Resolution plans and resolution strategies: do they make G-SIBs resolvable and avoid ring fence?

Costanza A Russo

Abstract

The paper analyses the public section of the 2015, 2016 and 2017 resolution plans of the eight largest US Global Systemically Important Banks. It unfolds the beneficial effects that the statutory obligation to draft such plans had on the rationalisation of groups structure and on US G-SIBs insolvency preparedness. However, the detailed analysis of those plans also shows how banks have almost uniformly chosen a Single point of Entry (SPOE) resolution strategy which may not be in their best interest and may not be the most effective strategy given the location and the type of entities covered. This leads the Author to argue that the choice of an SPOE may rather be the preferred option of the relevant US Agencies, leading to a phenomenon of "regulatees' capture". The paper also shows how in case of insolvency of a US based G-SIB with entities located in the EU tensions may arise with the EU authorities, which may prompt them to ring fence assets or to provide financial support to subsidiaries of US banks. This is mainly because of the uncertainty driven by: the existence of two types of resolution plans in the US; by the sufficiency, or lack thereof, of pre-positioned loss absorbing capital at group level which may not overcome the double leverage problem; by deficiency in US law to deal with the liquidation of G-SIBs under an SPOE; and by the use of different insolvency procedures and policies in the US and the EU which may afford different degrees of protection to bank stakeholders.

Keywords: bank recovery and resolution plans; Single Point of Entry Strategy; Dodd Frank Act; ring-fencing; bank resolvability, TLAC, double leverage.

1. Bank resolution and living wills in the US and the EU: same principles, different practices.

Ex ante planning for resolution in banking marks the shift from taxpayers bail-out to the imposition of losses on shareholders and creditors, and it is a first step towards decreasing complexity in large financial institutions. The need to introduce recovery and resolution plans, also known as living wills, follows a move advocated by the Financial Stability Board (FSB) and by the Basel Committee on Banking Supervision (BCBS)[1]. In 2011, the FSB included "Recovery and Resolution Planning" among the Key Attributes for Effective Resolution Regimes[2].

Today, living wills are covered under both EU and US law. Therefore, global systemically important banks (G-SIBs) incorporated in those countries have (or should have by now) drafted such plans[3].

The main body of law that governs living wills in the EU includes the Bank Recovery and Resolution Directive (BRRD)[4] and the SRM Regulation[5], both issued in 2014. The US legislator has centred its attention mainly on resolution planning, with provisions included in the Dodd Frank Act (and its implementing Regulations)[6], in the Federal Deposit Insurance Corporation rules[7].

Soft law standards issued by the FSB on resolution planning aim at aligning the relevant policies at international level, given that the failure of a G-SIB may inevitably involve different jurisdictions[8]. However, the analysis included in this paper discusses existing clashes between EU and US policies, even though their actual extent is difficult to assess due to the lack of a publicly available section[9] of those plans in Europe[10].

---

[1] BCBS (2010), *Report and Recommendations of the Cross Border Bank Resolution Group*, available at www.bis.org

[2] See FSB (2011), *Key attributes for effective Resolution Regimes for Financial Institutions*, Key Attribute 11, available at www.financialstabilityboard.org

[3] The introduction of recovery and resolution planning is seen as a "good illustration of forward-looking risk based supervision from both a macro prudential and a micro-prudential perspective" and as a supplement of "risk-based supervision in a number of ways". See Dalvinder Singh, "Recovery and Resolution Planning: Reconfiguring Financial Regulation and Supervision", in Jens-Hinrich Binder and Dalvinder Singh (eds), *Bank resolution. The European regime* (OUP 2016), at 1.52 and 1.54.

[4] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institution and investment firms and amending Council Directive 82/891/EEC and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council in OJ 2014 L 173/90.

[5] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2015 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, in OJ 2014 L 225/1.

[6] 12 CFR Part 243 and 12 CFR Part 381 (discussed in the next sections as Regulation QQ).

[7] These will be covered in details in the next sections.

[8] A lower degree of harmonisation at international level can be observed on bank insolvency laws instead.

[9]Only after taking resolution action against Banco Popular, the SRB made public a non-confidential version of the group resolution plan. See Banco Popular, *Group Resolution Plan*, 2016, (Security Classification: SRB GREEN), available here https://srb.europa.eu/sites/srbsite/files/resolution_plan_2016.pdf

[10] At the time of writing, Europe appears to lag behind resolution preparedness whereas greater progress has been made in the area of recovery planning, mostly due to the work of the European Banking Authority. This was also noted in a report by the European Court of Auditors, which acknowledged the area of resolution plans being "still very much a work in progress". See ECA, *Single Resolution Board: Work on a challenging Banking Union task started, but still a long way to go*, Special Report n 23, 2017, available here

.

For instance, recent examples of failure or near failure of banks have highlighted how EU authorities opted for resolution tools which had a limited impact on subordinated bondholders[11]. Based on the findings of this paper, the social and political need to protect this category may not have been factored in by the US G-SIBs resolution plans. In principle, US requirements on Loss Absorbing Debt[12] prescribe that eligible instruments have to be unsecured and with medium term maturity but there are no rules on their subordination. However, the reliance placed by the plans on available liquidity at the onset of the crisis, which will be used to recapitalise local and foreign subsidiaries, is the key element to dissuade foreign authorities from ring fencing assets. To the extent to which a considerable amount of capital will be needed, banks are likely to use both unsubordinated and subordinated debt. So, EU based retail bondholders of US G-SIBs are at risk of suffering losses too. .

It should also be noted how the threshold for taking supervisory action in relation to a bank in financial strain is not perfectly harmonised either. In the EU, art 32 (4) of the BRRD gives alternative options for considering an institution as failing or likely to fail (the so called FOLF test)[13]. There are few cases where the evaluation seems to differ[14]. In the EU one case considers the institution infringing, or likely to be infringing, the requirement for continuing authorisation in a way that would

---

https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=44424. However, in the 2017 work programme of the Single Resolution Board priority is given to the following areas, among the others: the operationalisation of resolution strategies; the execution of bail –in; the identification of obstacles to resolvability; MREL analysis; the continued development and work of the Single Resolution Fund. The programme also includes a section on "Benchmarking resolution plan", where the Board expresses its intention to focus on benchmarking tools, harmonisation and dissemination of best practices identified in the assessed resolution plans. See SRB (2017), *Work Programme for 2017*, available here https://srb.europa.eu/sites/srbsite/files/srb_2016.5419_work_programme_2017_web.pdf. The Single Resolution Mechanism has also published a high level document on "Introduction to Resolution Planning" where the resolution planning phase is detailed as follows: at first there is a detailed overview of the bank which includes a description of bank's business model, critical functions, core business lines, internal and external interdependencies etc. Then, a preferred resolution strategy is drawn by the SRB which implies an evaluation as to whether the bank can instead be wound down under normal insolvency proceedings. If that is not the case, and the bank needs to be resolved, the next phase would be the evaluation of possible impediments to resolvability. Following that, the Board will move to address those impediments and determine bank's MREL. Finally, the bank is entitled to express comments in relation to the plan, which will form part of it. The chapters in which a plan should be divided into are: Strategic Business Analysis; Preferred Resolution Strategy; Financial and Operational Continuity in Resolution; Information and Communication Plan; Conclusion of the Resolvability Assessment; Opinion of the Bank in relation to the Resolution Plan. See SRM, *Introduction to Resolution Planning*, September 2016, available at https://srb.europa.eu/sites/srbsite/files/intro_resplanning.pdf.pdf

[11] See mainly the cases of Banco Popular, acquired by Santander and of Veneto Banca, sold to Banca Intesa. In both cases, the banks tried to raise liquidity in capital markets, but the amounts successfully raised did not prove sufficient in the medium term.

[12] 12 CFR Part 252 (Regulation YY; Docket no 1438; RIN 7100-AD-86) *Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organisations*

[13] On the FOLF Test, see also EBA, *Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU*, EBA/GL/2015/07, 26 May 2015, available at https://www.eba.europa.eu/documents/10180/1085517/EBA-GL-2015-07+GL+on+failing+or+likely+to+fail.pdf/02539533-27ed-4467-b442-7d2fa6fcb3d3

[14] The terminology is different too. While EU law uses the "failing or likely to fail" test, US law mentions the company being "in default or in danger of default". See, for instance Title II, Sec 202, (a)(1)(A)(iii) Dodd Frank Act.

justify the withdrawal of the authorisation, including but not limited to those cases where it "has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds"[15]. In the US instead, Title II of the Dodd Frank Act allows for possible supervisory action – among the others- if a case is, or will soon be, starting under Ch 11, (with no equivalent requirement included under EU Law) and if "the financial company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion"[16]. Taking the requirements for authorisation as a benchmark (EU) seems to be broader than capital depletion (US). It is unclear whether under US law the relevant conditions need to be met cumulatively or alternatively. EU law instead clearly states that the circumstances can be "one or more"[17].

The duty to consult trade unions and employees representatives throughout the recovery and resolution process embedded in the BRRD[18] also betrays a greater attention in Europe to the social repercussions of banks' failure than what is formalised under US law. A provision of a similar ethos is included in the Dodd-Frank Act only in case of intervention of the Orderly Liquidation Authority. In this case, the FDIC and the FED have to describe how the default of a large financial institution would effect "economic conditions or financial stability for low income, minority or underserved communities"[19]

In terms of recovery, the work of the European Banking Authority has showed a considerable degree of sophistication in the design of such plans. However, the decision to precautionary recapitalise institutions with funding problems, as it happened with Monte dei Paschi di Siena in early 2017, may hint at possible difficulties in the implementation of recovery plans, but also at how EU authorities may tend to postpone the resolution phase[20]. In the US, supervisory authorities seemingly rely more on the existence of robust internal governance mechanism as a first line of defence to implement possible recovery actions rather than on the drafting of such plans, as the Authorities focus is on resolution preparedness[21].

A further clash may have wider repercussions in case of cross border banking failure Here, the EU and the US - home to the majority of G-SIBs - have adopted different policies. While US law favours liquidation over resolution, European authorities would only use national insolvency procedures whenever public interest[22] is not at stake. Yet given that the insolvency of a G-SIB located in the euro-area may likely pose concerns to public interest, one can argue that such an entity would be

[15] See art 32 (4) (a) BRRD
[16] See Sec 203 (4)(A) and (B) Dodd Frank Act
[17] See Art 32 (4) BRRD
[18] See par 35 of the BRRD and par 48 of the SRM Regulation.
[19] See Sec 203 (a)(2)(C) Dodd frank Act.
[20] See Olivares-Caminal R and Russo C (2017), *Precautionary recapitalisation: time for a review?*, in – depth analysis for the European Parliament, available here http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602092/IPOL_IDA(2017)602092_EN.pdf
[21] Recovery plans are prescribed under US law too. However, the amount of guidance and transparency around them is considerably lower. See FED, *Consolidated Recovery Planning for Certain Large Domestic Bank Holding Companies*, SR 14-8, September 25, 2014, available at www.federalreserve.gov/supervisionreg/srletters/sr1408.htm
[22] While there is no specific definition of public interest, consideration is given to the provision of critical functions, the need to protect depositors, public and clients funds and assets, as well as the existence of a threat to financial stability. These are the resolution objectives set out by the BRRD and the SRM Regulation.

resolved[23]. As mentioned, the default option for US G-SIBs is the insolvency procedure regulated by Chapter 11 of the US Bankruptcy code. This difference may explode abruptly in the case of insolvency of a local G-SIB with considerable amount of cross border activities and may lead to uncoordinated and protective actions by the relevant national authorities. This in turn may lead to the loss of franchise value for the group to the actual detriment of EU (and other foreign based) entities. The use (or the expectation by EU authorities) of liquidation proceedings under Title II of the Dodd Frank Act may possibly mitigate this tension, because it is a regulatory led procedure (with however objectives not necessarily coincident with those of EU authorities).

Another element may increase cross border tensions in case of insolvency of a US G-SIB. This relates to the existence of two different plans that these SIBs have to draw up, one disciplined by the Dodd Frank Act (DFA plan) and the other by a rule issued by the Federal Deposit Insurance Corporation (CIDI plan). As explained in this paper, the two plans differ in scope and subject matter, with DFA plans focused on the group as a whole and CIDI plans covering only the deposit taking entities and their subsidiaries. Resolution strategies differ too and have a different impact on creditors, shareholders and financial contracts. However, the deposit taking institutions of a group are also included in the DFA plan, so it is left to the discretion of US resolution authorities to decide which plan to activate in case of insolvency of the deposit institution. The reason why discretion may increase tensions is because the decision will most likely be taken upon the occurrence of a stress, and because many of the entities covered by both plans are in fact located in Europe. The uncertainty over which plan will be triggered, coupled with the uncertainty over the degree of protection that foreign depositors and other creditors face, may give European resolution authorities incentives to take protective actions.

In September 2017 the SRB and the FDIC signed a Cooperation Arrangement (CA) where they intend to consult each other regularly on cooperation and exchange of information in the area of resolution[24]. The CA establishes some common principles regarding resolution of firms with cross

---

[23] It is also worth mentioning how, even where the public interest test was not met at SRB level – as with the insolvency of Veneto Banca in Italy-, a different conclusion could still be reached at national level. In the Veneto Banca case, the SRB decided that the bank was failing or likely to fail, yet as there was no public interest at stake, the bank was resolved under the applicable Italian insolvency law. However, the Italian government decided that there was in fact a public interest to protect the regional economy and therefore provided financial and other support to the acquiring bank to favour the purchase. See D.L. 25 Giugno 2017, n 99*. Disposizioni Urgenti per la Liquidazione Coatta Amministrativa di Banca Popolare di Vicenza s.p.a.e di Veneto Banca s.p.a*., in G.U. n 146 of 25.6.17, converted into Law on 08.08.2017 (Legge 31 Luglio 2017 n 121, in G.U n 184 of 08.08.17). This decision seems to be consistent with an earlier opinion of the SRB, in 2015, which deemed the liquidation of the group under national insolvency proceedings as not credible due to the "potential adverse impact of liquidation of the group on market confidence and the risk of contagion to tother credit institutions". See SRB, *Decision concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A. (the "Institution"), with the Legal Entity Identifier 549300W9STRUCJ2DLU64, addressed to Banca d'Italia in its capacity as National Resolution Authority*, (SRB/EES/2017/11), 23 June 2017, available here https://srb.europa.eu/sites/srbsite/files/srb-ees-2017-11_non-confidential.pdf, at par (19).

