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FDIC Finalizes Dodd-Frank Act Living Will Requirements for Systemically Important Companies

On September 13, 2011, the Federal Deposit Insurance Corporation (FDIC) approved a Final Rule that requires certain bank holding companies, foreign banks or companies, and systemically important nonbank financial companies, to periodically submit resolution plans, or "living wills," describing how they can be resolved in an orderly manner under the Bankruptcy Code in the event of material financial distress or failure. Once approved by the Board of Governors of the Federal Reserve System (FRB), the Final Rule will be issued jointly by the FDIC and the FRB (collectively, the "Agencies"). Implementing Section 165(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Final Rule establishes rules and requirements regarding the submission and content of a resolution plan, as well as procedures for review of the plan by the Agencies. In April 2011, the Agencies released for public comment a proposed version of the resolution plan rules (Proposed Rule). The Final Rule reflects a number of significant changes that were largely prompted by comments submitted by banking organizations, industry groups, and other interested parties.[1]

The Dodd-Frank Act required that the Agencies jointly issue final rules no later than January 21, 2012. The FDIC staff proposed to the Board of Directors of the FDIC that the effective date of the Final Rule be 30 days after its publication in the Federal Register. The Final Rule will likely become effective prior to the statutory deadline.

I. Who is "Covered" By the Final Rule?

The following companies are required to submit resolution plans under the Final Rule (collectively, the "Covered Companies"):

- Nonbank financial companies that have been designated by the Financial Stability Oversight Counsel (FSOC) as being systemically important under Section 113 of the Dodd-Frank Act and therefore are supervised by the FRB;[2]

1 As a complement to the Final Rule, the FDIC also approved on September 13 an Interim Final Rule that requires each US insured depository institution with $50 billion or more in total assets to submit a plan for the resolution by the FDIC, as receiver, of such institution in the event of the institution's failure. Currently, 37 insured depository institutions are covered by the Interim Final Rule. Comments on the Interim Final Rule are due on November 21, 2011.

2 The FSOC has not yet finalized the regulations which establish the standards for designation as a

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- Bank holding companies that have US$50 billion or more in total consolidated assets; and
- Foreign banks or companies that are, or are treated as, bank holding companies under Section 8(a) of the International Banking Act of 1978, *and* that have US$50 billion or more in total consolidated assets.

The Agencies have estimated that there are 124 companies that would be subject to the Final Rule. To mitigate the possibility of balance sheet manipulation to escape the Final Rule's coverage, the Final Rule provides that once a bank holding company becomes a Covered Company, it will remain so until it has less than US$45 billion in total consolidated assets, as determined based on the most recent annual or, as applicable, the average of the four most recent quarterly reports. Such a company may become a Covered Company once again if it reports US$50 billion in total consolidated assets on its most recent annual report or, as applicable, the average of its four most recent quarterly reports.

II. Timeframe for Submission

The Final Rule provides Covered Companies with more time to prepare and submit resolution plans than would have been provided under the Proposed Rule. Under the Proposed Rule, resolution plans for all Covered Companies would have been due 180 days following the effective date of the rule. Under the Final Rule, each Covered Company is required to submit its initial resolution plan on a staggered basis depending on the size of the company's US-based nonbank operations as of the effective date of the Final Rule. A Covered Company must submit its initial resolution plan in accordance with the following schedule:

- By **July 1, 2012** if it has **US$250 billion or more** in total nonbank assets (or, in the case of a foreign-based company, in total US nonbank assets);
- By **July 1, 2013** if it has **US$100 billion or more** in total nonbank assets (or, in the case of a foreign-based company, in total US nonbank assets);
- By **December 31, 2013** if it has **less than US$100 billion** in total nonbank assets (or, in the case of a foreign-based company, in total US nonbank assets).

A company that becomes a Covered Company after the effective date of the final rule must submit its resolution plan by the July 1 following the date it becomes a Covered Company, provided that it has been a Covered Company for at least 270 days. While the Final Rule is unclear on this point, it appears that if a company has become a Covered Company less than 270 days before July 1, such company would be expected to file its initial resolution plan by the end of the 270 day period. For example, with respect to a company that becomes a Covered Company with US$100 million or more in total nonbank assets on May 1, 2013, it appears that such company would be expected to file its initial resolution plan by January 27, 2014.

