The Meeting of the Systemic Resolution Advisory Committee

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

December 11, 2013 - 8:47 A.M.

The meeting of the FDIC Systemic Resolution Advisory Committee ("Committee") was called to order by Martin J. Gruenberg, Chairman of the Board of Directors, Federal Deposit Insurance Corporation ("Corporation" or "FDIC").

The members of the Committee present at the meeting were: Anat R. Admati, George G.C. Parker Professor of Finance and Economics, Graduate School of Business, Stanford University, Stanford, California; Michael C. Bodson, President and Chief Executive Officer, The Depository Trust and Clearing Corporation (DTCC), New York, New York; Michael Bradfield, Mercersburg, Pennsylvania; H. Rodgin Cohen, Senior Chairman , Sullivan & Cromwell LLP, New York, New York; William H. Donaldson, Chairman, Donaldson Enterprises, New York, New York; Peter R. Fisher, Senior Managing Director, BlackRock Investment Institute, New York, New York; Janine M. Guillot, Former Chief Operating Investment Officer, CalPERS, Sacramento, California; Richard J. Herring, Jacob Safra Professor of International Banking and Professor of Finance, The Wharton School, University of Pennsylvania, Philadelphia, Pennsylvania; Thomas H. Jackson, Distinguished University Professor and President Emeritus, Simon Business School, University of Rochester, Rochester, New York; Simon Johnson, Ronald A. Kurtz Professor of Entrepreneurship, MIT Sloan School of Management, Cambridge, Massachusetts; Donald L. Kohn, Senior Fellow, Economic Studies Program, Brookings Institution, Washington, D.C.; John A. Koskinen, Non-Executive Chairman of the Board of Freddie Mac, Washington, D.C.; Douglas L. Peterson, President, Standard and Poor's, New York, New York; John S. Reed, Chairman, Corporation of MIT, New York, New York;

Gary H. Stern, Director, The Depository Trust and Clearing Corporation (DTCC), The Dolan Company, and the National Council on Economic Education, New York, New York; Paul A. Volcker, Chairman, Trustees of the Group of 30, New York, New York; and David J. Wright, Secretary-General, International Organization of Securities Commissions.

Member Charles A. Bowsher, Chairman and Member of the Research Advisory Council of Glass, Lewis & Company, LLC, Bethesda, Maryland, was absent from the meeting.

Members of the Corporation's Board of Directors present at the meeting were: Martin J. Gruenberg, Chairman; Thomas M. Hoenig, Vice Chairman; Jeremiah O. Norton, Director(Appointive); and Thomas J. Curry, Director (Comptroller of the Currency).

Corporation staff who attended the meeting included: Steven O. App, Annmarie H. Boyd, Steven E. Byrd, John P. Conneely, Kymberly K. Copa, Carolyn D. Curran, Christine M. Davis, Amie Dorman, Bret D. Edwards, Diane Ellis, Robert E. Feldman, Ralph E. Frable, Fred W. Gibson, Marianne Hatheway, Herbert J. Held, Martin D. Henning, James J. Hone, Craig R. Jarvill, Kathy Kalser, Rose M. Kushmeider, Alan W. Levy, Roberta K. McInerney, Thomas A. Murray, Arthur J. Murton, Richard Osterman, Bimal V. Patel, Barbara A. Ryan, R. Penfield Starke, Marc Steckel, Maureen E. Sweeney, F. Angus Tarpley III, David Wall, Cottrell L. Webster and John D. Weier.

William A. Rowe, III, Deputy to the Chief of Staff and Liaison to the FDIC, Office of the Comptroller of the Currency, was also present at the meeting.

Chairman Gruenberg opened and presided at the meeting. He began by welcoming the Committee members and noting that the meeting provides a timely follow up to the final adoption yesterday by the FDIC's Board of Directors of the "Volcker Rule" and the issuance for publication in the *Federal Register* of the FDIC's single point of entry ("SPOE") strategy. He also welcomed Thomas H. Jackson, from the University of Rochester, Rochester, New York, as a new member of the Committee.