[24] See FDIC-SRB, *Cooperation Arrangement Concerning the Resolution of Insured Depository Institutions and Certain Other Financial Companies with Cross Border Operations in the United States and the European Banking Union*, 27 September 2017, available here https://srb.europa.eu/sites/srbsite/files/fdic-srb_rca_-_final_-_september_20_2017_.pdf. The European Banking Authority has entered into a similar cooperation agreement with different US agencies in charge of bank resolution. See *Framework Cooperation Arrangement between the European Banking Authority and U.S Authorities* available here

border operation –such as the need to enter into *ex ante* preparation, to ensure flexibility in the design of arrangements and tools in the field of cross border cooperation. "Where possible and appropriate"[25] *ex post* and *ex ante* resolution action should be consistent and "resolution options (…) consistent with (authorities) respective resolution objectives"[26]. In the specific field of resolution planning, authorities intend to provide reciprocal assistance and information related to firms business, legal, organisational and operational requirements[27]. Whereas such agreement certainly represents a step forward in the field of cross border cooperation, it does not specifically address the above clashes, nor does it establish a principle of universal recognition of foreign-based firm's resolution strategy.

This research also highlights how in the US resolution options are genuinely market-oriented, with a limited role played by resolution authorities. In Europe market dynamics may be distorted by more intrusive forms of public intervention via state aid, precautionary recapitalisation, *ex ante* bail in aimed at reorganising the business, existence of a resolution fund, and other public measures to sustain the carve out of legacy assets. It should also be noted that in Europe it is the resolution authority that draws up the plan in collaboration with the firm. In the US, under Title I of Dodd Frank the onus falls on the firm, with the authorities approving it or asking to address identified deficiencies and shortcomings.

2. Methodology and main findings

This paper investigates the 2015,2016 and 2017 resolution plans of all the US banks included in the FSB list of the thirty global systemically important banks (G-SIBs)[28] with a view to assess US G-SIBs degree of resolvability. It also critically analyses the implication of the chosen resolution strategies at national and international level.

Despite existing problems, the research exposes the beneficial effect that the drafting of living wills had on groups' operational, financial, legal, and organisational structure. In this sense, *ex ante* resolution planning achieved one of its primary aims. Given the consideration placed by policymakers upon groups organisation for resolvability and resolution purposes, the analysis included in this paper covers governance mechanisms; legal entity rationalisation; and group interconnections and interdependencies in great depth.

At least in the US, requiring large and complex financial institutions to draw up resolution plans allows also taxpayers to know in detail how banks operate and how they are structured. This shared knowledge and understanding is only made possible by the existence of a public section of these plans which is mandated by US law. Even if the content of the public section must represent only a tiny fraction of the overall plan, it is still an invaluable treasure trove for all stakeholders and a bow to transparency and to (private) accountability. This in turns helps in the reduction of agency costs as it reduces information asymmetries. So far, European authorities seem to value confidentiality over

www.eba.europa.eu/documents/10180/1762986/Framework+Agreement+-+EBA-US+agencies+-+September+2017.pdf

[25] FDIC-SRB, *Cooperation arrangement*, (ft 24), par 14.

[26] *Ibidem.*

[27] FDIC-SRB, *Cooperation arrangement*, (ft 24), par 21.

[28] Namely: JP Morgan Chase, Goldman Sachs Group Inc, Morgan Stanley, Citigroup, State Street Bank, Wells Fargo, Bank of America Corporation, and Bank of New York Mellon.

transparency given that a similar requirement is not included in European legislation[29] nor is there any sign that supervisors are heading in that direction[30]. Yet, having a public section of a resolution plan does not seem to make banks more vulnerable. Rather, it may make them more accountable to the public as a whole.

What allows the interpreter to make an informed assessment of the plans is also the existence of publicly available feedback letters provided by the US Agencies in charge of approving them, namely the Federal Reserve (FED) and the Federal Deposit Insurance Corporation (FDIC) (the Agencies). In their latest guidance, the Agencies have also publicly specified the criteria used to assess banks and what is expected under each set. These policies in turn improve their own transparency and degree of accountability as it is now possible to observe –albeit only part of –Agencies actions to improve SIBs resolvability.

US institutions have now been required to indicate how the current version of the plan has improved compared to the previous one. This paper evaluates the 2015, 2016, and 2017 versions of the plan mandated by the Dodd Frank Act against the feedback provided by the Agencies.

From a crisis management perspective, the paper confirms that the decision to leave bank insolvency to *lex generalis*, as Chapter 11 of the US Bankruptcy code can be considered, may give rise to a wealth of issues that will most likely require regulatory intervention to avoid a disorderly failure. This strengthens the finding of the suitability of a *lex specialis* for the management of bank insolvency, as correctly opted for in Europe. The plans have also surprisingly shown uniform and standardised actions to contain the crisis and to transition to the wind up/liquidation stage. Whereas the solutions considered may work smoothly for idiosyncratic crises, in case of a systemic event or one that involves different market sectors, the strategies adopted by the banks may not prove to be feasible because the all rely on availability of liquidity on third parties to support sales. In turn, this exposes a critical issue in bank insolvency, namely the problem of funding in the resolution phase. This is addressed unsatisfactorily by European legislation and Authorities too. In the UK instead, the PRA has an established facility to provide banks with liquidity to support the resolution strategy[31].

From a public policy perspective, the critical analysis of the plans suggests two striking conclusions. The first relates to the existence of a "regulatees capture" phenomenon whereby firms have preferred a resolution strategy which seems to be chiefly in the regulators' best interest. The second is that all resolution options consider the management of banks' failure as being self-contained: it will be administered by US authorities only. The extent to which this is realistic remains unclear as it hinges upon the existence of effective cooperation mechanisms between authorities

[29] Par 44 of the SRM Regulation subjects resolution plans to the "requirements of professional secrecy" laid down in the Regulation due to "the sensitivity of information contained in them". Par 116 too insists on the need to keep confidential any information related to resolution plans.

[30] However, in the UK the Bank of England issued in May 2017 a document detailing the amount of MREL that certain SIB operating in the UK must hold to be prepared for resolution. See Bank of England (2017), *Minimum requirements for eligible liabilities and own funds*, available here www.bankofengland.co.uk/financialstability/Pages/role/risk_reduction/srr/mrel.aspx

[31] See PRA, The Bank of England's approach to resolution, October 2017, available here https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/resolution/boes-approach-to-resolution.pdf?la=en&hash=8213BE00D67C4CADB948D51FEBD164E136A70BE6, at p 22

located in different countries, which are notoriously not always successful. The US Agencies in charge will have to exercise all their persuasive powers to reassure third country Authorities that the universal insolvency procedure they have approved is not going to have negative repercussions on their local creditors, investors and the economy. Third country Authorities need also to be satisfied that the amount of liquidity prepositioned to each foreign subsidiary is enough to withstand the crisis and that the contractual mechanisms which impose further downstream of capital will be honoured. In Europe, the proposed requirement to set up an intermediate holding company for foreign large financial institutions may make this exercise more complex as in fact expresses a regulatory preference for multiple points of entry in cross border resolution.

The paper is organised as follows: Part I broadly describes the US legal regime on resolution planning, and compares and contrast scope and content of the two types of plans financial institutions are required to draw up. In Part II, the analysis is centred on the beneficial effects that the introduction of resolution plans had on G-SIBs organisational structure. Specific attention is paid to governance mechanisms; legal entity rationalisation; and group interconnections and interdependencies. The assessment is conducted taking into account the feedback letters that the FED and the FDIC have provided to these banks. Part III moves to investigate the Single Point of Entry as the resolution option included in the DFA plans and critically analyses its weaknesses. Part IV concludes.

Part I

1.1 The US legal framework

The legal framework pertaining to recovery and resolution planning in the US includes both primary and secondary sources. Title I of the Dodd Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act)[32] grants the Financial Stability Oversight Council (the FSOC)[33] powers to make recommendations to the Board of Governors of the Federal Reserve System on the resolution plans

[32] As it is well known, the Dodd Frank Act is an incredibly complex piece of legislation which relies heavily on the implementing measures issued by relevant agencies. This piecemeal approach resulted in a long and articulated maze of rules and regulations that may be seen as lacking coherence. The Act includes roughly 1300 sections, divided into 16 titles. It is available here http://www.cftc.gov/idc/groups/public/@swaps/documents/file/hr4173_enrolledbill.pdf. A list of all Dodd-Frank final rules and orders is available at http://www.cftc.gov/LawRegulation/DoddFrankAct/Dodd-FrankFinalRules/index.htm. For an academic analysis of the Act, see Coffee, John C. (2011), Systemic risk after Dodd-frank: contingent capital and the need for regulatory strategies beyond oversight, *Columbia Law Review*, vol. 111, no. 4, pp. 795–847. www.jstor.org/stable/41305139; Wan, Joshua S. (2016), Systemically important asset managers: perspectives on Dodd-frank's systemic designation mechanism, *Columbia Law Review*, vol. 116, no. 3, pp. 805–841. www.jstor.org/stable/43783395. Fischer, F. (2015), Dodd-Frank's failure to address CFTC oversight of self-regulatory organization rulemaking, *Columbia Law Review*, vol. 115, no. 1, pp. 69–125. www.jstor.org/stable/43153767; Hansberry, Heidi l. (2012), In spite of its good intentions, the Dodd—Frank act has created an FCPA monster, *Journal of Criminal Law and Criminology*, vol. 102, no. 1, pp. 195–226. www.jstor.org/stable/23145789, Richardson, M (2012), Regulating Wall Street: the Dodd Frank Act, in *Economic Perspectives*, vol 36, issue 3, p 85-97; Stunda R (2016)., The impact of Dodd-Frank on the economy and financial institutions five years later, *Journal of business & accounting*, vol9(1):167-177; Prasch R (2012), The Dodd Frank Act: financial reform of business as usual? , at *Journal of Economic Issues,* vol 46, issue 2, p 549-556.

[33] The FSOC was established by the Dodd-Frank Act (Title I, sub (A), Sec 111) to identify risks to financial stability, to promote market discipline, and to respond to emerging threats to the stability of the United States financial system.

of certain banks and non-bank financial holding companies[34]. Most importantly, sec 165 (d) requires bank holding companies with total consolidated assets of $50 billion or more, and nonbank financial companies designated by the FSOC as systemically important (and as such supervised by the Federal Reserve) to periodically submit resolution plans to the FED and the FDIC[35]. The rule applies also to foreign bank holding companies with US financial operations above a certain threshold[36].

Each plan must be credible and describe the company's strategy for rapid and orderly resolution under the U.S. Bankruptcy Code in the event of material financial distress or failure of the company[37].

At their minimum, these plans must include three different types of information: 1) information regarding the way and the extent to which a deposit taking institution is insulated from risks arising from the activities of the non-bank subsidiary of the parent institution; 2) a full description of ownership structure including assets, liabilities, and contractual obligations; and 3) identification of the cross-guarantees tied to different securities, of major counterparties, and a process for determining to whom the collateral of the company is pledged[38]. Also, the institution should include any other information requested by the FED and the FDIC[39], which are included in secondary FED and FDIC measures (joint measures). Should the plan not be credible, or should it not facilitate an orderly resolution under Chapter 11 of the US Bankruptcy Code, the FED and the FDIC can reject it and ask for a resubmission[40]. Failing the plan still to be credible, the Agencies can impose more stringent capital, leverage or liquidity requirements, or restrictions on growth, activities and operations of the company and its subsidiaries until a new plan is being submitted, as happened to Wells Fargo in 2016[41].

---

[34] See Sec 112 (2) (I); 115 (b) (1) (D) and (d) (1) Dodd Frank Act.

[35] The FDIC is the US federal agency in charge of deposit insurance. As of 30 September 2011, the FDIC insured approx. 6.78 trillions of deposits held in more than 7445 depository institutions. See FDIC, 12 CFR Part 360 RIN 3064-AD59 (s.c. IDI Rule), at p 2.

[36] FED, *Board's Regulation QQ (12 CFR 243) on "Resolution Plans"* available here www.ecfr.gov/cgi-bin/retrieveECFR?gp=&SID=745f36bbc567b55fbe7525379a8bb3d6&r=PART&n=12y4.0.1.1.13 Sec 243.2 (f) (3). Regulation QQ, issued in accordance to sec 165 (d) (8) of the Dodd-Frank act, includes among those institutions required to submit a resolution plan: "Any foreign bank or company that is a bank holding company or is treated as a bank holding company under section 8(a) of the International Banking Act of 1978 (12 U.S.C. 3106(a)), and that has $50 billion or more in total consolidated assets, as determined based on the foreign bank's or company's most recent annual or, as applicable, the average of the four most recent quarterly Capital and Asset Reports for Foreign Banking organizations as reported on the Federal Reserve's Form FR Y-7Q ("FR Y-7Q")". In the literature, see: Lapres D A (2011), The implications of the financial reform act for foreign banks, financial institutions and financial regulators, in IBJL 531; White GH (2010), The global reach of the Dodd-Frank Act, 10 JIBFL 579.

[37] See www.fdic.gov/regulations/reform/resplans/

[38] See sec 165(d) (1) Dodd - Frank Act

[39] See sec 165 (d)(1) Dodd – Frank Act

[40] See sec 165 (4) and (5) (A) Dodd – Frank Act. In this case, the FED however shall consult with each member of the Financial Stability Oversight Council (FSOC) that primarily supervised an involved entity, see Regulation QQ, (ft 36), 243.7 (a), whereas it only may consult with foreign supervisory authorities or any other federal or State supervisor (Regulation QQ 243.7 (b)).

[41] In their assessment of the 2015 plans, the Agencies concluded that the bank had not successfully addressed two of the three deficiencies (related to "legal entity rationalisation" and "shared services") and decided to impose growth restrictions. Wells Fargo has been prohibited from establishing international bank entities or acquiring any non-bank subsidiaries until the Agencies are satisfied that the deficiencies have been successfully

In 2011 the FED issued the main regulation on resolution, Regulation QQ[42], which implements the Dodd Frank provisions. Regulation QQ contains the detailed list of items that need to be included in the plan. These are divided into different categories: strategic analysis, corporate governance relating to resolution planning; company organisational structure and related information; information system management; interconnections and interdependencies; supervisory and regulatory information; and reference to relevant information from previous plans.

In 2012, the FED issued a supervisory letter regarding a consolidated supervision framework for large financial institutions[43], followed in 2013 by joint general guidance on resolution plans for both domestic and foreign based institutions (the 2013 Guidance)[44]. Further specifications on heightened supervisory expectation for recovery and resolution planning of the eight domestic bank holding company which may pose elevated risk to financial stability[45] and a set of principles for recovery and resolution preparedness followed suit[46]. The subsequent version of the Guidance (2017 Guidance[47] aims at assisting firms in developing their plans by indicating those areas "where additional detail should be provided and where certain capabilities or optionality should be developed to demonstrate that each firm has considered fully, and is able to mitigate, obstacles to the successful implementation of the preferred strategy"[48].

The 2017 Guidance considers the following as key vulnerabilities in resolution: capital, liquidity, governance mechanisms, operational, legal entity rationalisation and separability, and derivatives and trading activities.

Banks should also comply with Regulation YY[49] that requires, among the others, domestic holding companies with total consolidated assets of $50 billion or more to hold enhanced levels of capital

---

addressed. Should they not be satisfied, they will impose further restrictions. Specifically they will "limit the size of the firm's non-bank and broker dealer assets to levels in place on September 30, 2016". See FDIC-FED Joint Press Release, *Agencies announce determination on October resolution plan submissions of five systemically important domestic banking institutions*, December 13, 2016, available here https://www.federalreserve.gov/newsevents/press/bcreg/20161213a.htm

[42] Regulation QQ, (ft 36).

