolution.<sup>5</sup> The objectives of the review were to encourage consistent cross-country and cross-sector implementation; to evaluate (where possible) the extent to which standards and policies have had their intended results; and to identify gaps and weaknesses in reviewed areas and to make recommendations for potential follow-up (including via the development of additional principles) by FSB members.

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<sup>4</sup> Financial Stability Board, *Implementing the Key Attributes of Effective Resolution Regimes – How Far Have We Come?* [http://www.financialstabilityboard.org/publications/r\\_130419b.pdf](http://www.financialstabilityboard.org/publications/r_130419b.pdf).

<sup>5</sup> Financial Stability Board, *Key Attributes of Effective Resolution Regimes*. [http://www.financialstabilityboard.org/publications/r\\_111104cc.pdf](http://www.financialstabilityboard.org/publications/r_111104cc.pdf).



The FDIC also has evaluated information and strategies concerning G-SIFI resolution regimes prepared by U.S. and foreign authorities in the course of its involvement with multi-lateral cross-border initiatives, most notably the Crisis Management Group process established by the FSB, including efforts to develop resolvability assessments for individual G-SIFIs. These ongoing institution-specific resolution planning efforts have underscored the complex structure of the large G-SIFIs that may become subject to the FDIC's Orderly Liquidation Authority.

## **Conclusion**

In conclusion, the FDIC, working with our foreign colleagues, has made substantial progress in one of the most challenging areas of the financial reforms adopted in the Dodd-Frank Act. The cross-border issues presented by the failure of a G-SIFI with international operations are complex and difficult. The new authorities granted to the FDIC under Title I and Title II of the Dodd-Frank Act provide a statutory framework to address these important issues. While much work remains to be done, the FDIC is much better positioned today to address the failure of one of these institutions.