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Resolving systemically important financial institutions

Speakers

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Introduction

Good afternoon and thank you for the opportunity to take part today in the Eurofi High Level Seminar. I would like to acknowledge the extraordinary contributions made by Jacques de Larosière to advance the international financial regulatory dialogue, including under his Eurofi Chairmanship. I would also like to offer my congratulations to David Wright as he assumes this important responsibility. I have had the pleasure of working with David, who served as a member of the FDIC's Systemic Resolution Advisory Committee.

Today, I would like to talk with you about the significant progress that has been made to foster cross-border cooperation among the major jurisdictions of the world on the resolution of systemically important financial institutions, as well as the work of the FDIC on this critically important issue.

The Resolution of Systemically Important Financial Institutions

Let me begin by providing some background on the FDIC's efforts in regard to systemic resolution. This work has been at the forefront of our priorities during the post-crisis period.

When the financial crisis hit in 2008, major jurisdictions around the world were unprepared to deal with the failure of a global, systemically important financial institution, or G-SIFI.

The crisis demonstrated that large, complex financial institutions can experience severe distress. Lacking the necessary authorities to manage the orderly failure of such an institution, policymakers were forced to choose between two bad options: taxpayer bailouts or financial collapse.

In the United States, passage of the Dodd-Frank Act provided essential new authorities to manage the orderly failure of a systemically important financial institution.

Living Wills

The act requires the largest bank holding companies and designated systemic nonbank financial companies to prepare resolution plans, also referred to as "living wills." These living wills must demonstrate that the firm could be resolved under bankruptcy without severe adverse consequences for the financial system or the U.S. economy.

The FDIC and the Board of Governors of the Federal Reserve System are charged with reviewing and assessing each firm's plan. If a plan does not demonstrate the firm's resolvability, the FDIC and the Federal Reserve may jointly determine that it is not credible or would not facilitate an orderly resolution of the company under the Bankruptcy Code and issue a notice of deficiencies. If a firm fails to remediate the deficiencies identified in the joint notice, the agencies may jointly impose additional capital, leverage, or liquidity requirements. The agencies may also restrict the firm's growth, activities, or operations.

If, after two years from the imposition of these prudential requirements, the firm still fails to submit an acceptable plan, the agencies may order a firm to divest certain assets or operations to facilitate an orderly resolution.

Last week, the FDIC and Federal Reserve Board jointly announced determinations and provided firm-specific feedback on the 2015 resolution plans of eight systemically important, U.S. financial institutions.

The agencies jointly determined that the 2015 resolution plans of five firms were not credible or would not facilitate an orderly resolution. The agencies issued joint notices of deficiencies to these five firms detailing the actions the firms must take to address them. Each firm must remediate its deficiencies by October 1, 2016. If a firm has not done so, it may be subject to more stringent prudential requirements.

The agencies jointly identified shortcomings in the 2015 resolution plans of the three other firms, which the firms must address. All eight firms must submit their next full plans by July 1, 2017.

Orderly Liquidation Authority

Given the challenges and the uncertainty surrounding any particular failure scenario, the Dodd-Frank Act also provides the Orderly Liquidation Authority, which is a public-sector special resolution regime for institutions whose failure or distress would pose risks to U.S. financial stability. This is a public backstop to our bankruptcy process.

The Orderly Liquidation Authority is intended to enable the FDIC to carry out the process of winding down and liquidating the firm, while ensuring that shareholders, creditors, and culpable management are held accountable and that taxpayers do not bear losses.

The Orderly Liquidation Authority provides the FDIC several authorities—not all of which are available under bankruptcy. They include the authority to establish a bridge financial company, to stay the termination of certain financial contracts, to provide temporary liquidity that may not otherwise be available, to convert debt to equity, and to coordinate with domestic and foreign authorities in advance of a resolution to better address any cross-border impediments. In the years since enactment of Dodd-Frank, the FDIC has made significant progress in developing the operational capabilities to carry out a resolution if needed.

In my view, we are at a point today that if a systemically important financial institution in the United States were to experience severe distress, it would be resolved in an orderly way under either bankruptcy or the public Orderly Liquidation Authority.

Cross-Border Cooperation

As in the United States, the other leading jurisdictions of the world have enacted expanded authorities for the resolution of systemically important financial institutions.