Chairman Gruenberg then provided an overview of the meeting agenda, noting that it would focus on the FDIC's progress over the past year in three key areas: (1) cross-border cooperation; (2) the resolution plans that companies must submit under Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act") ("Title I"); and (3) the FDIC's Title II

SPOE resolution strategy. With respect to cross-border cooperation, he advised that the joint paper released last year by the FDIC and the Bank of England on a common approach to systemic resolution has proven to be a very constructive development by highlighting the cooperation between our respective jurisdictions and framing some of the issues relating to the resolution of systemic companies. He noted that, at the outset of the crisis in 2008, the issue of resolving global systemically important financial institutions ("SIFIs") was not on the international agenda or receiving serious consideration by any national jurisdiction; that the environment has transformed and this area is now a major issue with every major national jurisdiction, particularly the home countries of global SIFIs; and that this issue has been the subject of national legislation and, in Europe, it has additionally been the subject of regional activity by the European Union ("EU"). He also noted that, in addition to its work with the United Kingdom ("UK"), the FDIC has engaged other key national jurisdictions, including Switzerland, Germany, Japan and the European Commission ("EC"), to develop close working relationships; that there has been an eagerness to engage with the FDIC both in recognition of the importance of the issue for their home jurisdictions and the value that the FDIC's experience brings to such engagements; that the FDIC anticipates cross-border tabletop exercises with the UK and other jurisdictions; and that a joint working group has been established between the FDIC and the EC on both resolutions and deposit insurance.

Chairman Gruenberg next discussed the Title I resolution plans, advising that the first round of resolution plans were submitted last year by the 11 largest companies; that the FDIC and the Board of Governors of the Federal Reserve System ("Federal Reserve") issued guidance in April 2013 laying out five benchmarks for resolution under bankruptcy or Title II of the Dodd-Frank Act ("Title II") to be addressed in the second round of resolution plans to be submitted by these companies: funding and liquidity, counterparty actions, critical operations, cross-border cooperation, and multiple competing insolvencies; and that the FDIC and the Federal Reserve are currently reviewing the second round of plans submitted by these companies in October 2013, which are subject to evaluation under the statutory standard of resolvability under bankruptcy.

Finally, Chairman Gruenberg discussed the Title II SPOE resolution strategy, advising that the FDIC has released for publication in the *Federal Register* a detailed description of how it envisions Title II would work and requested public

comment on the SPOE strategy and a set of key issues identified for consideration. He also advised that the FDIC has been working closely with the Federal Reserve on a proposed rule relating to a minimum holding company debt requirement to facilitate the implementation of the SPOE strategy. Mr. Volcker noted that his impression is that we are three quarters of the way there with the SPOE strategy which he mentioned was a remarkable accomplishment. Chairman Gruenberg then introduced Arthur J. Murton, Director of the Office of Complex Financial Institutions ("OCFI"), noting that he previously had been Director of the Division of Insurance and Research; that he had a key advisory role during the recent crisis, including the development of the debt guarantee program implemented during the crisis to guarantee the unsecured debt of U.S. banks; and that he also was deeply involved in structuring the Resolution Trust Corporation's asset disposition process during the 1990s.

Mr. Murton advised that the first panel would provide an update on the Title I resolution planning work and efforts to determine how bankruptcy could be more effective in the resolution of a SIFI. He then introduced the panel members: Herbert J. Held, Associate Director, OCFI; David N. Wall, Assistant General Counsel, Complex Financial Institutions Section, Legal Division; and Barry E. Adler, Bernard Petrie Professor of Law and Business, and Associate Dean for Information Systems and Technology, New York University School of Law.

Mr. Held began the presentation by noting that, under the Dodd-Frank Act, bankruptcy is the first option in the event of a failure of a SIFI; that, under Title I, companies are required to submit resolution plans—the so-called "living wills"—that describe their plans for a rapid and orderly resolution under the bankruptcy code or other relevant insolvency schemes in the event of material financial distress or failure; and that the Federal Reserve and the FDIC must review the resolution plans and may find that a plan would not facilitate an orderly resolution in bankruptcy. He advised that these companies are complex firms with thousands of legal entities that operate along business lines rather than by legal entities. He also advised that some of the key objectives of the initial resolution plans were to identify the critical operations of the firms, describe the firms' strategies to maintain those operations in a crisis situation, and map the critical operations and core business lines to the firms' material legal

entities. In addition, he continued, the resolution plans were required to identify and improve the firms' understanding of the resolution regimes for their material entities, both domestic and foreign, and identify the key obstacles to a rapid and orderly resolution. He noted that the first wave of resolution plans was filed in July 2012 by the largest firms, the second wave was filed in July 2013, and the third wave of filers—which would be the largest number of companies and include the remainder of the U.S. banks over $50 billion and large international banks with U.S. operations—would be submitting their plans in December 2013. He advised that additional guidance was provided jointly with the Federal Reserve to the first wave of filers after review of their initial resolution plans; that the FDIC and the Federal Reserve identified a set of obstacles to be addressed by the firms' 2013 plans, including multiple competing insolvencies, global cooperation, operations and interconnectedness, counterparty actions, and funding and liquidity; and that, while the 2012 plans were based on the failure of all material entities, the firms' 2013 plans may be based on a resolution strategy involving only the bankruptcy of a parent U.S. holding company—using a SPOE strategy—or the failure of material entities where the firm is compartmentalized. He concluded by noting that the FDIC, jointly with the Federal Reserve, was currently reviewing the 2013 resolution plans submitted by the first wave of filers in October 2013; and that three nonbank financial firms designated as systemic entities by the Financial Stability Oversight Council ("FSOC") would be required to file their resolution plans by July 2014.