The Final Rule requires each Covered Company to submit updated resolution plans annually on or before the anniversary of its initial submission date. The Agencies may jointly modify the date for an initial or annual submission so long as they provide written notice of such determination no later than 180 days prior to the date upon which they are requiring the resolution plan to be submitted. In addition to the initial and annual submissions of resolution plans, each Covered Company is required to provide the Agencies with notice no later than 45 days after any event or change in circumstances that results in, or could reasonably be foreseen to have, a "material effect" on the resolution plan, unless its annual resolution plan is due within 90 days. The notice must describe the material event and explain why it may require changes to the resolution plan. The material event must be addressed in the Covered Company's next resolution plan.

III. Informational Content of a Resolution Plan

A Covered Company domiciled in the United States is required to provide detailed information outlined in the Final Rule with regard to both its US operations and its foreign operations. A foreign-based Covered Company is required

systemically important nonbank financial company. Therefore, no such designations have been made to date. Recent comments by FRB Governor Daniel Tarullo suggest that a relatively small number of companies will be so designated.

to provide such information regarding its US operations, an explanation of how resolution planning for its US operations is integrated into its overall resolution planning, and a description of the interconnections and interdependencies among its US operations and its foreign-based operations.

Specifically, each resolution plan must include the following components:

Executive Summary. An executive summary must summarize the key elements of the Covered Company's strategic plan, material changes from the most recently filed plan, and any actions taken by the Covered Company to improve the effectiveness of the plan, or remediate or mitigate any material weaknesses or impediments thereto.

Strategic Analysis. A resolution plan must include a detailed and comprehensive strategic analysis describing the Covered Company's plan for rapid and orderly resolution in the event of material financial distress or failure of the Covered Company. The strategic analysis must include any key assumptions and supporting analysis for the resolution plan, and it must address a number of areas set forth in the Final Rule.

Corporate Governance. This component must include a detailed description of how resolution planning is integrated into the corporate governance structure of the company, including identification of the senior management official(s) primarily responsible for overseeing the plan.

Organizational Structure. The resolution plan must include detailed information about the Covered Company's organizational structure, including a hierarchical list of all material entities (including ownership, jurisdiction, and management information on each entity), critical operations and core businesses, financial statements, capital and cash flows, liabilities, off-balance sheet exposures, trading and derivatives activities, hedging activities, major counterparties, and trading systems.

Management Information Systems. This component must include a mapping of the key management information systems and applications to the material entities, critical operations, and core business lines of the company. The plan must also describe the process for supervisory and regulatory agencies to access such systems and applications.

Interconnections and Interdependencies. The resolution plan must identify the interconnections and interdependencies among the company and its material entities, critical operations, and core business lines, including shared resources, funding arrangements, credit exposures, and cross-entity arrangements.

Supervisory and Regulatory Information. The resolution plan must identify all the federal, state, or foreign agencies with supervisory authority or responsibility over the Covered Company and its material entities, critical operations, and core business lines.

IV. Tailored Resolution Plans

In response to comments on the Proposed Rule, the Final Rule permits smaller, less complex bank holding companies and foreign banking organizations that predominately operate through one or more insured depository institutions (or, in the case of a large number of foreign banking organizations subject to the rule, one or more branches or agencies) to elect to file a "tailored" resolution plan that focuses only on resolution of the company's nonbank operations and business lines subject to the Bankruptcy Code, and the interconnections of such operations with those of its US insured depository institution(s) and, in the case of a foreign banking organization, its branches and agencies. A Covered Company may elect to file a tailored resolution plan if, as of the end of the prior calendar year, it had less than US$100 billion in total nonbank assets (or, in the case of a foreign-based company, in total US nonbank assets), and total insured depository assets comprise 85 percent or more of the company's total consolidated assets (or, in the case of a foreign-based company, the assets of its US insured depository institution operations, branches, and agencies comprise 85 percent or more of its US total consolidated assets).

A Covered Company must submit written notice of its intent to submit a tailored resolution plan no later than 270 days prior to its required submission date. Within 90 days of receiving such notice, the Agencies will determine whether the Covered Company will be allowed to submit a tailored resolution plan or whether it must nonetheless submit the full resolution plan.