[43] See FED, *Consolidated Supervision Framework for Large Financial Institutions,* SR 12-17/CA letter 12-14, available at www.federalreserve.gov/supervisionreg/srletters/sr1217.pdf

[44] FDIC-FED, *Guidance for 2013 § 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012,* available at www.fdic.gov/regulations/reform/domesticguidance.pdf, and *Guidance for 2013 §165(d) Annual Resolution Plan Submissions by Foreign-Based Covered Companies that Submitted Initial Resolution Plans in 2012*, available at https://www.federalreserve.gov/newsevents/press/bcreg/joint_resolution_plans_foreign-based_guidance_20130415.pdf

[45] FED, *Heightened supervisory expectations for recovery and resolution preparedness for certain large bank holding companies- Supplemental Guidance on Consolidated Supervision Framework for Large Financial Institutions (SR letter 12-17/CA letter 12-14),* SR 14-1, available at www.federalreserve.gov/supervisionreg/srletters/SR1401.htm

[46] *Principles and practices for recovery and resolution preparedness*, attachment to SR 14-1. These focus on: Collateral Management, Payment Clearing and Settlement Activities, Liquidity and Funding, Management Information Systems, and Shared and Outsourced Services.

[47] FDIC-FED, *Guidance for 2017 §165(d) Annual Resolution Plan Submissions By Domestic Covered Companies that Submitted Resolution Plans in July 2015*, October 2016, available here www.fdic.gov/news/news/press/2016/pr16031b.pdf

[48] 2017 Guidance, (ft 47), p 3.

[49] Regulation YY (ft 12).

and liquidity. It also imposes foreign based banking organisations with total consolidated assets of $50 billion or more to set up a US based intermediate holding company as an additional prudential standard and to facilitate their resolution[50].

The assessment of a plan is a joint endeavour of the FED and the FDIC, which divide their evaluations into deficiencies and shortcomings in order of severity. However, the decision making process and the weight carried by each agency is unclear. For instance, in the case of Goldman Sachs the FDIC found the resolution plan to be deficient, whereas the FED was of a different opinion. The final assessment shows that the main criticisms were downgraded to "shortcomings" with a footnote explaining that in FDIC's opinion those were actually deficiencies.

In addition to the plans mandated by the Dodd Frank Act (known as DFA Resolution Plans), the IDI rule[51] requires systemically important insured deposit-taking institutions with 10 billion or more of asset, to include in their resolution plans provisions related to the resolution of the bank under the Federal Deposit Insurance Act (the FDI Act). These are known as CIDI resolution plans. Specifically, the CIDI plan will have to "enable the FDIC, as a receiver, to resolve the institution under sec 11 and 13 of the FDI Act 12 U.S.C. 1821 and 1823" [52]. The plan should be drafted taking into account FDIC three main goals in resolution: 1) ensuring access to deposits within one business day of the institution failure; 2) maximising the return on assets; and 3) minimise creditors' losses[53]. A specific guidance is also attached to the rule[54].

1.2 The plans: DFA vs CIDI plans

As mentioned above, based on the value of their consolidated assets foreign and domestic covered companies may have to draw two distinct resolution plans: one as disciplined by the Dodd Frank Act (DFA plan) and one as regulated by the IDI rule (CIDI plan).

DFA and CIDI plans differ considerably in terms of scope and applicable law. DFA plans require banks to devise a possible resolution strategy compatible with Chapter 11 of the US Bankruptcy code, which disciplines the reorganization or liquidation[55] of a failed company. A DFA plan will cover the parent holding company and those subsidiaries and affiliates that are considered material to the business (called Material Legal Entities). A CIDI plan will only cover the group deposit taking institution(s) which fall under a certain threshold, and its branches and consolidated subsidiaries

[50] As mentioned in the first paragraph and in the conclusions of this paper, a similar requirement for foreign banks is currently debated in Europe, as part of the proposed amendment to the Capital Requirements Directive and Regulation.

[51] See FDIC, 12 CFR Part 360 RIN 3064-AD59, s.c. IDI rule. Please note, an interim final rule was issued in 2011 and was effective from 1 January 2012 to 1 April 2012 until superseded by the current version. The previous Interim Final Rule was the 76 FR 58 379 (September 21, 2011).

[52] In essence, the FDI Act disciplines all aspects of a possible FDIC receivership. The receivership is activated upon the insolvency of the bank. As of January 2012, 37 institutions are covered by the IDI rule, which cumulative hold approx. 4.14 trillion in insured deposits

[53] See IDI rule, (ft 51), at p 19

[54] FDIC, *Guidance for Covered Insured Depository Institutions Resolution Plans Submissions*, available here www.fdic.gov/news/news/press/2014/pr14109a.pdf

[55] Even if CH 11 is focused on reorganisation, a liquidation plan is also possible. For a detailed summary of the main provisions of CH 11 see United States Court, *Chapter 11 – Bankruptcy Basics*, available here www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics

material to the business. This is the reason why identified Material Legal Entities (MLE)[56] and core business lines of the same group may differ among plans[57].

In practice, under a DFA plan all but one of the eight banks have opted for a resolution strategy that puts only the parent holding company into Bankruptcy proceedings under Chapter 11[58]. Upon filing for CH 11 the holding would transfer its assets and its shares of the MLEs to an intermediate holding company (IHC). The IHC will be run by a reorganisation trust acting in the interest of the bankruptcy estate. MLEs will either continue operating as going concern or be sold gradually, either entirely or by business lines. This is also one of the reasons why the Agencies insisted with banks to streamline core business lines and legal entities.

Under CH 11, bank management will then have to file for emergency motions to allow for the transfers and for the execution of the trust agreement. In the DFA plans which are the subject of this research, those and all the other necessary paperwork, have been roughly already prepared to avoid unnecessary delay.

Under a CIDI plan instead, banks will have to plan for an FDIC receivership as regulated by the FDI Act, sec 11 and 13. FDIC receivership may mean that the assets of the failing bank, the viable parts of the business, and deposits are transferred to a "bridge bank", whereas the liabilities are liquidated under the FDIC insolvency procedure. A variant version would transfer asset and liabilities of core business lines (other than those liabilities directly connected to the institution failure) to the bridge bank which in turn will continue operate the lines of business[59]. Some plans also include a similar provision to what is included in DFA plans in terms of downstreaming of financial resources, in this

[56] The IDI Rule defines Material Entity as "a company that is significant to the activities of a critical service or a core business lines". Similarly, Regulation QQ defines it as "a subsidiary or foreign office of the covered company that is significant to the activities of a critical operation or core business line". One submitter bank distilled the legal definition even further, identifying MLE as those that: "(a) contract with and manage key global client relationships in the local marketplace ("Client Facing" or "CF"), (b) are direct members or participants of Financial Market Utilities ("Membership Holder" or "MH"), (c) accept client deposits/provide a source of liquidity necessary to fund Critical Operations and settlement obligations ("Liquidity Provider" or "LP") and (d) are instrumental in managing and moving liquidity to and FMUs/paying agents, and/or provide other key operational infrastructure ("Service Infrastructure" or "SI"). In addition, State Street assessed an entity's role within the delivery of its Critical Operations, focusing on the levels of dedicated personnel, whether work could be transferred to other designated Material Entities or where specific contracts with FMUs are held" See State Street, *Resolution Plan,* 2015, p 29 available www.fdic.gov/regulations/reform/resplans/

[57] The different identification of core business lines of the covered companies is justified also by the applicable definitions. The IDI rule defines them as "those business lines of the CIDI, including associated operations, services, functions and support that in the view of the CIDI upon failure would result in a material loss of revenue, profit or franchise value", IDI Rule, (ft 51), sec 360.10 (b). Sec 243.2 (d) of Regulation QQ defines them as "those business lines of the covered company including associated operations, services, functions and support that in the view of the covered company upon failure would result in a material loss of revenue, profit or franchise value". Basically, in the CIDI plans the focus is on the deposit taking institution, whereas in the DFA plans the focus is on the non-bank financial company or the domestic or foreign bank holding company. So for instance, for DFA purposes one company identified its core business lines as: investment banking, financial advisory, underwriting, institutional client services, fixed income, currency and commodities, client execution, and equities. For CIDI purposes instead the same company identified the following core business lines: deposit taking, private bank lending, corporate lending, and interest rate derivatives product. A noticeable difference can be found in the definitions of critical operations instead, which in the IDI rule are called critical services.

[58] This is an example of a Single Point of Entry strategy, as will be discussed extensively in Part IV of this paper.

[59] This is the case of State Street Bank CIDI plan.

case from the parent to the ailing bank before it enters receivership. The downstreaming may take the form of debt forgiveness or capital injections. The great majority of the analysed CIDI plans devised the following strategies: a "multiple acquirer strategy", a "recapitalisation/IPO strategy" and a "liquidation strategy"[60] with banks regulating differently the scope of the bridge bank[61]. Under a "Multiple Acquirer strategy" the core business lines transferred to the bridge bank would be sold to third purchasers[62]. The "recapitalisation /IPO strategy" includes the creation of a third company to which transfer the bridge bank assets and whose shares are then sold on to the market via an IPO. This may require the transfer of funding to the bridge bank if needed, which can be recovered with the proceeds of sale. The "liquidation strategy" aims at orderly liquidating the bridge bank should none of the alternatives be successful. Some plans consider a wind down strategy too in the latter case.

As required by the FDIC, the strategies have to be designed on the basis of the bank "current structure and operating model" and take into account "historical facts and conditions"[63]. These should also assume that the covered institution is in fact insolvent, as "the financial condition of the CIDI, at the point of appointment of the FDIC as a receiver, should reflect an insolvency –based ground for receivership under the FDI Act"[64]. Inevitably, the failing bank may require the transfer of funds from the FDIC or the Deposit Insurance Fund.

---

[60] The Multiple Acquirer Strategy and the Liquidation Strategy are actually being requested by the FDIC. The FDIC also details certain expectations as to the content of the strategies. See FDIC, *Guidance* (ft. 57).

[61] Even though some plans are more articulated than others. For instance Goldman Sachs Bank (GSB) plan is extremely detailed. It considers both a multiple acquirer strategy and a liquidation strategy and it specifically includes the transfer of the derivatives portfolio of the covered institution to the bridge bank. Both strategies will terminate with the winding down of the bridge bank. Under the Multiple Acquirer Strategy GSB loans would be sold through the disposal of entire portfolios to a small number of targeted investors and "in some cases, purchasers may also assume some of the bridge bank's insured term deposits in order to finance the loans". As for the derivatives portfolio, part of it will reach maturity whereas the remaining positions would be closed either via novation, negotiated termination or portfolio sale. Overnight deposits are expected to be withdrawn over several weeks, whereas term deposit with a remaining tenure of more than one year "may either be transferred to other banks in conjunction with the sale of certain loan portfolios, or they may be transferred without a corresponding asset sale, albeit at a higher premium. The remainder is repaid upon reaching contractual maturity". Under the liquidation strategy the bridge bank is wound down as follows: "Loans: In comparison with the Multiple Acquirer Strategy, the Liquidation Strategy calls for the bridge bank's loans to be sold in a more piecemeal fashion, to a wider range of investors over a longer period of time. Derivatives: The exit strategy for the bridge bank's derivatives positions is the same under the Liquidation Strategy as under the Multiple Acquirer Strategy. Deposits: All of the bridge bank's overnight deposits are assumed to be withdrawn by clients over several weeks, and its term deposits are repaid upon reaching contractual maturity." See Goldman Sachs Bank US, *Resolution Plan, Public Filing*, September 1, 2015, available www.fdic.gov/regulations/reform/resplans/

[62] For instance, State Street bank envisages a great interest from global, national or regional financial institutions, private equity or other buyers of financial assets. Ideally Global Custody should be preserved "as an integrated business in a sale transaction, in order to minimize disruption to its clients and to maximize the value of the basket of interconnected and synergistic services that State Street offers today; Material Entities that are sufficiently self-sustaining and able to continue operations in the ordinary course of business would not need to be placed into resolution proceedings". See *CIDI Resolution plan for State Street Bank and Trust Company, Section 1: Public Section*, September 1, 2015, at p 16, available at www.fdic.gov/regulations/reform/resplans/

[63] As included in FDIC, Guidance (ft 57), p 3.

[64] *Ibidem*, p 2

DFA and CIDI plans differ also in terms of objectives and protected interests. The IDI rule identifies the protected interests as those of the depositors to receive prompt access to their deposits (one business day or two if the failure occurs on a day other than a Friday); the maximisation of the net present value return from the sale or asset disposition; and the minimisation of the amount of losses suffered by creditors. The IDI rule also requires the strategy to be the least costly alternative to the Deposit Insurance Fund (DIF)[65]. By contrast, Regulation QQ requires an orderly and rapid resolution for the purpose of mitigating the risk that the failure of the covered company could have adverse effects on financial stability in the United States[66].

Even though they do not appear to be mutually exclusive, those competing aims justify different resolution strategies. However, the actual resolution strategy employed during a crisis may come at a cost for the relevant stakeholders and the same covered company. As many banks have noted, business reorganization under a DFA plan allows the relevant MLEs to survive and to be wound down over time in an orderly manner. This may preserve the inherent value of the entities and possibly realise profits for the benefit of the bankruptcy estate. A CIDI resolution may instead turn into a fire sale of assets, may be lengthier, may possibly entail a disorderly close out of certain derivative and other hedging contracts, may cause a great administrative burden on the FDIC and may not be in the best interest of the creditors of the company. From the same perspective of the FDIC, a DFA strategy by definition would require no transfer of funds from the deposit insurer, which would make it the least costly option.

One may argue however that the resolution toolkit at FDIC disposal ("deposit payoff, insured deposit transfers, payment and assumption agreements, whole bank transactions and open bank assistance"[67]) has been well tested over time as the FDIC has specific experience in handling bank failures which spans several decades. Those tools can be directly managed by the FDIC or see the involvement of private parties. The CH 11 restructuring procedure instead is mainly a judicial administered procedure not frequently tested against the insolvency of a large and complex financial institution, having been used almost exclusively for the Lehman Brothers insolvency, absent viable alternatives at the time. Also, these G-SIBs have a strong presence in foreign jurisdictions therefore their restructuring would inevitably need coordination with foreign supervisors, even if the living will considers otherwise. Judges may find it difficult to achieve an optimal level of coordination. This issue seems to be less poignant in Europe where resolution and liquidation procedures are mostly handled by supervisory agencies.

This uncertainty over the most effective procedure may not be beneficial for foreign resolution authorities either. Despite the said distinctions in applicability, there are elements of coincidence

---

[65] One of the respondents to the FDIC consultation document related to the IDI rule highlighted the distortions that this provision may ingenerate. The respondent noted that it is the FDIC to be best suited to evaluate the cost of the resolution strategy, which can be done only after its execution; and that giving covered companies the power to choose the "least costly" strategy would dissuade them from considering other resolution strategies. See IDI Rule (ft. 51) p. 9-10.