During the discussion that followed, Committee members raised a number of issues relating to the Title I resolution plans. Mr. Herring commented that the public section of the resolution plans lacks standardized terminology and provides only minimal information on a firm's structure and its subsidiaries; and that a more rigorous approach should be used in determining what constitutes proprietary information that remains confidential. Noting that one issue identified in the first group of resolution plans was the complexities of these organizations and the lack of alignment between the legal entities and the operations, Mr. Kohn asked if the next round of plans in this process would address ways to make these institutions more amenable to resolution by requiring them to simplify their structure. In response, Mr. Held advised that, over the past two years, the firms have taken steps to simplify their structures; that the number of entities within their structures has declined fairly dramatically for some

organizations; and that this area presents a major obstacle that they must address and prove they can overcome. Mr. Herring suggested that disclosing information on efforts to simplify the structure of these organizations would give the public more confidence in the procedure by providing a more systematic way of understanding the progress that is being made. Noting that proprietary information presents an issue, Chairman Gruenberg indicated that there would be real value provided by focusing on consistency in the information disclosed in the public section of the resolution plans and identifying particular information that could be made available to the public.

Mr. Jackson noted that there seems to be a disconnect between Title I and Title II with respect to the resolution plans; that the Title I plans are focused on bankruptcy even though it may be difficult to resolve many of these firms under the current bankruptcy regime; and that it may be useful to have more information provided in the Title I plans to address how the firms could be resolved under the Title II SPOE strategy. Mr. Held responded by emphasizing that the Title I resolution plans are an integral part of the FDIC's Title II planning; and that the information reviewed in the resolution plans for compliance with Title I is vital to the Title II planning. Mr. Stern asked whether the FDIC has noticed a significant difference in the quality and credibility of the second round of resolution plans that have been submitted, and whether the boards of directors of the organizations have been involved in the resolution plan process. Mr. Held responded by noting that the first round of plans were self-examinations by the firms that focused on their structure and interconnections, and the identification of resolution obstacles; that the second round of plans are focused on how they would overcome the resolution obstacles that have been identified; and that it appears that the firms' boards of directors and senior management have been involved in developing the resolution plans. Mr. Cohen advised that, at least with respect to the resolution plans in which he was involved, the boards of directors were deeply involved in providing substantial comment on the plans before they were submitted; and that these plans take into account the problems encountered at Lehman Brothers and AIG and have focused on liquidity and counterparty exposure as critical elements of the plans. From the standpoint of a credit rating agency, Mr. Peterson emphasized the importance of cross-firm analysis and better disclosures, particularly more transparency on derivatives and derivative valuations as early warning systems; he also stressed the importance of more consistency on credit portfolios, such as how credit is priced and accrued. In

response, Mr. Murton indicated that the FDIC's supervisory staff has been actively involved in reviewing these firms from a resolution perspective and performing horizontal reviews for consistency across the firms, which has been helpful in the resolution planning process.

Mr. Murton then turned the panel discussion over to Mr. Adler for a presentation on the resolution of a SIFI under bankruptcy law. Mr. Adler began by noting that there are a number of potential obstacles to an effective bankruptcy of a SIFI: the ineligibility of corporate affiliates for bankruptcy; the process under the current bankruptcy code may start too late; a liquidity crisis may hobble any resolution attempts if there is a worldwide liquidity crisis and funds are unavailable; regulator voice may be required if these firms have effects on the worldwide economy and there is financial distress; the need to limit contagion, which the bankruptcy code currently is not designed to address; a resolution may be required faster than the customary timeframe; and the need for global coordination. He briefly discussed some of these potential obstacles, explaining how they would be handled under current bankruptcy law and outlining improvements that could be made to the bankruptcy code. With respect to the first obstacle involving the ineligibility of corporate affiliates, he noted that some of a covered financial institution's subsidiaries or other affiliates, such as banks and insurance companies, are ineligible for bankruptcy under the current law; that, to avoid inconsistent results and disruption during bankruptcy, insolvency processes of a corporate group should be administratively—but not substantively—consolidated; and that the current FDIC treatment of insured depository institutions could be included in consolidated administration since that process works very well. He emphasized that administrative consolidation of a corporate group would require amendment of the current bankruptcy laws similar to the proposal for the addition of a Chapter 14 to the bankruptcy code. He continued, noting that another potential obstacle is that the process may start too late based on the tendency of equity-controlled enterprises to wait too long in seeking resolution of financial distress; and that the prospect of a "hard landing" for equity and managers has exacerbated this tendency. He advised that bankruptcy laws should be amended to permit involuntary petition by a SIFI's primary regulator without being limited by a SIFI's failure to pay its debts as provided under current law; and that the trigger for an involuntary petition by a regulator could be balance sheet insolvency or insufficient capitalization, and

