

The Fed and the FDIC speak out on the Living Will Process

Yesterday the Fed and the FDIC published their views on the Living Wills submitted by the largest banking firms. These banks have submitted three rounds of living wills and the next version is due in July 2015. The agency comments are based on the Plans submitted in October 2013. These documents were prepared at the cost of millions of dollars in consulting and legal fees and represent hundreds upon hundreds of hours of work.

Nonetheless, these efforts were not enough. The Fed said that these 11 banks must take meaningful action to improve their resolvability in bankruptcy and reflect those improvements in the resolution plans due to be filed by the firms in July 2015. The FDIC stated that the Plans were not credible. Common errors included the use of optimistic and unrealistic assumptions about the ability of the firm to avoid the consequences of bankruptcy, reliance on unsupported expectations regarding the international resolution process, and failures to address structural and organizational impediments to an orderly resolution of the firm in bankruptcy.

If serious action is not taken, the Fed is threatening to determine that the Plans are deficient. In that case, the Fed could require specific action to improve the resolvability of the bank in a bankruptcy. In addition, the Fed may also use its supervisory authority to order specific actions consistent with the safe and sound operation of the firm to achieve improvements in the resolvability of the firm.

The Fed is expecting at least the following actions:

- establishing a rational and less complex legal structure that would take into account the best alignment of legal entities and business lines to improve the firm's resolvability;

- developing a holding company structure that supports resolvability;

- amending, on an industry-wide and firm-specific basis, financial contracts to provide for a stay of certain early termination rights of external counterparties triggered by insolvency proceedings;

ensuring the continuity of shared services that support critical operations and core business lines throughout the resolution process; and

demonstrating operational capabilities for resolution preparedness, such as the ability to produce reliable information in a timely manner.

In addition, the Fed indicates that more of the content in the Plans will be made public in the future.