[66] See Regulation QQ (ft 36), Sec 243.2 (o).

[67] See, Bennett R. L. and Unal H. (2014), Understanding the components of bank failure resolution costs, *FDIC-CFR working paper*, p. 4, available here fdic.gov/cfr. On a related matter, the OECD recently published a report on the estimated costs that could be incurred by bank creditors and taxpayers in case of a bank who has or is about to fail. See Blix Grimaldi M. et al*.* (2016), Estimating the size and incidence of bank resolution costs for selected banks in OECD Countries, *OECD Journal: Financial Markets Trend*, 1.

among the two plans. Entities covered in the CIDI plan are also included in the DFA plan. The problem is that entities in the CIDI plan too are located abroad and foreign resolution authorities may have incentives to ring fence them because if a deposit taking entity becomes insolvent, the choice of resolution strategy (DFA vs CIDI) is left to US Agencies' discretion. For instance, covered CIDI entities of BNY Mellon are in Germany (n. 3), India (n 1), Belgium (n 2) and UK (one only). In the case of Citi, CIDI firms are in the UK (n. 2), Ireland (n. 2), Japan (n. 2), Singapore (n. 2), Hong Kong (n. 3), Bahamas, Philippine, Germany, Costa Rica, and India. The multiple acquirer strategy for the banking entities require the transfer of all assets and liabilities to a US bridge bank. The size of those subsidiaries may also be large. For instance, the total assets of Citi main banking company in London (CBNA London) were 262.6 billion and total liabilities 262.6 billion as of end 2014. Furthermore, some CIDI plans consider two possible strategies, usually a multiple acquirer and a liquidation strategy. This would add an extra layer of uncertainty as the actual choice will be left to the FDIC at the point of crisis.

It should finally be mentioned here that a CH 11 procedure may be interrupted by a decision of the Secretary of the Treasury (taken in agreement with the US President) to resort to Title II of the Dodd Frank Act instead[68]. This grants the FDIC with the "Orderly Liquidation Authority" (OLA) to deal with those failures which may impact financial stability. While OLA is meant to be a "backup resolution authority"[69] for the default of systemically important institutions that causes severe economic distress, the rationale behind its use is a threat to financial stability, as with DFA plans. Yet OLA activities are modelled upon traditional FDIC receivership procedures[70]. Even though one possible strategy may well be the resolution of the parent holding company followed by recapitalisation of a

[68] Sec 208 (a) Dodd Frank Act states that "Effective as of the date of the appointment of the Corporation as receiver for the covered financial company under section 202 (…) any case or proceeding commenced with respect to the covered financial company under the Bankruptcy Code or the Securities Investor Protection Act of 1970 (15 U.S.C. 78 aaa et seq.) shall be dismissed". The same fact that proceedings have commenced before a bankruptcy court is an indicator of the default of the company under OLA requirements (see Sec 203 (4) (A))

[69] See Yellen J L, *Supervision and Regulation*, Testimony by Ms Janet L Yellen, Chair of the Board of Governors of the Federal Reserve System, before the Committee on Financial Services, US House of Representatives, Washington DC, 28 September 2016, at p 3, available at www.bis.org.

[70] OLA has been put under scrutiny by the current administration, which started in 2017. Critics of the special insolvency procedure broadly argue that it institutionalises the idea that banks may be "too big to fail" mainly because Title II establishes an *ad hoc* fund to be accessed by the FDIC in case of need. Because the Fund may have an impact on public budget, it is debated whether Congress could repeal Title II with a simple majority only. See Bernake B, *Why Dodd-Frank's orderly liquidation authority should be preserved*, February 28, 2017 at www.brookings.edu. Irrespective of the political debate, Title II establishes clear priorities and objectives in the use of OLA: banks should be liquidated in a manner that mitigates risk to financial stability and "minimises moral hazard"; creditors and shareholders will bear the losses; the original management will be replaced; and staff responsible for the financial condition of the company will have to bear losses too. See Dodd-Frank Act, Sec 204 (a) (1), (2), and (3). The FDIC is also prohibited from taking any equity interest in, or becoming a shareholder of, the failing company. See Sec 206 (6).The Fund is disciplined at Sec 204 (d). Ironically enough, an IMF study recently shows that the implicit government subsidies for systemically important banks in the United States may be increasing, irrespective of the existence of the Fund. See IMF (2014), *Global financial stability report: moving from liquidity to growth –driven markets*, Ch. 3, at p. 104, available at www.imf.org

newco à la CH 11[71], it will still be administered by the FDIC[72]. This may hint at a possible preference for the efficacy of a regulatory-led insolvency procedure in case of systemically important institutions[73].

Part II

2.1. US G-SIBs resolution plans: a qualitative assessment

CIDI and DFA plans are divided into a confidential and a public section. Regulation QQ[74] indicates the information that needs to be provided in the DFA plans[75]. This includes the detailed description of the resolution strategy; of the corporate governance related to resolution planning; and of the company organisational structure. A detailed inventory and description of management information systems; the identification and mapping of interconnections and interdependencies; and further supervisory and regulatory information should also be included[76]. These provisions apply to both national and foreign based firms, although there are some specific requirements for foreign institutions[77]. The confidential part of the plan covers the detailed strategic analysis and specific quantitative information on the above items. The stress scenarios banks need to cater for are baseline, adverse and severely adverse economic conditions[78]. Firms are prohibited from assuming the provision of any public funding to avoid their failure.

---

[71] Among those analysed only one submitter specifically mentions OLA procedures to favour a recapitalisation under Title II in the unlikely event of their default and of the lack of viable private sector solutions. See J.P Morgan Chase Bank, N.A., *Resolution Plan Public Filing*, September 1, 2015, at p. 3. Available here www.fdic.gov/regulations/reform/resplans/. The possibility of creating a new-co which "parallels the framework of a Chapter 11 reorganization" is also mentioned in the minutes of an FDIC advisory committee, See *Meeting of the Systemic Resolution Advisory Committee of the Federal Deposit Insurance Corporation*, January 25, 2012, at p. 31 available at www.fdic.gov. However, it should be noted that some commentators exclude the possibility of creating a "bridge bank" under CH 11. This entails that the possible bridge bank, which will in fact be a recapitalised newco acting as a source of strength for the viable subsidiaries, is still fully an OLA disciplined mechanism. See FED (2011), *Study on the Resolution of Financial Companies under the Bankruptcy Code*, at p. 7 and at ft 43, available at www.federalreserve.gov/boarddocs/rptcongress/default.htm

[72] See also the FDIC paper detailing how the FDIC could have managed an orderly wind down of Lehman Brothers had Title II of Dodd Frank Act been in existence at the time: *The Orderly Liquidation of Lehman Brothers Holdings Inc. Under the Dodd Frank Act,* in FDIC Quarterly, Early release for the upcoming 2011, Volume 5, No. 2 , at www.fdic.gov.

[73] Contrary to this interpretation may run the fact that only seven respondents commented on the CIDI rule when it was put under consultation. Which is a relatively small number compared to the amount of banks that will be subjected to it and considering that respondents include banks, individuals and industry and trade groups. This may also reflect banks' perception that in case of systemic crisis, they will be liquidated under Title II of the Dodd Frank Act, rather than under FDI Act.

[74] Regulation QQ (ft 36).

[75] More specific information requirements are included in the 2013 Guidance, (ft 47).

[76] See Regulation QQ (ft 36), 243. 4 (a) (1), (b) (j).

[77] Other minor differences are based on companies' size. So if the covered company holds less than 100bn in total non-bank assets and their total deposit insured assets comprise 85% or more of the covered company's total consolidated assets, it should file a tailor made version of the plan which is limited to certain informational items only. See Regulation QQ 243.4 (3) (ft 36).

[78] Regulation QQ (ft 36) Sec 243.4 (4) (i); FDIC-FED, *Guidance for 2013* (ft 47), II (D): Stress Scenarios.

The 2016 and 2017 public section of the plans, which can be checked against the public feedback given by the Agencies[79], allows us to demonstrate how US large and complex banks are now better prepared to face insolvency from a financial, organizational, legal, and operational, perspective. In fact, in both their latest feedback letters (December 2016 and 2017)[80] the Agencies have expressed broad satisfaction at banks progresses towards resolvability. No deficiencies (the most severe criticism) have been identified in the 2017 plans, and only limited changes have been suggested to certain groups, for their 2019 submissions[81]. As for the deficiencies present in the 2016 plans, these have been considered as "adequately addressed" by all banks in their 2017 submissions[82].

While the following analysis is necessarily firm specific, these improvements have been observed across the board, which makes it possible to attribute them collectively to US G-SIBs.

2.2 Financial preparedness

Banks have now a stronger capital and liquidity base due to more specific calculation methodologies that consider the need of both material legal entities and branches in resolution[83]. Whereas statutory and other regulatory provisions already dictate capital amount, the Agencies subjected the approval of the resolution plan to the existence of an "adequate amount of loss absorbing capacity"[84] to recapitalise those material entities that will continue operations while the parent files for bankruptcy. Agencies have requested both internal and external sources of total loss-absorbing capital (TLAC) at parent level[85]. TLAC then has to be supported by a capital calculation methodology

[79] In the US, G-SIBs submitted resolution plans for the first time in 2013. However, the Agencies made public the feedback letters only starting from April 2016. This means that in those letters Agencies provide comments on the 2015 plans, and indicate the deficiencies and shortcomings that they wanted to be addressed in the 2016 or 2017 plans. Following that, in December 2016 Agencies issued feedback letters for "Targeted Submissions", namely to those banks which had deficiencies to address in their 2016 plans. Finally, in December 2017 the Agencies issued feedback to all eight G-SIBs commenting on the 2017 plans submission. All letters are available at www.federalreserve.gov/supervisionreg/resolution-plans.htm

[80] Available here www.federalreserve.gov/supervisionreg/resolution-plans.htm

[81] Specifically, these relate to the separability analysis of divestiture options for Wells Fargo and Goldman Sachs (See FDIC-FED, *Feedback Letter to Wells Fargo & Company*, December 2017, at p 4; FDIC-FED, *Feedback Letter to The Goldman Sachs Group*, Inc, December 2017, at p 6); to the analysis of their derivative portfolio (See FDIC-FED, *Feedback letter to Bank of America Corporation*, December 2017, at p 5); or in relation to their legal entity rationalisation with specific reference to the possible difficulty in providing liquidity assistance to 27 MLEs (See FDIC-FED, *Feedback Letter to Morgan Stanley*, December 2017, at p 5). Letters are available here www.federalreserve.gov/supervisionreg/resolution-plans.htm

[82] See FDIC-FED, Agency Feedback Letters for 2016 Targeted Submissions, all available at www.federalreserve.gov/supervisionreg/resolution-plans.htm

[83] Methodologies and capital calculation are detailed and required in the 2017 Guidance (ft 47), pp 4-8. For plans that addressed specifically capital and liquidity deficiencies see: Citigroup, *October Submission, Section I: Public Section*, October 2016, pp 16-20 and *2017 Resolution Plan, Public Section*, July 1, 2017, pp 34-38; JP Morgan Chase, *Resolution Plan Public Filing, 2016,* pp 17 -20 and 34-35 and *2017 Resolution Plan Public Filing,* p 82. Bank of America, *Bank of America Corporation 2016 Resolution Plan Submission, Public Executive Summary*, p 12-15 and *Bank of America Corporation 2017 Resolution Plan Submission, Public Executive Summary*, p 11-16; State Street Corporation, *2016 Submission for State Street Corporation: Public Section*, pp 19-27; and *2017 Resolution Plan, Public Section July 1, 2017*, pp 24-30. All plans are available at www.federalreserve.gov/supervisionreg/resolution-plans.htm

[84] 2017 Guidance (ft 39), p 4

[85] On TLAC see: Davies P, *The Fall and Rise of Debt: Bank Capital Regulation after the Crisis*, at EBOLR, (2015) 16: 491-512; Wilmarth A E Jr, *SPOE +TLAC = More Bail outs for Wall Street*, at Banking and Financial Services Policy Report, (2016), vol 35, number 3, , 1-15; Kupiec P H, *Will TLAC regulations fix the G-SIB too-big-to-fail*

which estimates the amount of capital material entities may need to operate or to be orderly wound down in case of parent bankruptcy (so called Resolution Capital Execution Need- RCEN)[86]. Conversely, firms also need to have the "liquidity capabilities"[87] necessary to execute the resolution strategy. These are satisfied ensuring that the parent holding company holds sufficient High Quality Liquidity Assets (HQLA) to cover the sum of all stand-alone material legal entity net liquidity deficits over 30 days[88], as calculated by the relevant internal model (so called Resolution Liquidity Adequacy and Positioning, RLAP)[89] as well as a "methodology for estimating the liquidity needed after the parent's bankruptcy filing to stabilize the surviving material entities and to allow those entities to operate post-filing" (Resolution Liquidity Execution Need, RLEN) [90]. Agencies have also requested banks to take into account branches interconnectedness when estimating liquidity needs[91]. Cross-border intercompany flows has been streamlined too[92].

2.3 Organisational preparedness

Firms have broadly entered into a process of legal entities rationalisation[93]. As a result, many entities have been incorporated, divested or liquidated, foreign markets presence reduced, business lines linked more aptly to legal entities, and clearer lines of ownership identified[94]. The rationalisation process has been carried out following criteria that support the firm resolution strategy as well as, in theory at least, minimise risk to US financial stability in case of insolvency. For instance, in the case

---

problem?, at J Fin Stab, (2016), 24: 158-169. See also Wojcik K-P, *Bail-in in the Banking Union*, at CMLR, (2016), 53: 91-138 (specifically at pp 115-117).

[86] 2017 Guidance, (ft 47), p 5

[87] 2017 Guidance, (ft 47) p 6

[88] 2017 Guidance, (ft 47), p 7

[89] 2017 Guidance, (ft 47), p 6

[90] 2017 Guidance, (ft 47), p 7.

[91] As asked to JP Morgan Chase. See FDIC-FED, Feedback letter to JP Morgan Chase, available here https://www.fdic.gov/news/news/press/2016/pr16031.html, at p 8

[92] See J P Morgan Chase, *2016 Resolution plan*, available here www.fdic.gov/regulations/reform/resplans/index.html

[93] "Legal entity Rationalization and Separability" was one of the key areas to be addressed in the plans listed in the 2017 Guidance.

[94] For instance, Goldman Sachs established clearer ownership lines as follows: "1) Operating entities should not have cross-holdings in each other; 2) Material operating and material service entities should not be owned by another material operating or material service entity; 3) There should be as few intermediate holding companies as regulatory or other considerations permit; and Fractional or split ownership of material entities should be avoided". See Goldman Sachs, *2016 Resolution Plan*, at p 52-53, available here www.fdic.gov/regulations/reform/resplans/index.html. See also JP Morgan Chase, Resolution Plan Public Filing 2016, at pp 21-29; BNY Mellon, *BNY Mellon Resolution Plan, Public Section*, October 1, 2016, pp 25-29, available here www.fdic.gov/regulations/reform/resplans/,;

of JP Morgan[95] criteria are an improved version of what prescribed by the Agencies[96]. Internal governance mechanisms have been enhanced too[97].