include a determination that there is, or will be, systemic financial crisis.

Regarding a liquidity crisis as an obstacle to the resolution of a SIFI, Mr. Adler explained that it is impossible to run a bankruptcy process without new financing, but that private sources of debtor-in-possession financing may be unavailable in the middle of a systemic financial crisis. He suggested that the government could serve as the debtor-in-possession lender and, through the SIFI's primary regulator, exercise control over the SIFI and the bankruptcy process. Mr. Johnson commented that proposing the government provide funding administered by a bankruptcy judge is unlikely to be politically viable and appears to be a Title II resolution that skips over the bankruptcy process. In response, Mr. Adler explained that these proposals would not be a wholesale replacement of the bankruptcy code for the specific rules in Title II but instead these proposals reflect the current bankruptcy law, including the priority rule, with some additional amendments; that the dominance of the debtor-in-possession lender is often cited as a problem with the current bankruptcy process because the secured lenders who take control do not always have the interest of the firm as a whole in mind; and that having the primary regulator in control as the debtor-in-possession lender may be beneficial in the resolution of a SIFI because the regulator can take into account concerns such as contagion and payment of systemically important debts. Mr. Bradfield commented that the approach being proposed would not avoid all of the complications of bankruptcy, particularly if it minimizes the rights of other creditors. Mr. Adler responded by noting that cases can be conducted very quickly through the current bankruptcy process with prepackaged bankruptcies in which the major creditors' disputes have been resolved in advance to quiet dissent; that the same type of process could be applied through the bankruptcy process if there is an effective resolution plan; that bankruptcy judges can conduct expedited proceedings that replicate the speed provided in Title II; and that there is an advantage to using the current bankruptcy process and a long established set of insolvency rules rather than new and untested procedures, such as those of Title II. Mr. Cohen commented that there seems to be a widespread assumption that Title II is an anomaly and an approach that is radically different than anything that existed before; that the opposite conclusion is correct and Title II is simply a recognition that financial institutions are resolved differently than other corporations; and that the proposed approach suggests that there should be a special arrangement at the holding company level recognizing

modern corporate structure, not as a substitute for Title II but as a logical complement.

Mr. Adler briefly discussed other measures for an effective bankruptcy process, noting that the capitalization structure is a key feature of the resolution plans; and that, if there is sufficient loss-absorbing debt in place to allow for a bail-in, the bankruptcy code in its current form could solve the problem of restructuring relatively easily, provided there is an administrative process in place in which the business lines and entities can be reconciled and the viable assets sold to a bridge company. He also noted that transparency of obligations and counterparties by requiring the use of clearinghouses would be essential to the current bankruptcy process working properly; and that the current bankruptcy code would be more effective with a temporary stay, including with respect to financial contracts, to permit the transfer of assets to a bridge institution.

After thanking Mr. Adler for his presentation, Chairman Gruenberg announced that the meeting would briefly recess. Accordingly, at 10:18 a.m., the meeting stood in recess.

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The meeting reconvened at 10:40 a.m. the same day, at which time Mr. Murton introduced R. Penfield Starke, Assistant General Counsel, Litigation and Resolutions Branch, Legal Division, to join Mr. Held to provide an update on Title II and the FDIC's SPOE strategy document, which has been issued for publication in the *Federal Register* with a request for public comment.