V. Agency Review Process and Consequences of Noncompliance

The Final Rule requires the Agencies to review a resolution plan within 60 days of submission and determine jointly whether the resolution plan is incomplete or that additional information is necessary to facilitate review. If the resolution plan is incomplete, the Covered Company will have 30 days to submit a revised plan. If the Agencies determine that the resolution plan is not credible or would not facilitate an orderly resolution of the Covered Company under the Bankruptcy Code, then they will notify the Covered Company that the plan is deficient and such company must submit a revised plan addressing the deficiencies within 90 days of receipt of such notice. The Final Rule permits the Agencies to extend these timeframes on their own initiative or in response to an extension request.

The preamble to the Final Rule states that the Agencies do not anticipate that initial resolution plans will be found to be deficient, but rather that such plans will serve as a foundation for more robust annual resolution plans over the next few years. Recognizing that resolution plans will vary by company, the Agencies have stated that their evaluation of the plans will take into account variances among companies in their core business lines, critical operations, domestic and foreign operations, capital structure, risk , complexity, financial activities, and size, among other things. The Agencies have indicated that they expect the review process to evolve as Covered Companies gain more experience in preparing their resolution plans.

If a Covered Company fails to timely submit a resolution plan or such plan fails to remedy the deficiencies identified by the Agencies, then the Agencies may subject the Covered Company or any of its subsidiaries to more stringent capital, leverage, or liquidity requirements, or restrictions on the growth, activities, or operations. Such requirements or restrictions will apply until the Agencies determine that the Covered Company has submitted a revised resolution plan that adequately remedies the deficiencies. If the Covered Company does not submit a revised resolution plan that adequately remedies the deficiencies within two years of the imposition of the requirements or restrictions, then the Agencies in consultation with the FSOC, may order the divestiture of assets or operations as they deem necessary to facilitate an orderly resolution of the Covered Company under the Bankruptcy Code.

VI. Confidentiality

One of the major concerns expressed in many of the comments on the Proposed Rule was the extent to which information submitted in connection with a resolution plan would receive confidential treatment, given that the Final Rule requires Covered Companies to submit very detailed, internal proprietary information that would not normally be made available to the public. Commenters expressed concern that the Proposed Rule did not provide adequate assurance that resolution plans would be kept confidential, particularly given the public disclosure requirements of the Freedom of Information Act (FOIA). The Final Rule attempts to address this concern by explicitly permitting a Covered Company that submits a resolution plan to request confidential treatment in accordance with exemption 4 of FOIA (i.e., the exemption for trade secrets and commercial or financial information), and the corresponding regulatory exemptions of the Agencies. However, while the preamble to the Final Rule suggests that some information will be subject to exemption 8 of FOIA as "confidential supervisory information" (i.e., the "examination exemption"), the absence of explicit language in the Final Rule makes it unclear the extent to which confidential treatment will be granted under exemption 8 of FOIA.

The Final Rule states that each resolution plan must be divided into a public section and a confidential section. The public section of the resolution plan must include the executive summary. The Final Rule lists 11 types of information that must be included in the executive summary

to the extent material to an understanding of the covered company, including:

- The names of material entities;
- A description of core business lines;
- Consolidated or segment financial statements regarding assets, liabilities, capital, and major funding sources;
- A description of derivative activities and hedging activities;
- A list of memberships in material payment, clearing, and settlement systems;
- A description of foreign operations;
- The identities of material supervisory authorities;
- The identities of the principal officers;
- A description of the corporate governance structure and processes related to resolution planning;
- A description of material management information systems; and
- A description, at a high level, of a Covered Company's resolution strategy.

A Covered Company must submit a properly substantiated request for confidential treatment of any information in the confidential section of its resolution plan that it believes is subject to protection from disclosure under exemption 4 of FOIA. The Agencies will determine at their discretion whether to grant FOIA exemption requests. Thus, confidentiality will likely remain a highly controversial issue as Covered Companies begin to submit their initial and annual resolution plans.