2.4 Legal Preparedness

In preparation for resolution, firms have established intermediate clean holding companies (IHC)[98]. IHC acquisition of material legal entities in resolution should theoretically facilitate the continuation of activities of MLEs. Firms have also conducted detailed legal analysis to minimise obstacles arising from the preferred resolution strategy, including problems connected to state and bankruptcy law, bridge bank creation, the granting of emergency motions, and creditors' protection[99]. Criticisms by the Agencies on this issue hint at the scale of the difficulties incurred, but these are impossible to evaluate since the actual legal analysis is not included in the public section.

2.5 Operational Preparedness

Banks are better equipped from an operational perspective because of the development of mechanisms to have access to critical shared services[100], market infrastructure, and payment,

---

[95] The bank focused on four specific areas to which apply rationalisation criteria: 1) organisation and business model, 2) financial resources, 3) interconnectedness, and 4) operational continuity. To each area corresponds sub criteria. The guiding principles in developing them were: 1) transparency; 2) actionability; 3) measurability. See JP Morgan Chase and Co, Resolution Plan Public Filing, 2016, p 21-22, available here www.fdic.gov/regulations/reform/resplans/index.html

[96] In the 2017 Guidance, Agencies asked firms to develop criteria that govern firms' corporate structure and arrangements between legal entities. Specifically Agencies requested that application of the criteria should: "(A) Facilitate the recapitalization and liquidity support of material entities, as required by the firm's resolution strategy. Such criteria should include clean lines of ownership, minimal use of multiple intermediate holding companies, and clean funding pathways between the parent and material operating entities; (B) Facilitate the sale, transfer, or wind-down of certain discrete operations within a timeframe that would meaningfully increase the likelihood of an orderly resolution of the firm, including provisions for the continuity of associated services and mitigation of financial, operational, and legal challenges to separation and disposition; (C) Adequately protect the subsidiary insured depository institutions from risks arising from the activities of any nonbank subsidiaries of the firm (other than those that are subsidiaries of an insured depository institution); and (D) Minimize complexity that could impede an orderly resolution and minimize redundant and dormant entities. These criteria should be built into the firm's ongoing process for creating, maintaining, and optimizing its structure and operations on a continuous basis." See 2017 Guidance, (ft 28), at p 19.

[97] For banks with organisational deficiencies and for how these have been addressed see BNY Mellon, *Resolution Plan, Public Section, October 1, 2016*, pp 25-28 and *Resolution Plan, Public Section, July 1, 2017* p 65-68; Wells Fargo, *2016 Resolution Plan Submission, Public Section*, pp 7-9 and 13-15, and *2017 Resolution Plan, Public Section*, July 1, 2017, pp 29-31; State Street, *2016 Submission for State Street Corporation: Public Section*, p 13-18; JP Morgan Chase, *Resolution Plan Public Filing 2016*, pp 21-28 and *2017 Resolution Plan Public Filing*, p 52-54; Bank of America, *2016 Resolution Plan Submission*, pp 15-21, and *2017 Resolution Plan Submission*, *Public executive Summary*, pp 17-21; Citigroup, *October Submission, Section I: Public Section*, October 1, 2016, 11-13. All plans are available at www.federalreserve.gov/supervisionreg/resolution-plans.htm

[98] This is an improvement from the 2015 plan submission, as noted in the Agencies feedback letters to all eight G-SIBs.

[99] As requested to BNY Mellon, Goldman Sachs, Bank of America, Citigroup, and JP Morgan.

[100] For instance one bank has developed a "service taxonomy" and a "taxonomy mapping" as follows: "State Street has developed a Service Taxonomy that captures and describes all of the services conducted within the organization, not just Critical Services. The Service Taxonomy is organized in a three-tiered structure, (…)*: Level One* describes at a high level the business or corporate service area providing the services and is similar to business units or departments; *Level Two* is a more granular breakdown that indicates the type of services provided within a particular Level One area; and *Level Three* describes with specificity the services being

clearing and settlement activities in resolution[101]. Firms are now also better able to manage and quantify collateral, and have created management information systems which allow them to map capital, services, specific risks, and other activities to the various subsidiaries[102].

The 2016 version of the plans shows other areas of improvement from the previous submission. At different levels banks have: improved their monitoring of intraday liquidity risk and reduced intraday liquidity funding with third party repos, simplified their derivative booking model, aligned derivative trades, market risk and legal entity. They also improved tracking ability of intercompany funding network, reduced asset size, clearly identified objects of sale to support resolution strategy, simplified their derivative models, and developed securities and lending playbooks[103].

In their December 2017 feedback letters, the Agencies noted "meaningful improvements"[104] over each G-SIB prior resolution plan in the following areas: a) capital and liquidity capabilities, including methodology for estimating financial resources needs; b) the development of a framework for the pre-positioning of capital; c) governance mechanisms; d) contractual mechanisms among MLEs and with third party providers and key vendors; e) playbooks; f) ownership and funding structure and legal entity rationalisation; g) increased optionality in sale of assets planning.

Besides those just mentioned, all banks "have taken important steps to enhance the firm's resolvability and facilitate its orderly resolution in bankruptcy" to comply with Agencies rules on "total loss absorbing capacity, clean holding companies, and stays of qualified financial contracts"[105].

Part III

---

provided. State Street inventoried all services provided according to this hierarchy and assessed all of the Level Three services to identify which of these services are Critical Services. As a global custodian, State Street often provides Critical Services in multiple locations, utilizing redundant capacity to provide coverage 24 hours per day." Even though, contrary to expectations: "Maintaining Critical Services in each current location would not be necessary to the execution of State Street's Resolution Plan. State Street's continuity plans will reflect maintaining Critical Services at the appropriate level in Material Entities in order to support Critical Operations in resolution." See *2016 Submission for State Street Corporation: Public Section*, at p 11, available here www.fdic.gov/regulations/reform/resplans/index.html

[101] For a description of the specific operational deficiencies and how these have been addressed, see: Wells Fargo, *2016 Resolution Plan Submission, Public Section*, October 1, 2016, p 10-12 and 2017 Resolution Plan, Public Section, July 1, 2017, pp 21-23 State Street, *2016 Submission for State Street Corporation: Public Section*, at p 10-13 and 2017 Resolution Plan, Public Section July 1, 2017, at p 29-31; JP Morgan, *Resolution Plan Public Filing,* 2016, at p 32-33 and 2017 Resolution Plan Public Filing, at pp 46-48; BNY Mellon, *Resolution Plan, Public Section*, October 1, 2016, at pp 21-24 and *Resolution Plan, Public Section*, July 1, 2017, at pp 47-64. All available at www.federalreserve.gov/supervisionreg/resolution-plans.htm

[102] See 2017 Guidance, (ft 47), p. 12. With regard to clearing and settlement capacity in resolution, a good practice can be considered the one introduced by State Street, which created a "Stress Cash Positioning Operating Model ("SCPOM"), in which State Street documents its protocols to satisfy settlement funding requirements and addresses the central processing of extensions of credit in connection with settlement and liquidity needs". See State Street, *Resolution Plan, 2015*, at p 20, available here www.fdic.gov/regulations/reform/resplans/index.html

[103] These are improvements indicated by the Agencies in their April 2016 Letters.

[104] See FDIC-FED, December 2017 Feedback Letters, available here https://www.federalreserve.gov/supervisionreg/resolution-plans.htm

[105] *Ibidem*

3.1. How living wills have contributed to the resolvability of US G-SIBs

On both sides of the Atlantic, the initial debate on living wills was mostly dominated by those who believed in the efficacy of the instrument on the basis of the recognised benefits of *ex ante* planning; greater transparency; market discipline; and burden sharing. The commentators who were sceptical about the ability of such plans to deal with the failure of a large and complex organisation focused on: their contingency; the difficulties stemming from competing legal and insolvency regimes; market appetite; different currencies; and on the lack of disciplining effect due to their non-binding nature[106]. At that time however, there were no examples of recovery or resolution plans. This paper contributes to fill that gap.

Based on the finding of this research, it is possible to affirm that the main benefits of introducing resolution plans can be traced in the improvements in group internal governance and legal structures. Nonetheless, SIBS are still too complex and large, and the areas of improvement present weaknesses as discussed in the text.

The following sections cover banks governance mechanisms, legal entity rationalisation and group interconnections because of the impact these have on resolvability. The analysis considers the Agencies feedback and follow up actions taken by the banks.

3.2 Banks governance mechanisms

G-SIBs more efficient internal governance framework to handle crisis came as a consequence to the repairing actions taken to address the deficiencies identified by theAgencies feedback. The improvements coalesce around two main areas: 1) the establishment of *ad hoc* committee(s) in charge of crisis prevention/management; and 2) the creation of "management playbooks" which detail actions to be taken upon the occurrence of a triggering event[107].

---

[106]See Avgouleas et al (2013), Living Wills as a Catalyst for Action, in *Journal of Financial Stability*, vol 9, pp.210-218; Feibeleman A (2011), Living Wills and Pre-Commitment, in 1 Am. U. Bus. L. Rev. pp. 93-112; Goodhart,C (2010), *How Should We Regulate Bank Capital and Financial Products? What Role for Living Wills?,* 2010, available at www.futureoffinance.org.uk; Huertas T, *Living Wills: How Can the Concept be Implemented?*, speech at the Wharton School of Management, University of Pennsylvania, 12 February 2010, available at www.fsa.gov.uk.; Kaufman G (2010), *Living Wills: Putting the Caboose before the Engine and Designing a Better Engine*, available on www.ssrn.com; Feldman R (2010), *Forcing Financial Institution Change Through Credible Recovery/Resolution Plans: an Alternative to Plan-Now/Implement-Later Living Wills*, Federal Reserve Bank of Minneapolis Economic Policy paper; Packin N G (2012), The Case Against the Dodd-Frank Act's Living Wills: Contingency Planning Following the Financial Crisis, in *9 Berkeley Bus L J*, pp 29-93; Herring R (2010), Wind Down Plans as an Alternative to Bail Outs: the Cross Border Challenges, in: Scott K et al (eds), *Ending Governments Bail outs as we know them*, Hoover Institution Press, at pp 125-162; Costner C R (2012), Living Wills: Can a Flexible Approach to Rulemaking Address Key Concerns Surrounding Dodd-Frank Resolution Plans?, in 16 N C Banking Inst, pp 133-160; Mayer S and Tarbert H (2011), Test Your Resolution: Living Wills in an Era of Regulatory Uncertainty, in *128 Banking L J*, pp 916-946.

[107] Specifically, the 2017 Guidance requires that, among the others, governance mechanisms related to playbook and triggers: "should detail the board and senior management actions necessary to facilitate the firm's preferred strategy and to mitigate vulnerabilities, and should incorporate the triggers identified below. The governance playbooks should also include a discussion of (A) the firm's proposed communications strategy, both internal and external; (B) the boards of directors' fiduciary responsibilities and how planned actions would be consistent with such responsibilities applicable at the time actions are expected to be taken; (C) potential conflicts of interest, including interlocking boards of directors; and (D) any employee retention policy." Also, "The firm should demonstrate that key actions will be taken at the appropriate time in order to

Firms have set up committees which, by different degrees or names, are in charge of overseeing "the end-to-end development and implementation of the bank" resolution strategy, and in some cases "provide strategic leadership to the resolvability programme"[108]. Other banks have also introduced "global recovery and resolution planning group", "resolution planning officers", and "enterprise resolution execution office"[109]. Whether or not included in "bankruptcy playbooks", banks have also prepared the necessary first day and emergency motions to be submitted to Courts upon filing for bankruptcy.

Furthermore, banks have now a system of internal management and controls able to identify *ex ante* a triggering event (based on capital, liquidity and market metrics, as requested by the Agencies), have codified information management systems for the senior management and the board, and have introduced resolution playbooks for directors and senior management which clearly indicates triggers for actions, the actions to be taken, and the person responsible for it.

Agencies comments also highlighted the existence of mechanisms deemed unsatisfactory to the timely execution of pre-bankruptcy liquidity support to MLEs. In some cases, this was linked to the inexistence of clear triggers that "directly connect the liquidity and capital needed to execute the SPOE strategy with the decision to file for bankruptcy"[110]. In other cases, even where an "asset restriction agreement" was in place[111] or a "capital contribution" arrangement was being developed, its content was still unsatisfactory[112]. In one case, the same robustness of existing governance mechanisms was called into question due to the existence of material errors in the plan[113]. Questions were raised across the board on how the ability of the parent to transfer funds while still in going concern may be hindered by US state and bankruptcy law.

To address this, banks have "recalibrated" their framework to trigger "subsidiaries funding and recapitalisation action" when the firm holds sufficient liquidity and capital in the relevant entities to

mitigate financial, operational, legal, and regulatory vulnerabilities. To ensure that these actions will occur, the firm should establish clearly identified triggers linked to specific actions for: (A) The escalation of information to senior management and the board(s) to potentially take the corresponding actions at each stage of distress post-recovery leading eventually to the decision to file for bankruptcy; (B) Successful recapitalization of subsidiaries prior to the parent's filing for bankruptcy and funding of such entities during the parent company's bankruptcy to the extent the preferred strategy relies on such actions or support; and (C) The timely execution of a bankruptcy filing and related pre-filing actions." See 2017 Guidance, (ft 47), p 9 and 10.

[108] See *BNY Mellon Resolution Plan, Public Section*, October 1, 2016, at p 33, available here https://www.fdic.gov/regulations/reform/resplans/. In the specific case of BNY Mellon the "Resolvability Steering Committee" is supported by a "Resolvability Leadership Team" which manages the day-to-day programme and advises the Committee of key strategic issues and execution risks.

[109] See Bank of America, *Bank of America Corporation 2016 Resolution Plan submission*, Public Executive Summary, at p 23, available at www.fdic.gov/regulations/reform/resplans/

[110] See FDIC-FED, *Feedback letter to Bank of America Corporation*, April 12, 2016, at p 9, and available here https://www.fdic.gov/news/news/press/2016/pr16031.html

[111] FDIC-FED, *Feedback letter to State Street Corporation*, April 12, 2016, at p 13 available at https://www.fdic.gov/news/news/press/2016/pr16031.html.

[112] See FDIC-FED, *Feedback letter to Citigroup Inc.*, April 12, 2016, at p 6, available here https://www.fdic.gov/news/news/press/2016/pr16031.html; and FDIC-FED, *Feedback letter to Bank of America Corporation,* p 10, available here https://www.fdic.gov/news/news/press/2016/pr16031.html;

[113] See FDIC-FED, *Feedback letter to Wells Fargo & Company*, April 12, 2016, at p 6 available at https://www.fdic.gov/news/news/press/2016/pr16031.html

"conduct an orderly wind-down"[114], and are legally prepared to face creditors and fiduciary challenges to their resolution strategy[115].