Given the global operations of these institutions, developing effective cross-border relationships among the major jurisdictions has been crucial.

The FDIC has worked closely with all the leading financial jurisdictions – the United Kingdom, the European Union’s Banking Union, Switzerland, and Japan – on cross-border resolution.

Of the 30 G-SIFIs identified by the Financial Stability Board, four are headquartered in the United Kingdom, eight are headquartered in Banking Union member states, and eight are headquartered in the United States. Moreover, a substantial majority of foreign assets held by the U.S. G-SIFIs are located in the United Kingdom and in the Banking Union.

To advance the close working relationships between U.S. and U.K. financial authorities, the FDIC hosted in October 2014 a meeting of the heads of the finance ministries, central banks, and leading financial regulatory bodies of the two countries. This event's high-level discussion furthered understanding among the principals regarding the key challenges to the successful resolution of U.S. and U.K. G-SIFIs, and how the two jurisdictions would cooperate in the event of a cross-border resolution. The event built upon prior bilateral work between authorities in our two countries, which, since late 2012, has included the publication of a joint paper on G-SIFI resolution and participation in detailed simulation exercises between our respective staffs.

At the same time, the FDIC is working closely with the EU's Single Resolution Board (SRB), which oversees the Banking Union’s Single Resolution Mechanism. This close working relationship—including active participation at the principal and senior staff levels —began from the SRB’s inception. Our efforts are focused on cooperation and resolution planning for G-SIFIs with assets and operations in the United States and the Banking Union. I will be participating in the SRB’s first annual conference next week in Brussels. And, just last week, the SRB’s Chair, Elke König, addressed a meeting in Washington, D.C., of the FDIC’s Systemic Resolution Advisory Committee.

In addition, the FDIC and the European Commission have for several years maintained a joint working group—with senior executives from the European Commission responsible for financial regulation and senior executives from the FDIC—that meets regularly to focus on both resolution and deposit insurance issues.

The FDIC also is engaged in regular bilateral meetings with foreign authorities and recently concluded staff-level exercises with Swiss and German authorities. The FDIC has held yearly bilateral meetings with our Japanese counterparts, including an in-person facilitated discussion, regarding multiple aspects of resolution strategies under our respective resolution regimes.

I would also note that cross-border crisis management groups of supervisors and resolution authorities have been formed for each of the G-SIFIs. The FDIC co-chairs all of the groups for the U.S. G-SIFIs and participates in 14 groups for foreign G-SIFIs.

Two further important examples of progress on cross-border resolution are the ISDA protocol providing for stays on derivative contracts in the event of a SIFI resolution, and the FSB agreement on Total Loss Absorbing Capacity.

I believe that these examples demonstrate a transformed environment for cross-border cooperation on systemic resolution from that which existed before the financial crisis. This work will remain a leading priority for the FDIC.

Deposit Insurance

Finally, I would like to make three brief points about the FDIC’s role as an insurer of deposits held in the U.S. banking system.

First, the FDIC, as a deposit insurer, has long been a foundation of public confidence and financial stability of the U.S. banking system.

Second, the FDIC also is responsible for the resolution of failed banks and has found great synergy between its deposit insurance function and its resolution function. The FDIC’s combined responsibilities for deposit insurance and resolution have strengthened the FDIC’s ability to carry out both of those tasks.

Third, the FDIC’s additional responsibility as a bank supervisor has underscored the benefits of close cooperation in the performance of all these functions, including deposit insurance and resolution.

I understand that the European Union is now engaged in an important discussion of the European Commission’s proposal for a European deposit insurance scheme for the Banking Union. From the U.S. perspective, we have derived great value from having a national deposit insurance system covering all of our 50 states and from the close relationship in our system among supervision, deposit insurance, and resolution. The FDIC also has derived great operational value from having combined deposit insurance and resolution authority. Viewed from the FDIC’s experience, I would suggest that there is logic to combining the functions of resolution authority and deposit insurer and thought that this experience may be relevant to your considerations.

Conclusion

In conclusion, I would like to thank you for the opportunity to participate in this important program. We place enormous value on our working relationships with our European counterparts and look forward to deepening those relationships in the years ahead.