Mr. Held began by noting that Title I and Title II provide the authority to resolve a SIFI, with bankruptcy being the preferred option; that Congress, in providing these authorities, recognized that SIFIs may not be resolvable under bankruptcy without posing a systemic risk to the U.S. economy; and that Title II provides the backup authority to place a SIFI into a receivership process if a resolution through bankruptcy would have a serious adverse effect on U.S. financial stability. He explained that resolution of a SIFI under Title II has the dual objectives of promoting market discipline and maintaining the stability of the U.S. financial system; that the orderly liquidation authority of Title II provides the necessary tools for the rapid and orderly resolution of a covered financial company; and that Title II establishes certain policy goals for the orderly liquidation authority: (1) owners and management

responsible for a covered financial company's failure must be held accountable, (2) the stability of the U.S. financial system must be maintained, and (3) the resolution of the failed company must impose losses in accordance with statutory priorities and without imposing a cost on the U.S. taxpayers. He noted that the review of the Title I resolution plans by the FDIC and the Federal Reserve identified obstacles to the resolution of a SIFI through the bankruptcy process or an orderly resolution under Title II; and that one of the biggest challenges to resolution is the organization of SIFIs under a holding company structure with hundreds or thousands of interconnected legal entities that span many jurisdictions, both in the U.S. and internationally, with core business lines rarely aligned with legal entities and funding dispersed between affiliates as the need arises. He advised that the FDIC developed the SPOE strategy to address these obstacles; and that, under the SPOE strategy, the top-tier parent holding company is placed into receivership and shareholders, debt holders, and management are held accountable for the failure; and that the SPOE strategy has the benefits of keeping the operating subsidiaries open, protecting against contagion of the financial system, and maintaining vital links among the operating subsidiaries to ensure continuity of services.

Next, Mr. Held discussed the resolution process, noting that, after the FDIC's appointment as receiver for the failed holding company, which would follow the "three keys" process, a bridge financial company ("bridge company") would be created and substantially all of the assets of the receivership estate would be transferred to the bridge company, leaving most of the liabilities in the receivership estate. He explained that the board of directors and senior management of the failed holding company would be replaced; that the FDIC would enter into an initial operating agreement with the board of directors of the bridge company, detailing their responsibilities and directing them to: determine the cause of the failure and develop a plan to remedy it, retain accountants and valuation consultants to prepare financial statements to support a debt for equity swap, develop a business plan for the bridge company, and develop funding, liquidity, and capital plans with regulatory approval; and that a plan for restructuring the company would be established. He emphasized that corporate governance of the bridge company is a key aspect of the SPOE strategy; that the bridge company would be well-capitalized, enabling it to obtain funding from customary sources in the private market; that, if private sources of funding are not immediately available because of market conditions, the Dodd-Frank Act provides for short-term

funding from an Orderly Liquidation Fund, which would be available on a fully secured basis and, if necessary, backed by assessments against the largest financial companies; and that taxpayer losses are prohibited under the Dodd-Frank Act.

Committee members voiced a number of concerns regarding the SPOE strategy. Mr. Volcker expressed his concern that the SPOE strategy has the appearance of temporarily assisting the failed holding company and allowing it to continue as a surviving institution that has shed some of its bad assets, without a liquidation of the company. Sharing this concern, Mr. Fisher stated that the appearance of the holding company ultimately remaining whole, with the operating subsidiaries remaining intact, could result in the loss of counterparty discipline on the operating subsidiaries. In response, Mr. Cohen pointed out that counterparties may not understand the level of their risk; that the SPOE strategy is not unique and multiple points of entry—including a receivership—could be used if the problems at an operating subsidiary are too severe; and that, if the company actually fails, counterparties have the risk of suddenly becoming subordinated creditors. Responding to Mr. Volcker's concern, Mr. Murton indicated that the SPOE strategy document emphasizes that, if a company goes into a Title II receivership, it would be subject to changes, simplification, and restructuring and emerge from that process in a condition that would allow it to be resolved under bankruptcy. Mr. Jackson commented that the Dodd-Frank Act does not adequately distinguish between appropriate loss-bearing capacity and the idea of liquidation and that, at the heart of the issue, is ensuring appropriate loss-bearing capacity; that the SPOE strategy technically results in a new entity in a legal sense; that the SPOE strategy uses a bail-in model of a single entity recapitalization made into a two-entity recapitalization that achieves the same substantive result; and that, before the bridge company would be released back into the world, it would have a business model that subsequently could be resolved under Title I.