However, the actual effectiveness of governance mechanisms should be weighed against the existence, or lack thereof, of compliance and enforcement mechanisms. The question arises at to what happens if triggers are not activated or procedures are not timely escalated or set in motion, for plans are silent on the matter. A possible delayed action on the banks' side may have a severe impact on the effectiveness of supervisory action once the crisis manifests.

3.3 Legal Entity Rationalisation

Legal and organisational complexity has long been at the root of supervisory inability to resolve large banks in a timely and orderly manner[116]. To address this fault, Agencies have asked firms to align their legal entities to business lines in a way that supports resolution. This means that scope of the rationalisation process is to facilitate the recapitalization and liquidity support of material entities, to facilitate the sale, transfer, or wind-down of certain discrete operations, and minimize complexity that could impede an orderly resolution and to minimize redundant and dormant entities[117]. The FDIC and the FED have also asked firms to identify operations that can be sold or transferred in resolution and to facilitate buyers' evaluation[118].

The Agencies were mostly dissatisfied with the criteria banks initially used to align legal entities to the resolution strategy for they: failed to establish clear ownership lines, had not been applied consistently to relevant MLEs, lacked "specificity"[119] or allow for too much discretion which in turn may be used to "prioritize business as usual needs over resolution needs"[120]. In few cases, the Agencies criticised the divestiture options because of the lack of a proper separability analysis or for the lack of "sufficient optionality"[121] under relevant market conditions.

In a collective effort to be "responsive"[122] to Agencies comments, banks engaged in a comprehensive review of their legal entity structure. They have identified MLEs which are relevant for resolution

---

[114] See *The Goldman Sachs Group*, (ft 64), at p 6.
[115] But also "claims of fraudulent transfer, preference, breach of fiduciary duties, and equitable claims". See *The Goldman Sachs Group, Inc. Resolution Plan 2016, Submission. Public Document.* September 30, 2016, at p 23. Available here https://www.fdic.gov/regulations/reform/resplans/
[116] Recent structural reforms in banking, such as the s.c. Volker rule in the US and the implementing measures of the Vickers Commission in the UK, go into the direction of remedying legal complexity too.
[117] See 2017 Guidance, "legal entity rationalization criteria", (ft 47), at p 19.
[118] See 2017 Guidance, "legal entity rationalization criteria: separability", (ft 47), at p 19.
[119] See FDIC-FED, Feedback letter to Bank of America and to Wells Fargo, available here https://www.fdic.gov/news/news/press/2016/pr16031.html. In the letter to the former this is seen only as a shortcoming, whereas in that to the latter is considered a deficiency.
[120] See FDIC-FED, Feedback letter to State Street Bank, p 7, and ID., Feedback letter to Wells Fargo, at p 8 both available here https://www.fdic.gov/news/news/press/2016/pr16031.html.
[121] See FDIC-FED Feedback letter to JP Morgan Chase, available here https://www.fdic.gov/news/news/press/2016/pr16031.html
[122] Reference is to the latest criteria Agencies have included in their 2017 assessment guidance which consider responsiveness as "whether the companies complied with the prior feedback". See FDIC-FED, Resolution Plan Assessment Framework and Firm Determination 2016, available at www.fdic.gov , at p 11. In reality, a Damocles sword hangs over the firms which can see their size and activities axed should Agency not be satisfied with the plan. See above the case of Wells Fargo, at (ft 44).

purposes, have dissolved low activities and dormant or redundant entities[123]. The governance framework governing legal entity rationalisation has been improved too and is subject to periodic review.

To address the separability concerns now firms have clearly identified "objects of sale", namely those entities which can be easily sold. In one case have established frameworks to assess when the benefits of resolution planning "outweigh increased complexity that may serve business as usual"[124], created data-driven tools to "store, maintain and regularly update information on operational interconnections across the firm in a structured, searchable and analyzable manner"[125] which can also be used to apply the firm's legal entity rationalisation.

Questions remain here too. Despite efforts to simplify their structure, their actual asset size is still large, the number of entities entering the resolution process will inevitably be broader than the MLEs considered, and the identification of objects of sale may be of little use in case of severe economic conditions when it may be difficult to find buyers or not to resort to fire sales of assets. For instance, even though Bank of America has reduced its legal entities population by approx. 60% (or 1600 entities), has eliminated about 40 intermediate holding companies and 250 entities are in line for divesture, the bank still holds over 1000 subsidiaries and branches, active in the US, Europe and Asia, against only seventeen material legal entities identified for resolution purposes[126]. At year-end 2016, Bank of America held over 2 trillion of dollars in total assets[127]. JP Morgan Chase,Bank of America and Citigroup are the first three G-SIBs in the FSB list[128].

3.4 Group interconnections and interdependencies

Group interconnections and interdependencies epitomise the inherent clashes of the legal and economic meanings of a corporate group. From a legal perspective a group can be broadly seen as an agglomeration of independent legal entities and offices. From an economic point of view however, groups express different degrees of integration. This in turn may have an impact on the "legal perimeter" of the group itself. Also legal entities that belong to the group are usually subjected to powers of direction from the parent company, and are operationally interconnected, they share services and IT systems, and the financial success of one may depend upon the effective functioning of another. . Plans show how intricate the maze of interconnections is between material entities. Interconnections are a concern for resolution authorities as these represent an impediment to resolvability to the extent that make separation more complex[129]. Even though non-material

---

[123] See for instance BNY Mellon, *Resolution Plan Public Section*, October 1, 2016, at p 27, available here https://www.fdic.gov/regulations/reform/resplans/

[124] See State Street Plan, p 18

[125] It refers to the tool called: Connection, set up by BNY Mellon. See BNY Mellon, *Resolution Plan*, at p 4, 10 and 25 available here https://www.fdic.gov/regulations/reform/resplans/

[126] See Bank of America Corporation, *2016 Resolution Plan Submission*, at p 4, available here https://www.fdic.gov/regulations/reform/resplans/

[127] Citi is not much smaller, with just under 2 trillion in consolidated asset at Q1 2015. See Citigroup INC, Resolution Plan, 1 July 2015, at p 84, available here https://www.fdic.gov/regulations/reform/resplans/

[128] The 2017 list can be accessed here www.fsb.org/wp-content/uploads/P211117-1.pdf

[129] Regulation QQ, (ft 36), Sec 243.4 (g), requires banks to "identify and map to the material entities the interconnections and interdependencies among the covered company and its material entities, and among the critical operations and core business lines of the covered company that, if disrupted, would materially affect the funding or operations of the covered company, its material entities, or its critical operations or core

entities are excluded from the plan, one may argue that a similar web exists with these too. This adds a further layer of complexity to resolution.

As mentioned above, for resolution purposes banks have identified in their DFA plans the MLEs which will enter bankruptcy procedures. The number of MLE considered varies from 4 to 33[130]. MLEs can be broadly classified in three areas of activities: banking, broker/dealer and/or other investments services activities, and service providers. Geographically, they are scattered between the US, EU, Asia and South East Asia, as well as off shore centres. Interconnections and interdependencies among MLEs are instead of operational and financial nature. This distinction is in line with the FSB principles on the identification of critical functions and critical shared services.[131]

3.4.1 Financial interconnections

Financial interconnections among MLEs vary depending on the SIB, and it appears that the role of the parent holding company diverges too depending on the main business activity of the group, namely whether this is more investment/asset management or commercial/retail banking orientated. The parent can be merely a source of funding to subsidiaries or can have a more centralised role in contractual activities, from executing derivatives trading with subsidiaries to manage their interest rate or currency risk, or can act as a guarantor.

Financial interconnections can be broadly divided into: interconnections between the parent holding company and its MLEs, and interconnections among identified MLEs (also called interaffiliate transactions). Within these two classifications, the nature and depth of financial relations may vary significantly. In all cases though, the parent holding company is the equity (but in some cases also debt) holder of subsidiaries' capital. Whereas downstreaming of financial resources is widespread, upstreaming of funds (other than dividends) may be possible too. In some cases the holding, or the main bank subsidiary, acts as a guarantor of subsidiaries liabilities. It can also act as the main group contractual counterparty.

Interaffiliate transactions cover short term, secured and unsecured funding, derivative transactions for hedging purposes, charges for operational support, intercompany credit lines, advances, and intercompany placements. All of the considered G-SIBs have now adhered to the ISDA Protocol, which requires no automatic stay in resolution. For those financial contracts not governed by the Protocol, there are no cross default termination rights. Other reasons for interaffiliates financial transactions are risk management, trading and investments, client facilitations and other liquidity needs. In addition, interaffiliate accounts, such as margin accounts, securities accounts, deposit accounts, and cash accounts are often used for pooling purposes. Some banks have introduced

---

business lines. Such interconnections and interdependencies may include: (1) Common or shared personnel, facilities, or systems (including information technology platforms, management information systems, risk management systems, and accounting and recordkeeping systems); (2) Capital, funding, or liquidity arrangements; (3) Existing or contingent credit exposures; (4) Cross-guarantee arrangements, cross-collateral arrangements, cross-default provisions, and cross-affiliate netting agreements; (5) Risk transfers; and (6) Service level agreements".

[130] The number of material entities, excluding the parent company, range from 33 (JP Morgan Chase), 17 (Goldman Sachs), 14 (BNY Mellon), 16 (Bank of America Corporation), 28 (Citigroup), 15 (State Street), 4 (Wells Fargo & Company) and 5 (Wells Fargo Bank), and 17 (Morgan Stanley).

[131] See FSB (2016), *Recovery and resolution planning for systemically Important Financial Institutions: Guidance on Identification of Critical Functions and Critical Shared Services*, available at www.fsb.org

criteria allowing for trades to be centrally cleared and when this is not possible, "non-cleared trades should be collateralised on a daily basis"[132]. In very few cases subsidiaries are financially independent.

What is of chief relevance for our purposes however, is that in a few cases financial interconnections are extremely tight between US based MLEs and those located in foreign jurisdictions. In spite of the relevant provisions included in the preferred resolution strategy, these types of financial interdependencies may make ring fencing from foreign supervisory authorities still highly likely.

3.4.2 Operational Interconnections and the role of critical shared services

Operational interconnections are worth considering in detail because they are crucial to the smooth provision of critical shared services in resolution[133], which explains why service providers are in fact MLEs for resolution purposes. Critical shared services enable the provision of critical functions. In the case of Goldman Sachs and Morgan Stanley, service providers account for almost half of the group MLEs[134]. State Street decided to centralise the provision of the majority of its critical services in the banking main subsidiary and in a trust company, whereas JP Morgan decided to have the banking entity and its subsidiaries acting as the contractor for critical services firmwide[135].

The common perception is that critical shared services are chiefly IT and personnel based: subsidiaries provide transaction support services, information technology and hardware infrastructure, software development, and network services to the operating entities as well as HR services including payment of remuneration and benefits, and staff supporting services for group employees[136]. Yet plans show that operational dependencies are considerably more granular and embedded than what common knowledge suggests[137]. For example, service providers may allow for

[132] See Goldman Sachs, *Resolution Plan 2015,* at p 26-27
[133] For Agencies criticisms to one bank for failing to "identifying shared services and establishing SLAs and contingency arrangements that are critical to the successful execution of the bridge bank strategy", see FDIC-FED, Feedback letter to BNY Mellow, 12 April 2016, at p 6, available here https://www.fdic.gov/news/news/press/2016/pr16031.html.
[134] Reference is to the 8 service providers over 17 MLEs in Morgan Stanley and to the 8 service providers over 17 MLEs in Goldman Sachs. The remaining service providers are 9 in Citi, 6 in Bank of America, 3 in JP Morgan, 5 in BNY Mellon, 4 in State Street. See ft 88 for the total number of MLEs. An interesting analysis would be to look at the correlation between size of the service entities and their number. However, balance sheet data are not available for all service MLEs of all the analysed groups.
[135] See State Street model described in ft 99 below and the one by JP Morgan. In this latter case, "the Firm's main operating bank entity, JPMorgan Chase Bank, N.A. ("JPMCB"), acts as the main contracting agent firm wide. This results in the majority of JPMorgan Chase's third party vendor contracts for its Critical Shared Services being centralized in JPMorgan Chase Bank, N.A., its branches and subsidiaries. Furthermore, JPMorgan Chase Bank, N.A. is a central repository and manager of the majority of the firmwide technology, real estate, personnel and other assets for the Firm's Critical Shared Services. The concentration of assets, services and operations in these few entities results in contractual operational interconnectedness at JPMorgan Chase". See JP Morgan Chase, *Resolution Plan*, at p 17, available here https://www.fdic.gov/regulations/reform/resplans/.
[136] In some cases, staff may be directly employed by the service company and seconded to operating MLE, or the service company may only offer the remuneration package and other HR services. In the first case, the service company may also be the contractual counterparty to the firms pension plan; in other instances key personnel in resolution has been identified as being employed by the service company.
[137] Even though to different extent and level of details, all but one plan thoroughly describe operational interconnections with service providers. Wells Fargo instead provides the following succinct (and vague) description: "As the Company's largest subsidiary, WFBNA [Wells Fargo Bank, National Association] provides

access to Financial Markets Utilities (FMU), which are those infrastructures that facilitate payments, clearing and settlement of derivatives, customer securities and other cash and multiple currency transactions. The importance of a timely and safe access to FMU for the orderly functioning of daily business activity and during resolution cannot be underestimated.

Other examples of operational interconnections range from some relatively "minor areas", such as loan servicing, middle and back office support, operational support services to asset servicing[138] and broker dealer services, remote infrastructure management services, holding real estate leases together with relevant property services, vendor services, holding software licensing or managing other IP related activities, to "major" areas such as core legal and compliance services, treasury functions, business and product development and marketing, marketing support, decision management, "data processing centers, data storage, distributed systems and command centers"[139], "technology operations such as voice, video, system and network security, desktop, mobile and messaging, technology help desk, and remote access"[140], ATM management, and provision of services to retail and credit card services globally. In one case providers of critical shared services have been grouped based on clients and regions[141]. Depending on the banking group, the size of service MLEs range from hundred millions to few billions of dollars in total assets.

---

products and services to its affiliates, including each of the Company's other material entities, and WFBNA provides the majority of personnel, facilities, and systems infrastructure to support the Company's operations. WFBNA also provides technology and operations support to each of the Company's other material entities. The support services that WFBNA receives from other material entities are limited. WFBNA receives treasury, legal and other support services from the Parent, certain derivative clearing services from WFS LLC [Wells Fargo Securities LLC], and deposit account recordkeeping services for the sweep product offered by WFA LLC [Wells Fargo Advisors LLC] from FC LLC [First Clearing LLC]. Other points of operational interconnectedness include FC LLC clearing customer securities transactions on behalf of WFS LLC, WFA LLC and FiNet [Wells Fargo Financial Network LLC] and WFS LLC providing capital markets products and services to the Parent, WFBNA and other affiliates, including underwriting, debt placement, loan syndications and derivatives clearing services". See Wells Fargo & Company, Wells Fargo Bank, National Association, *Resolution Plan Public Summary*, July 1, 2015, at p 8, available here www.fdic.gov/regulations/reform/resplans/

[138] This becomes particularly relevant in those firms, such as BNY Mellow, where asset servicing is a core business line. Bank of America calls its Legacy Assets and Servicing a business segment with no core business lines attached.