VII. Interplay Between the Final Rule and the Interim Final Rule

As a complement to the Final Rule, on September 13, 2011, the FDIC approved an Interim Final Rule that requires each US insured depository institution with US$50 billion or more in total assets to submit a plan for the resolution by the FDIC, as receiver, of such institution in the event of the institution's failure (the "IDI Interim Final Rule"). The IDI Interim Final Rule followed a Notice of Proposed Rulemaking that was published in the Federal Register on May 17, 2010, requiring Special Reporting, Analysis, and Contingent Resolution Plans at Certain Large Depository Institutions. That proposed rule would have required each insured depository institution with greater than US$10 billion in total assets that is owned or controlled by a holding company with more than US$100 billion in total assets to submit to the FDIC a resolution plan demonstrating the insured depository institution's ability to be separated from its parent structure and resolved in an orderly fashion. In response to comments related to the passage of the Dodd-Frank Act, the FDIC delayed the issuance of the IDI Interim Final Rule to coordinate with the rulemaking implementing Section 165(d). Furthermore, to align the IDI Interim Final Rule more closely with the Section 165(d) rule, the FDIC raised the minimum asset size for a covered insured depository institution (CIDI) from US$10 billion to US$50 billion and eliminated the requirement that the CIDI be owned or controlled by a holding company with US$100 billion in assets or more.

The FDIC drafted the IDI Interim Final Rule to closely correspond with the informational requirements of the Final Rule. The IDI Interim Final Rule specifically provides that an insured depository institution may incorporate data and other information from its holding company's resolution plan. Currently, with the exception of three thrifts covered by the IDI Interim Final Rule, the holding companies of each insured depository institution covered by the IDI Interim Final Rule are required to file resolution plans under the Final Rule which implements Section 165(d) of the Dodd-Frank Act.

The IDI Interim Final Rule states that it was meant to complement the Final Rule and avoid duplication of costs and efforts on insured depository institutions and their holding companies. However, the IDI Interim Final Rule and the Final Rule serve different purposes. The IDI Interim Final Rule requires a CIDI to submit a resolution that should enable the FDIC, as receiver, to resolve the institution in a manner that ensures that depositors receive access to their insured deposits within one business day of the institution's failure (two business days if the failure occurs on a day other than Friday), maximize the net present value from the sale or disposition of its assets, and minimize the amount of any loss

realized by the creditors in the resolution. The Final Rule, on the other hand, is focused on minimizing systemic risk in the resolution of the Covered Company in order to protect the financial stability of the United States while maximizing recovery for the creditors.

VIII. Conclusion

The Final Rule imposes significant planning and information-gathering requirements on Covered Companies and raises a number of important legal and practical considerations for Covered Companies. Although the Final Rule addresses many of the concerns raised in public comments, it leaves many key issues unanswered. For example, it lacks a clear, objective definition for what constitutes a "credible" resolution plan. It also does not address how, if at all, the Agencies will coordinate with foreign jurisdictions to achieve international consistency for Covered Companies with cross-border operations. For foreign-based Covered Companies, it remains unclear at a practical level just how such companies are to apply the Final Rule's requirements to their relevant US operations. While the Final Rule attempts to address the important issue of the confidentiality of resolution plans, it is likely to remain a controversial issue and subject of great concern for Covered Companies.

The Agencies have recognized the significant burden associated with developing an initial resolution plan, as well as establishing the processes, procedures, and systems necessary to update the plan annually or as otherwise appropriate. The Agencies have postponed guidance on credit exposure reporting requirements and will likely issue such guidance in connection with the Board's separate rulemaking regarding credit concentrations. While the staggered submission deadlines and opportunities to qualify to submit tailored plans provide some relief to smaller Covered Companies, the largest Covered Companies face a tremendous challenge to prepare initial resolution plans by July 2012. Given the broad scope of the Final Rule, Covered Companies need to start promptly gathering information and preparing initial resolution plans. Such companies will also need to devote substantial resources to updating their resolution plans annually because the Agencies expect that the initial plans will serve as a foundation for the development of more robust annual resolution plans over the coming years. It will be important for Covered Companies to open a dialogue with the Board and the FDIC during the development of their resolution plans. Maintaining an open line of communication with the Agencies will help ensure that the resolution planning process will result in a plan that meets the requirements of the Final Rule.

Arnold & Porter LLP is available to assist you in determining how the Final Rule and IDI Interim Final Rule may affect your business. For further information, please contact your Arnold & Porter attorney or:

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