Mr. Held then discussed the priority of claims in the resolution process, noting that shareholders' equity, subordinated debt, and unsecured liabilities will remain with the holding company receivership and bear the losses; that certain unsecured creditors' claims may be transferred to the bridge company, such as vendor-type claims; that transfers with disparate impact would only be made to maximize value to the creditors or continue essential operations of the bridge company; and that the FDIC has limited its discretion to treat

similarly situated creditors differently. He continued, advising that termination of the bridge company would require the FDIC's approval of an enforceable restructuring plan; and that, as part of this process, there would have to be a valuation of the bridge company for an exchange of creditor claims for newly issued securities. He explained that there would be a claims waterfall to take into account the order of preference of creditors; and that, in the event the senior secured creditors take a haircut in the initial valuation, subordinated creditors would not receive anything until the senior secured creditors were paid in full, with the subordinated creditors then receiving a portion of any increase in value. The Committee members discussed a number of issues regarding the SPOE strategy, including the apparent disconnects between the proposed resolution strategy involving a restructuring of the company and the common perception of what would constitute a liquidation of the company. Chairman Gruenberg emphasized that the issues raised by the Committee members illustrate the complexity of the challenges in developing a resolution strategy that addresses a set of competing public goals and outcomes that are not easily reconcilable; and that the SPOE strategy document that the FDIC has released for public comment describes how the FDIC envisions utilizing its authorities to implement that resolution strategy and identifies issues on which it requests comment to enhance the FDIC's thinking on this strategy.

In conclusion, Mr. Held advised that fresh start accounting would be used as the accounting framework for the termination of the bridge company, which is similar to an exit from a Chapter 11 bankruptcy; that the bridge company would hire the accountants and evaluation firms to do the accounting; that the FDIC, in its receivership capacity, would review the valuation with its financial advisors to structure a new debt stack; and that the receiver would distribute the securities to the creditors in the order of preference. He also described the timeline that the FDIC envisions for the resolution under the SPOE strategy.

Mr. Murton then announced that the meeting would recess for lunch. Accordingly, the meeting stood in recess at 11:54 a.m.

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The meeting reconvened at 1:16 p.m. that same day, at which time Mr. Murton introduced Robert Young, Managing Director, and David Fanger, Senior vice President, Financial Institutions

Group, Moody's Investor Service, to present the next panel discussion on systemic support and U.S. bank ratings.

Mr. Young began by noting that the presentation would provide a brief overview of Moody's bank rating methodology and the systemic supports in both a global and U.S. context that are incorporated in it, followed by a discussion of the framework for analyzing the orderly liquidation authority and the SPOE strategy that resulted in Moody's rating action in November 2013, which removed all of the ratings uplift from large bank holding company senior debt.

Mr. Fanger explained that Moody's approach to rating banks is a building block approach that evaluates a bank's intrinsic risk factors, such as risk positioning, risk management, operating environment, the financial fundamentals, and franchise value; and that, prior to determining the final risk of default, Moody's also evaluates external factors, such as the likelihood of support for a particular institution, regulatory regime, legal framework within the country in which that bank is principally domiciled or headquartered, and risk of government intervention—particularly in the context of avoiding foreign currency moratoria. Noting that Moody's methodology takes into account government support, as well as potential support from a strong parent company or other cooperative group, he briefly discussed the support considerations that Moody's evaluated through the recent crisis and the steps taken to reduce support assumptions between the enactment of the Dodd-Frank Act in July 2010 and November 2013. He advised that Moody's analysis of the credit risk of the orderly liquidation authority and the feasibility of achieving the FDIC's objectives of maximizing value while minimizing contagion focused on four primary hurdles: (1) international regulatory cooperation; (2) market structure changes to reduce interconnections; (3) capital structure changes; and (4) corporate structure changes to reduce complexity. He emphasized that Moody's analysis is forward-looking, assessing the probability of support and probability of default and attempting to reflect that probability in a single rating system and with a rating horizon that can extend for up to 30 years.

Mr. Young advised that, although progress has been made with respect to international regulatory cooperation and market structure changes are being addressed to reduce the interconnections that create contagion and risk to the broader financial system, the current political environment makes it likely that a SPOE receivership would be used; and that Moody's

believes it should not include government support in the large bank holding company ratings. Mr. Fanger noted that this does not mean that the U.S. government would not step in and provide support in some circumstances, but that, if the U.S. government provides support, holding company creditors would still suffer a loss; and that the SPOE strategy would be used in combination with other actions that could benefit the operating companies to some extent, with no benefit to the holding company creditors. Mr. Young concluded by noting that the greater probability of default for holding company creditors is offset by an expectation of lower loss severity from an anticipated increase in the minimum debt requirements and a greater preservation of franchise value under the orderly liquidation authority. He explained that support would be maintained at the bank operating company level, but that the source has changed from taxpayers or bail-out of the firms to holding company creditors through a bail-in of the debt or loss-absorbing capital at that level; that some support would be maintained for subordinated debt at the operating company level; and that systemically important international operating subsidiaries that are key to the functioning of the firm would benefit from support being provided to or from the holding company to their domestic affiliates.