[139] See Citi, *Resolution Plan 2015*, available here www.fdic.gov/regulations/reform/resplans/, at p 65

[140] *Ibidem*, p. 65

[141] See for instance State Street which relies on a system of: "Centers of Excellence ("COEs") and Shared Services ("ShSs"), which are operated across the world, in order to provide comprehensive and consistent services to its clients. A COE is a group of personnel located throughout the world providing a single dedicated service across multiple client categories and utilizing centrally designed procedures and IT applications. COEs are utilities and ShSs representing like-activities across business lines, organized regionally and globally and containing client service components. ShSs also provide services across multiple client categories utilizing centrally designed procedures, but ShSs differ from COEs in that they focus more on regional and local needs. Each COE and ShS operates across multiple locations, including legal entities. This delivery model allows State Street to substantially reduce its geographic concentration risk by developing redundancies across regions, as well as to realize certain efficiencies by lowering service costs while achieving greater scale of operations and increasing the value of information technology investments to process standardization. Moreover, many of State Street's shared internal services are provided through Centralized Corporate Service groups that are housed in SSBT [State Street Bank and Trust Company]. The centrality of SSBT to State Street's operating model substantially mitigates the risk of loss of ShSs in a resolution scenario. Because most shared corporate services and many of State Street's business operations are conducted within and delivered by SSBT, such services and operations would continue to be provided under the SPOE Strategy, because SSBT will be recapitalized and State Street entities receiving services will be able to continue to pay for them. Additionally,

Unfortunately, from the plan it is difficult to infer whether service MLEs also manage the group MIS, (management information systems). Should this be the case, a disruption in the relevant service entity may exacerbate the resolution process.

The following characteristics emerge from all plans: 1) service providers may be located outside of the US, most often in India, Singapore, UK, Hong Kong, and Japan; 2) servicing MLEs are not merely "providers" of services but also receive critical services from other MLEs; 3) services are provided to MLEs and/or core business lines; 4) service providers tend to be financially independent from operating entities; 5) tend to have a substantial risk free funding model as they rely mostly on cash/fees, accounts receivables, and fixed assets such as computer; software; premises; and other equipment[142]; and their liabilities are mostly accounts payable and taxes; 6) they are not projected to enter bankruptcy proceedings[143]; 7) services provision is regulated by binding interaffiliate service level agreements conducted at arm's length that provide for continuity in case of resolution of contracting entity.

In principle, arm's length contracts would indeed ensure continuity. However, the combination of 1) and 5) above raises questions about their actual efficacy. Service companies rely on cash, which stems mostly from the fees corresponded by contracting entities. Group financial distress can constitute an alarming bell to foreign regulators. They could impose limitations on the provider activities because the ability of the distressed entity to correspond fees can be jeopardised. Only Citi Bank makes it clear that in resolution service companies can access an intercompany line of credit should they experience cash shortages[144]. Irrespective of regulatory intervention[145], the internal control systems of service MLEs located abroad may also halt the provision of relevant services. Given that service MLEs based in foreign jurisdiction still provide services globally, an abrupt interruption may precipitate the resolution phase, and hamper the ability of continuing MLEs to operate smoothly.

Furthermore, whilst the majority of plans shows that service provision has been almost entirely centralised and regulated by interaffiliate service agreements, there are instances where it is still provided by third parties. In this case, group distress may give incentive to the latter to breach the agreement or to delay the provision of services. In the case of JP Morgan, the master vendor template has been modified to "to remove the suppliers' right to terminate, and to amend the

---

the failure of SSC would not trigger local resolution proceedings for entities that provide services in support of Global Custody or the termination of such services. Key service contracts are also designed to maintain continuity of service."

[142] Other assets may derive from "prepaid expenses related to corporate taxes; deposits [in other banks] and advance payments on employees insurance plans".

[143] In one case however some service entities are classified as "objects of sale", to be sold jointly with the core business line for which they provide the majority of critical services. See Morgan Stanley, *2015 Resolution Plan*, p 43, available here www.fdic.gov/regulations/reform/resplans/

[144] However, it should be acknowledged that such mitigation strategy may only work if credit lines still operate smoothly in resolution. Ironically, the same firm admits that while the terms of their service agreements have been strengthened "to prohibit termination of intercompany services in resolution", this is possible "so long as payment is received for the service". See Citi Bank N.A., *IDI Resolution plan, Public Section*, September 1, 2015, at p. 10 available here www.fdic.gov/regulations/reform/resplans/

[145] It should also be noted that authorities may not be able to intervene if the service company is not carrying out a regulated activity. Also, not in all business plans foreign authorities are considered as "material": not being a material authority may hamper their ability to identify the problem in a timely fashion.

termination clause for each of its critical vendor contracts"[146] as well as the change of control clause. However, the same template includes "an amended resolution-friendly termination clause and resolution-friendly change-of-control clause".[147]

Also, the circumstance that services are not only provided to legal entities but to business lines too requires a genuine coincidence of business functions with entities to make the contractual mechanism valid and easily enforceable.

Finally, as seen service MLEs are intertwined because they are both receivers and providers of services. Unless there is a fair degree of substitutability, this may increase their level of interdependence, which hampers their ability to ensure continuity of services should any be an object of sale. Conversely, should any operating entity be sold, there must be in place a well-functioning system that allows for an orderly "uncoupling" of the operating entity from the servicing one(s).

PART IV

4.1 The Single Point of Entry resolution strategy in practice

The distinction between a Single Point of Entry (SPOE) and a Multiple Point of Entry (MPE) strategy came about already in 2012 when the FSB issued a consultative document on "Making Key Attributes Requirements Operational"[148]. In that document the Board specified the main characteristics of each strategy and suggested the underlying conditions that have to be met for each to work. The SPOE "involves the application of resolution powers at the top holding or parent company level by a single resolution authority", whereas the MPE "involves the application of resolution powers by two or more resolution authorities to multiple parts of the group (ideally simultaneously) including strategies in which a group is broken up into two or more separate parts"[149]. Depending on corporate structure, legal, financial or operational separation, and funding arrangements, one strategy may be preferable over the other. However, a combination of both can also be appropriate. Among the pre-requisite to make an SPOE strategy effective the FSB lists: "sufficient certainty on the part of host authorities that the home authorities would allow resources generated by a recapitalisation at holding company level or made available from other sources to be down-streamed to subsidiaries"[150]. This can be achieved by "statutory requirements for a holding company to support subsidiaries (such as 'source of strength' rules); guarantees by the holding company; subordination of holding company claims; and cases where subsidiaries are incorporated as limited liability companies"[151].

In the US, the Agencies gave both domestic and foreign based firms the following options in terms of possible resolution strategy: "1) The Bankruptcy or failure of all Material Entities; or 2) Bankruptcy of the parent holding company or U.S. parent, as may be applicable, and a limited number (if any) of

---

[146] See JP Morgan Chase, *Resolution Plan. Public section,* 2016, at p 32 available here www.fdic.gov/regulations/reform/resplans/.
[147] *Ibidem*.
[148] FSB (2012), *Recovery and resolution planning: Making Key attributes requirements operational. Consultative document*, available at www.fsb.org/wp-content/uploads/r_121102.pdf
[149] *Ibid* at p 15
[150] *Ibid*, at p 15
[151] *Ibid* at fn 8.

Material Entities; or 3) The Bankruptcy of one or more Material Entities within the Covered Company, and the Covered Company is compartmentalized in a manner that mitigates the risk that such Bankruptcy(ies) would result in other Material Entities entering resolution regimes" [152].

Plans show how seven of the eight SIBs opted for a resolution strategy under 2) above, with only the parent holding company entering bankruptcy proceedings and the MLEs continuing operations. This is an example of an SPOE strategy.

The actual plans differ among each other in some details, but overall they envisage the following pattern.

The resolution process has been stylised in different stages: stress, runway, stabilisation, and post-resolution period.

The stress period is a pre-crisis condition where banks should intervene based on their risk management and contingency planning[153]. At this stage, some banks will also resort to capital and liquidity plans to inject further liquidity on the basis of the actual needs of MLEs experiencing stress.

The runway period indicates the existence of a material financial distress which cannot be recovered and marks the beginning of the resolution process. Several actions correspond to this period aiming at transferring High Quality Liquid Assets (HQLA) on the basis of the relevant liquidity and capital methodologies (RLEN and RCEN discussed above) to MLEs. Actions indicated in the different playbooks will be taken. Measures aimed at employees' retention, continuity of critical services, management of information systems, access to FMU, coordinating activities with regulators and other stakeholders are activated too. In some plans, at this stage existing lines of credit or other financial arrangements to upstream resources are being terminated. Two G-SIBs will also trigger a mechanism akin to bail in[154].

During the stabilisation period the necessary actions post CH 11 filing are implemented with MLEs now operating under the ownership of an intermediate holding company (IHC). MLEs will then be orderly wound down or sold, on the basis of what was included in the bank resolution plan.

Finally, the post resolution period sees the satisfaction of the bankruptcy estate creditors with the proceeds of sales and/or the residual value of the orderly wind down proceeds, or with the proceeds of the IPO of a remaining company created with the subsidiaries left out of resolution.

From a legal point of view, the SPOE strategy rests upon two main elements: 1) a contractual mechanism and 2) the creation of an intermediate holding company (IHC), in some cases referenced

[152] See 2013 Guidance, (ft 47), at p 3. Considering that the 2017 Guidance is silent on the matter, we consider those strategies as still required. Agencies specify that bankruptcy "encompasses a proceeding under the U.S. Bankruptcy Code as well as a proceeding under another applicable insolvency regime. See ft 3 at p 3 of the 2013 Guidance

[153] Based on the requirements of the BRRD, European banks draw up recovery plans which are then presented for approval to the supervisor. In the US, while it is likely to imagine that banks have similar plans, these don't appear to be as regulated as in Europe. In this matter, the responsible Authority is the FED, which issued guidance for the GSIB in 2014, see FED, *Consolidated Recovery Planning for Certain Large Domestic Bank Holding Companies*, (ft 24).

[154] See Citi, *2016 resolution plan*, at p 7 and State Street, *2015 resolution plan* at p 9, both available here www.fdic.gov/regulations/reform/resplans/

to as a NewCo or bridge vehicle. The contractual mechanism, most commonly called support agreement, allows for the transfer of the parent holding assets- namely holdings in the MLEs- to the IHC and for the activation of financial support to MLEs in the runway period. The parent holding company will only keep the liquidity necessary to cover the administrative burdens of entering CH 11. The IHC will be run by a reorganisation trust appointed by the bankruptcy court. The trust will run the MLEs for the benefits of the bankruptcy estate. Upon filing for CH 11, an emergency transfer motion will be necessary to create the trust. Trustees may have to be vetted by regulators and then approved by the court. The petitioning parent company may have to file for so called "sec 363 sales" under CH 11 to validate the transfer of assets to the IHC. The trustees will act as fiduciaries to the bankruptcy estate and will have all the powers, and limitations, attached to that role. The plans make no mention as to who will actually manage the IHC, whether existing group managers, or managers freshly appointed by the trust.

The IHC will have to take on the covered financial contracts that were in the hands of the parent company. Similarly, in those cases in which the parent holding was acting as a guarantor, this role will now be subsumed by the IHC. Also, it is likely to imagine that unless already existing, the IHC will have to obtain the necessary regulatory approval. If the banking arm of the group is to be wound down, one can infer that the transfer of deposits and other customers' property to a third party will have to take place.

4.2 The SPOE as an (unresolved) problem of collective regulatory action?

The almost homogeneous choice of the SPOE as the preferred resolution strategy among the eight SIB can be surprising especially in those cases where a relevant number of MLEs are located in foreign jurisdictions, as with Bank of America and JP Morgan Chase[155]. In 2015 Wells Fargo opted for an MPE and, even though the Agencies feedback do not directly relate to the choice of resolution strategy, the original plan -as well as the subsequent resubmission- have both been rejected by the authorities. The 2017 plan was eventually approved (and it still includes an MPE strategy)[156]. In the same year BNY Mellon had opted for a two tier strategy. Under this strategy, the parent holding company would have filed for CH 11 with the sale of certain business lines (asset management and clearing services) conducted under sec 363 of the Bankruptcy Code, and the main banking subsidiary put under FDIC receivership via a bridge bank. The said bank affirmed the feasibility of running two proceedings in parallel due to the limited financial and operational interconnections between the two procedures and because of the ability of existing affiliates to provide shared services due to service level agreements[157]. However, the Agencies deemed the strategy to be operationally deficient particularly with regard to the continuity of shared and critical services in resolution, and to the bridge bank ability to operate. The former criticism insisted on the difficulties in mapping and then disentangling shared and critical services. The latter related mostly to the service and operational interdependencies among the parent holding and the bank arm, and on the actual ability

[155] For instance, of the 33 MLEs of JP Morgan Chase, 13 are located abroad (London, Belgium, Bahamas, Philippines, China, Singapore, Australia, Japan, India, Germany, Ireland, Canada and Luxemburg); of the 17 MLEs of Bank of America, 7 are located abroad (London, Frankfurt, Singapore, India and Japan). It also strikes as odd that BNY Mellon that operates in 35 different jurisdictions, has only 4 foreign MLEs (Indian, London and Belgium), of which two are branches.

[156] See Wells Fargo, 2017 Resolution Plan, Public Section, July 1, 2017, available at www.federalreserve.gov/supervisionreg/resolution-plans.htm

[157] See Bank of New York Mellon 2015 and 2016 resolution plans.

of the bridge bank to have access to foreign deposits dually payable in the US to use as a collateral for intraday credit. Finally, the bridge bank ability to operate may have been hampered by legal and operational problems that could impede the transfer of custodial assets to the bridge bank. Agencies explicitly mentioned that every deficiency could have been overcome by the choice of an SPOE strategy, and perhaps not surprisingly the bank chose it when resubmitting its resolution plan.

It can be argued that two technical factors may justify the uniform choice of an SPOE strategy from the banks perspective. The adhesion by all SIBs to the ISDA Universal Resolution Stay Protocol and the *ex ante* positioning of HQLA in the form of TLAC to MLEs. The decision to sign up to the ISDA Protocol avoids a disorderly closing out of derivatives and other financial contracts in resolution and allows those contracts to be governed by a single set of rules globally. Cross default clauses will not be activated making the domino effect less likely. Possible pressures to wind down MLEs that engage in derivatives transactions may be eased. Counterparty trust in repayment should be preserved because under the Protocol the IHC becomes a guarantor. Adherence to the Protocol would make the close out and netting or the novation of the contracts smoother whenever waiting until maturity is not possible or convenient.