In the brief discussion that followed, Committee members commented on a number of issues relating to Moody's ratings methodology. Mr. Peterson commented that S&P continues to include government support in their ratings of the major banks. Noting that Moody's removed support for the holding company, Director Norton asked whether Moody's was suggesting that it would expect some future government support, or whether its baseline expectation is that it will be SPOE only, without additional government measures. In response, Mr. Fanger explained that the portion of support at the subsidiary level translates into a 60 to 80 percent probability that creditors at the operating subsidiary will benefit from some form of support that allows them to avoid a default; that the support will be the combination of the bail-in of holding company creditors, which recapitalizes the holding company and allows the holding company to then recapitalize subsidiaries as necessary; and that the support is not incorporated into the holding company ratings. Mr. Herring observed that the counterparty's view, vis-a-vis the subsidiary, would change drastically when the bank holding company goes through a SPOE because they would only have the capital of the subsidiary; and that, although the counterparty discipline will be weaker before the SPOE, it will be stronger after the SPOE, and there will be more pressure on

the remaining operating subsidiary to recapitalize. Mr. Fanger noted that, to the extent the resolution of the holding company involves a further breakup of the firm, counterparties are also going to be wary because they are not certain who the other counterparties will be afterward; Mr. Young added that it is anticipated that the Federal Reserve's minimum debt requirements would be large enough to not only cover substantial losses at the subsidiary, but would also be sufficient to recapitalize the ongoing entity to a degree that attracts private market capital.

Mr. Murton then introduced the last panelists of the meeting, Mr. Wall and F. Angus Tarpley III, Counsel, Complex Financial Institutions Section, Legal Division, advising that they would provide an update on the FDIC's international coordination efforts. He briefly discussed some of the FDIC's outreach efforts to other jurisdictions, noting that the FDIC has been engaged with the Bank of England on a number of fronts, including the release of a joint paper a year ago, a staff-level tabletop exercise involving the discussion of potential cross-border resolution issues; that FDIC has engaged the European Commission, establishing a working group to exchange views on resolution and deposit insurance; and that FDIC has engaged in multi-lateral dialogue with the Financial Stability Board ("FSB") on cross-border resolution issues. Chairman Gruenberg elaborated on Mr. Murton's comments, advising that the FDIC also conducted a tabletop exercise last year with the principals of the U.S. financial regulatory agencies, which focused on the discussion of the agencies' roles and key considerations in various hypothetical scenarios including a potential Title II process; and that the tabletop exercise was extremely valuable in getting the responsible agencies to discuss key considerations in a Title II process, what the respective roles would be and how the FDIC would utilize its Title II authority. He emphasized that there would be significant value to conducting similar tabletop exercises with the principals of key foreign jurisdictions to discuss issues for consideration in a cross-border scenario, build relationships, and gain a mutual understanding of the regulatory system of each jurisdiction. He also commented that the FDIC has worked together with the Bank of England, the German Federal Financial Supervisory Authority ("BaFin"), and the Swiss Financial Market Supervisory Authority ("FINMA") to develop a joint letter to the International Swap and Derivatives Association ("ISDA") concerning how qualified financial contracts could be modified to facilitate a cross-border resolution; and that the FDIC's ongoing engagement with the principals of other jurisdictions has helped to build

institutional relationships and promote a broader discussion of cross-border issues.

Mr. Wall then discussed the joint letter to ISDA concerning the disorderly termination of derivatives contracts and recommending amendment of ISDA's standard documentation to provide a short-term stay of early termination rights and other remedies on the basis of the commencement of an insolvency or resolution proceeding or exercise of a resolution power with respect to a counterparty or its specified entity, guarantor, or credit support provider. He noted that there are two approaches to address the destabilizing effect of wholesale termination of derivative portfolios in the context of a resolution: one approach is through statutory regimes, such as the comprehensive approach of the Dodd-Frank Act or the provisions in the European Union's ("EU") proposed resolution directive, that impose a stay and other remedies; and a second approach is through changes to the language in the standardized documentation of private contracts used to set up derivative contracts to provide for a voluntary stay. He also briefly discussed other remedies, including: the nullification of termination rights under certain conditions, such as transfer of the contracts to a bridge institution; "cross-default" provisions that would prohibit default or termination against a subsidiary as a result of the parent's insolvency; and provisions that would protect against pre-default actions.

Next, Mr. Tarpley briefly summarized the recent EU efforts to develop a comprehensive package of financial reforms with respect to resolutions, noting that these initiatives include: (1) an EU resolution and recovery directive ("RRD"); (2) a single supervisory mechanism ("SSM"); and (3) a single resolution mechanism ("SRM"). The RRD in its current draft form, he explained, would establish a framework for EU member states for the resolution of banks and certain other financial institutions with a suite of powers similar to those exercised by the FDIC under its statutory authorities. He emphasized that the directive would not look the same in every member state within the EU because it would be implemented at the member state level, but it would provide a principle-based approach to harmonizing resolution, particularly cross-border resolution. He continued, noting that the SRM in its current draft form covers Euro zone members and those non-Euro zone members who choose to join, and would function in tandem with the RRD to provide a framework of resolution powers and authorities. Finally, he noted that the SSM creates a new system of European financial supervision, which would involve the European Central

Bank and national authorities of Euro zone member states. With respect to the impact of these EU developments on the FDIC's efforts, he advised that these initiatives provide a basic framework analogous to some of the tools and resources to those used by the U.S. authorities, including the orderly liquidation authority under Title II; and that, once these new powers are implemented, the similarities between the U. S. and a number of different jurisdictions should provide a basis for increased coordination on addressing cross-border resolution issues.

During the discussion that followed, Mr. Johnson noted that there are significant differences between the EU and the U.S. regarding their priorities with respect to the resolution approach and who bears what costs under some situations. In response, Chairman Gruenberg indicated that, at least with respect to the jurisdictions the FDIC has most recently engaged, there appears to be public resistance to the type of open-ended support that has been provided in the past, and a real sense that a different approach is necessary; that the directive for authorities at the national level on recovery and resolution is likely to be completed; that the single supervisory mechanism has been approved and is in the process of implementation; and that it appears the EU recognizes the value of establishing a European resolution mechanism as a compliment to their supervisory authority. Noting that the FDIC's SPOE strategy document called attention to the ring fencing problem, Mr. Cohen emphasized that dealing with the issue of ring fencing is critical to achieving international resolutions.

Mr. Murton went on to discuss the FSB. He pointed out that the FSB has identified key attributes of effective resolution regimes for financial institutions; that the FSB will be assessing member countries' compliance with the key attributes; and that the key attributes have many of the same characteristics and are consistent with the powers provided under the Dodd-Frank Act, requiring consideration of cross-border cooperation and resolution incentives, statutory mandates, recovery and resolution plans, and the establishment of crisis management groups with other key jurisdictions to discuss cross-border resolution. Noting that information sharing and access to confidential supervisory information between authorities has been a significant problem in the past, Mr. Kohn asked whether this problem has been overcome. In response, Mr. Tarpley advised that one of the components of the key attributes deals with the essential elements of cross-border cooperation agreements that set forth the framework for information exchange, and that the regulators have worked very

diligently to develop cooperative agreements within context of the crisis management groups to overcome some of those impediments. Mr. Murton concluded the discussion by advising that, while not a member of the FSB, the FDIC participates in the Resolution Steering Committee established by the FSB; and that a number of initiatives will be pursued in the next year, including an initiative on "gone-concern loss absorbing capacity" or "GLAC" that is similar to the Federal Reserve's expected minimum long-term debt requirement.

In bringing the meeting to a close, Chairman Gruenberg thanked the Committee members for their contributions, noting that the group brings invaluable experience and perspective to this complex policy area. He advised that staff would follow up with Committee members individually to identify a list of key issues on which the Committee should focus its efforts. He observed that in the U.S., as well as in other jurisdictions, the approach taken to deal with the financial crisis in 2008 held the system together, but represents an approach that is unlikely to have much receptivity for the future. He emphasized that, when an institution gets into difficulty, the focus would likely be on Title II, with an expectation of accountability for these firms while managing the fallout from a systemic standpoint; and that that is the foundation of the FDIC's efforts, which is not unique to the U.S. He advised that there appears to be a real shift in perspective globally that there are limits to the ability to provide open-ended public support for these global financial institutions; and that there is a desire to have a different approach the next time around, with accountability for the stakeholders of these companies. He concluded by noting that some progress has been made, but that there is more work to be done.

There being no further business, the meeting was adjourned at 3:05 p.m.

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
and Committee Management Officer
FDIC Systemic Resolution Advisory
Committee

December 11, 2013

Minutes

of

The Meeting of the Systemic Resolution Advisory Committee

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

December 11, 2013 - 8:47 A.M.

I hereby certify that, to the best of my knowledge, the attached minutes are accurate and complete.

Martin J. Gruenberg

Martin J. Gruenberg
Chairman
Board of Directors
Federal Deposit Insurance Corporation