However, the adhesion to an internationally agreed Protocol does not *per se* avoid disputes, as recent cases in Europe have shown[158].

Regulation YY requires the parent holding company to hold a minimum amount of external TLAC and other additional buffers. TLAC comprises Tier 1 regulatory capital plus eligible external long-term debt. To be eligible the debt has to be issued by the parent, be unsecured, be plain vanilla, be governed by US law, and having a maturity greater than 1 year[159]. TLAC instruments will contribute to the prepositioning of liquidity to national and foreign MLEs, which is a key provision of the plans. This would reassure foreign regulators on the financial soundness of the subsidiaries incorporated in their own jurisdictions. The plans also include arrangements for the parent to place extra capital at the point of resolution to foreign MLEs, which is further intended to avoid ring fencing.

However, the said SPOE cannot guarantee that ring fencing will not be imposed. Plans do not properly, or at least not in the public section, address the coordination problem with foreign authorities. Rather, banks seem to give for granted that the chosen resolution strategy is in the latter interest too. Yet is it hard to see how. One deficiency of the plans is the over-reliance on available financial resources in a moment of financial distress[160]. Even though the Agencies have prescribed a minimum amount of TLAC, market dynamics and the severity of the crisis event at the point of resolution may induce foreign authorities to take conservative actions. Also there is little or no consideration of the so called "double leverage" problem. Banks may fund the extra capital needed with debt instruments. However, the servicing of that debt may rely "on flows of dividend

[158] See LB EHF v Raiffaisen [2017] EWHC 522 (Comm), 20.3.2017; and Lehman Brothers Int v Exxonmobil [2016] EWHC 2699 (Comm), 28.10.2016

[159] In Europe, see Directive 2017/2399 of the European Parliament and of the Council of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy, in OJ L 345/96.

[160] The FSB too recommended minimum amount of TLAC financial companies should hold to ensure loss absorbency and recapitalisation capacity see FSB (2015), *Principles of Loss-Absorbency and Recapitalisation Capacity on G-SIBs in Resolution*, available here www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf

income which are uncertain and at the discretion of local boards and supervisors across the group"[161]. This may also put more pressure on unregulated entities[162]. It is not a case then that in the UK the PRA is specifically consulting on this problem[163]. The Agencies expressed a similar concern in their 2017 feedback letter to Morgan Stanley[164], when acknowledging that the large number of MLE included in the plan –coupled with their foreign location- increases the risk of misallocation of financial resources. And that "Projected pre-bankruptcy estimates could fall short of what one or more MEs need in resolution, including for purposes of stabilizing the firm"[165].Never mentioned is the accounting method used to evaluate the assets that can be sold or transferred, whose value may therefore fluctuate under different scenarios. Much will also depend on the maturity date of the debt component of TLAC at the point of resolution, to avoid a sudden withdraw of funds by TLAC holders. This may be the reason why Regulation YY establishes a minimum maturity date. However, a grandfathering provision had to be included to cover those debt instruments issued by the SIBs before 31 December 2016. Furthermore, plans indicate that the runway period spans over a week end. As experience has shown in practice, authorities located in different continents may doubt the actual ability of the parent before -and of the IHC after -to deliver the needed financial resources especially in such a short timeframe. The uncertainty over whether foreign MLEs will be given the same consideration of the national MLEs in case of scarce available liquidity may tip the balance towards ring fencing. Foreign, and domestic authorities too, may also question the financial capabilities of the IHC, since nothing is said on its own source of funding. In normal times, these would be dividends, lines of credit and other upstream of resources from the subsidiaries. However, in a crisis scenario none of the above is feasible. Even if the IHC is in effect an asset management company, its own financial sustainability should be taken into account.

Even though Cross Border Crisis Management groups should be in place for SIBs and progress has been made on international cooperation[166], as the joint FDIC-Bank of England paper on the preferred resolution strategy for SIBs[167]shows, mechanisms based on MoUs are still not binding. In fact, not even the same resolution plan has any binding value over the bank, regulators and judges.

Despite the mentioned progress, from a political perspective supervisory authorities in Europe seem to be wary of a specific US provision that forces foreign large banks to create a US incorporated holding company to continue operations. Therefore, they have recently put forward a proposal[168]

---

[161] See Woods S, *Geofinance*, Speech delivered at the Mansion House City Banquet, 4 October 2017, available here www.bankofengland.co.uk/speeches, at p 4.
[162] *Ibidem*
[163] See PRA, *Groups Policy and Double Leverage*, CP 19/07, October 2017, available at www.bankofengland.co.uk/prudential-regulation/publication/2017/groups-policy-and-double-leverage
[164] FDIC-FED, Feedback Letter to Morgan Stanley, 19 December 2017, available at www.federalreserve.gov/supervisionreg/resolution-plans.htm
[165] *Ibidem* at p 6
[166] See Russo C, *Third Country Cooperation Mechanisms within the Bank Recovery and Resolution Directive: will they be Effective?* , Ch 8, in «Bank resolution: the European regime», eds by Binder and Singh, OUP, 2016, at p 157, and Nieto M (2014), *Third Country Relations in the Directive Establishing a Framework for the Recovery and the Resolution of Credit Institutions*, Banco de España working paper, available at www.bde.es, for a discussion on these groups as well as for a critical analysis of the effectiveness of cooperation in cross border resolution.
[167] See BoE-FDIC, *Resolving Globally Active, Systemically Important, Financial Institutions*, 10 December 2012
[168] See art 21b of the Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial

directed to foreign large banks to set up an IHC in the Union. This move may indicate a preference in Europe for an MPE strategy for US G-SIBs .

Finally, whereas the SPOE is focused on MLEs only, one should not underestimate the behaviour of regulatory authorities located in jurisdictions other than those of the MLEs. They could ring fence the assets too, even if the subsidiaries are not seen as "material". Yet depending on the actual crisis, the financial resources of those other entities may be used for resolution purposes. Their ring fence may send shocking waves to the markets and have a signalling effect to other regulators.

Coordination may be an issue at domestic level too. Despite the Dodd –Frank attempted simplification, the US financial and banking supervisory framework is still composed of a patchwork of authorities that operate at state and federal level on the basis of the companies' activities. The orderly wind down of MLEs will require cooperation and coordination of different authorities, under separate legal regimes, particularly in the case of stock and commodities broker- dealers and insurance companies. These could not be resolved under CH 11 or under the FDIA: the broker-dealers will have to be liquidated by the SIPC Trustee pursuant to the Securities Investor Protection Act (SIPA) and CH 7of the Bankruptcy Code[169], whereas insurance companies are normally resolved under relevant state law. In fact, not even a deposit taking institution could access CH 11, having to be resolved under the FDIA instead. More recently the FDIC has issued a final rule on its powers under Title II however, which covers certain aspects related to insurance companies[170] as well as a joint draft rule with the SEC to regulate the insolvency of broker-dealers under Title II[171].

4.3 The choice of a SPOE as a case of "regulatees capture"?

We need to consider whether the SPOE can actually be the Agencies' preferred resolution strategy. A first indicator in this sense is the case of the only bank that opted for a two tier resolution strategy. From a theoretical point of view the operational objections raised to that strategy may well be applicable to an SPOE *ceteris paribus*, as in fact have been raised to other banks which similarly lacked the ability to disentangle operational and financial interconnections. Therefore, it is unclear why the Agencies indicated that the deficiencies could have been overcome by the choice of a "different" resolution strategy. We should also bear in mind that resolution plan drafting does not happen in a vacuum but is instead the product of a constant dialogue with the authorities.

The second aspect is that the Agencies never credibly gave banks the option of an MPE as a possible resolution strategy. If we look back to what included in the 2013 Guidance, mentioned above, nothing is said on the possibility of having multiple insolvency proceedings, or sub groups of insolvencies, on the basis maybe of business lines or jurisdictions. The options allow for: the failure of the parent holding only and maybe, but not necessarily, that of some MLEs (n2), the contemporary failure of all material entities (n1), or of only some of them with their parent

---

holding companies, remuneration, supervisory measures and powers and capital conservation measures COM/2016/0854 final - 2016/0364 (COD), available here www.eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52016PC0854

[169] See FED, *Study on the resolution*, (ft 71), at p 3.

[170] FDIC, *Certain Orderly Liquidation Authority provisions under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 12 CFR part 380.

[171] FDIC-SEC, *Covered Broker Dealer Provisions under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 12 CFR part 380 RIN 3064-AE39, 17 CFR part 302.

continuing operations in a way that actually avoids other material entities entering resolution regimes (n3). The insolvency of multiple parts of the group (ideally simultaneously) with a possible break up into separate sub groups under the responsibility of two or more resolution authorities is not mentioned. Option n 1 is extremely disruptive for any business so it is not a viable alternative.

The final reason relates to the requests made by the Agencies to amend group structure. The practical outcome of these was to have a group whose organisational and legal structure match perfectly the FSB indications of the preconditions that needs to be in place for an SPOE to work[172].

The question now arises as to why the SPOE may be the Agencies preferred resolution strategy. There are three, for obvious reasons merely speculative, possible answers to this question. One relates to the long-standing coordination problems among supervisory authorities. An MPE requires authorities' ability to take coordinated actions towards the achievement of a common goal (orderly resolution). However, national sovereignty and financial stability, fiscal implications and burden sharing, different legal regimes which grant different degrees of protection to creditors and shareholders, are all possible obstacles mostly unaccounted for in the plans. In this sense, taking exclusive national control on the insolvency of a G-SIB may be a safe harbour.

The second answer relates to the inability of the US legal regime to deal with multiple competing insolvencies even at national level. Given the described deficiencies of CH 11, it is probably more efficient to deal with the insolvency of the parent institution only -which is merely a pure holding company -than having to coordinate among different state and federal authorities with different legal regimes. It is not a case then that, should the insolvency be particularly severe, US authorities can use the powers and tools included in Title II of the Dodd-Frank Act instead of CH 11.

Title II brings us the final reason as to why Agencies may prefer an SPOE. The latter is the resolution strategy that will be adopted by the FDIC under Title II. In this respect, the SPOE drafted by banks would still work as a useful point of reference for the FDIC, *mutatis mutandis*.

Even though US Agencies may prefer the use of CH 11 to deal with the insolvency of a G-SIB, a cursory analysis of the Chapter exposes other legal problems which may affect the smooth running of the procedure. For instance, any interested party may request the appointment of a case trustee or examiner at any point prior to confirmation of the CH 11 plan, if there are reasonable grounds to believe that those in control of the debtor in possession participated in gross mismanagement, fraud, dishonest or criminal conduct in the management of the debtor or of the debtor's financial reporting [173]. The case trustee/examiner will be now responsible for managing the debtor's assets and even for the filing of the reorganisation plan which in turn may delay its approval.

Clarification is also needed on the applicability of the «363 sales» procedure, namely the one that regulates the use, sale or lease of the property of the estate outside of ordinary business[174]. «363

[172] For a detailed list please see FSB, *Recovery and resolution planning,* (fn 135), *Annex two;* and FSB, *Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies,* July 2013, from p 14, available here www.fsb.org/wp-content/uploads/r_130716b.pdf?page_moved=1
[173] See 11 U.S.C par 1104 (a)-(e).
[174] At 11 U.S.C par 363 (b).

sales» have bene used in the Lehman bankruptcy[175] and plans make often reference to them, yet it is argued that “it may be the company’s primary regulator that has arranged for a sale of the company (or its assets) to a third party. There is no provision in the Bankruptcy Code, however, for a government entity or a primary regulator of a financial company to file a motion for an order approving a 363 sale.”[176] For the interpreter the reference to those sales clarifies the timing of the relevant transfers. MLEs will be recapitalised before the holding files for bankruptcy and then, once filed, the transfer of parents’ assets to the IHC will take place under sec. 363 with the approval of the court. What remains unclear however, is the mechanism that will be used to upstream losses to the parent holding. Whereas in Europe resolution authorities will use the bail –in tool, in the US the application of this mechanism seems to be more nuanced as it is only acknowledged for resolution under Title II of the Dodd-Frank Act.

Problems may arise with a possible use of a bridging institution. As it has bene noted[177], CH 11 does not allow for the creation of a bridge bank, which means that any vehicle needed for the transfer of assets should be in place already at the time of bankruptcy, which may be the reason why Agencies have asked G-SIBs to create a clean holding company. However, during the actual bankruptcy proceedings other bridging vehicles may need to be created to support 363 sales.

Finally, at least from the public section, there still seems to be an oversimplification of the sheer complexity and size of systemically important institutions. As noted already above, there are only relatively few MLEs in the group, which strikes as odd compared to the consolidated size and total number of subsidiaries, branches, SPV, other vehicles, and ownership interests which all form part of the group. In resolution, group’s actual size and interconnections may emerge more prominently. What is not being highlighted in the plans is also that actions would need to be taken by relevant regulatory authorities to facilitate the execution of the strategy in terms of rights, contingent claims and obligations of involved parties, included creditors and shareholders rights. This analysis may however form part of the confidential part.

Conclusions

Banking resolution is at the forefront of regulatory agendas on both sides of the Atlantic. In the US, it seems possible to address the progress made because of a higher degree of transparency at both private and public level. Resolution authorities and banks in the EU should also adopt such degree of transparency because it improves the accountability of both and reduces agency costs while at the same time makes no harm to banking activities.

Notwithstanding the existence of weaknesses and imperfections, in terms of organisational and legal improvements US G-SIBs are today better suited to withstand insolvency. This is thanks to the requirement to draw up a resolution plan and to address the deficiencies identified by the Agencies.

The resolution strategy opted for by the almost entirety of US G-SIBs is an SPOE. However, the latter may decrease the chances of an orderly wind-down. This is because the SPOE may not be feasible

[175] See FED, Study on Resolution, (ft 71) at p. 14
[176] FED, Study on resolution, (ft 71), at p 14
[177] *Ibidem*, p 7

due to coordination problems with third countries authorities and to legal impediments attributable to the inability of CH 11 to deal with the insolvency of large and complex financial institutions. The actual availability of prepositioned financial resources at material entities level may be at stake too.

Finally, despite the existence of common standards at international level, EU and US authorities seem to differ in terms of approach to failure, with the former opting for resolution tools and the latter for bankruptcy proceedings.

There is also the risk that recognition of foreign G-SIBs SPOE resolution strategy may not be possible. For the requirement, existing in the US and proposed in the EU, to set up an IHC may affect the smooth execution of an SPOE strategy. This would in turn regionalise procedures, transforming an SPOE in an MPE in fact.

The existence of two different types of plans covering the same foreign companies adds a further layer of complexity and uncertainty in a cross border insolvency. EU authorities may probably feel more comfortable with Title II proceedings.

A final difference which may skew the incentives to implement a US G-SIB resolution strategy in Europe is the possibility that EU authorities have to resort to state aid , within certain limitations, as well as to precautionary recapitalisation measures (art 32 (4) BRRD) in case of a serious disturbance in the economy and a threat to financial stability. Those measures can be applied to EU MLEs of a failing US G-SIB, therefore changing resolution dynamics from what initially planned.