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Regulatory brief

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2014 Resolution Plans: The guidance you won't receive

Overview

Despite the absence of formal regulatory feedback on 2013 resolution plans, the nation's largest financial institution (so-called "Category 1" firms) should not be complacent. Rather, the 11 Category 1 firms should continue to improve both their resolution plans and their resolvability, in particular through aggressively executing and reporting on planned improvements and other ex-ante actions.

Category 1[1] filers submitted their second resolution plans to the Federal Reserve and FDIC on October 1, 2013. Using the guidance provided last spring ("April 2013 Guidance")[2], we believe most firms made significant enhancements to their resolution plans, and continue to develop and implement efforts to improve the resolvability of their firms.

In the April 2013 Guidance, the agencies identified five categories of obstacles to resolution. Firms were required to address each in their plans, including the actions taken or planned to mitigate each obstacle, with detailed plans and timelines for any ex-ante actions. The categories of obstacles are:

- Multiple competing insolvencies
- Global cooperation (or the lack thereof)
- Operations and interconnectedness, and the risk of discontinuity of critical services
- Counterparty actions, especially related to derivative close-outs
- Funding and liquidity

Less than 90 days remain before the July 1, 2014 deadline for Category 1 firms' third submissions. While it is difficult to advocate wholesale plan changes in the continued absence of meaningful firm-specific feedback, our strong advice is to not be complacent, and to continue to make progress on enhancing your plans.

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[1] Category 1 firms generally have $250 billion or more in US nonbank assets and filed their initial resolution plans in 2012.

[2] See PwC's *Regulatory Brief, Resolution planning: New guidance, more time, no specificity* (April 2013).

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This **Regulatory Brief** provides five suggestions for those firms deciding whether – and how – to further revise their resolution plans.

Five considerations for improving resolution plans

One would hope the regulators could agree on appropriate next steps for Category 1 firms in the coming weeks and communicate them before the July 1st deadline. However, we are not optimistic that the two agencies can reach consensus on the 2013 plan assessments and on direction for 2014 plan submissions in time.

Nevertheless, firms should continue to make progress. By doing so, they will not only be in a better position to satisfy regulatory expectations of their resolution plans, but can better impact the direction that the resolution planning process will take.

1. Don't assume silence means everything is OK and nothing needs to be done

The Federal Reserve and FDIC have been reviewing the 2014 plans for the last six months. The FDIC has been very vocal that this submission "counts" and that the plans will be assessed for resolvability. What that specifically means – whether there will be formal findings and what next steps will be required – is with little doubt the subject of significant discussion between the two agencies.

Don't wait for those issues to be resolved to refresh the plans. As of now, the submission date remains July 1, 2014. There is no need to wait on feedback before refreshing the plans with (a) 2013 financial and operational data, (b) any material structural, organizational, or business practice changes, or (c) newly identified Material Entities.

2. Develop progress reports on all ex-ante actions identified in the plans

Demonstrating meaningful progress on efforts to enhance resolvability will be critical to the regulators. Ensuring ex-ante projects are on track, identified milestones were achieved, completion dates remain firm, and that these efforts effectively mitigate identified resolution impediments will be key areas of focus in the next plan submission. If there was any question around the seriousness of regulators on firms making sufficient improvements and in a timely manner, the recent Comprehensive Capital Analysis and Review ("CCAR") announcements and capital plan rejections should leave no doubt.[3]

The Federal Reserve has clearly made resolution data and capabilities, including collateral management, liquidity and funding, immediately accessible MIS, and continuity of shared and outsourced services, part of business as usual standards.[4] We think firms should view this as a starting point, as the FDIC's and Federal Reserve's reviewers will probably be even more demanding of resolution preparedness capabilities (and the verification and validation of such).

Operationalizing the resolution plan to ensure continuity of critical operations will require that firms treat resolution planning as more than just an internal exercise. In addition to ex-ante actions to improve continuity of services (such as strengthening internal service level agreements and ensuring resilience of service centers), engagement will also be required with outside parties such as vendors, financial market utilities ("FMUs"), and key correspondent relationships.

3. Consider key assumptions made in the plan

Regulators may continue to challenge (and require further analysis on) some assumptions made in the plan, including: assumed customer, counterparty or FMU behavior in a stressed environment; regulator decisions; degree of ring-fencing or other host authority actions; market capacity; and untested capabilities.

Ultimately the burden may be on the firms to prove the reasonableness of assumptions. Even if assumptions are reasonable (or reasonable parties could disagree), the regulators may require further analysis on what would happen if the assumption turned out not to be correct, or to consider specific alternatives to the assumption.

One overarching assumption in the plans is the choice of idiosyncratic stress event. The regulators have not been overly prescriptive as to what this event should look like. In order to better assess resolvability, regulators may wish to see different such stress events in future submissions, such as more severe capital losses or liquidity failure. Firms should consider the impact of alternative scenarios.

4. Don't forget the CIDI plan

While the greatest focus to date has been on the 165(d) resolution plans for holding companies, firms should be working toward a fully operational resolution plan for their covered insured depository institution ("CIDI") where applicable. The FDIC's rule requires a plan where the CIDI fails, regardless of whether the CIDI fails in the 165(d) plan (for example in a single point of entry strategy). As the only resolution authority for CIDI's, the

[3] See PwC's *First Take: CCAR stress testing* (March 2014).

[4] See the Federal Reserve's *Supervision and Regulation Letter 14-1* (January 2014).

FDIC ultimately needs its own resolution playbook for each large CIDI, so the CIDI resolution plans are a major tool for the FDIC's preparedness.

Additionally, firms may want to re-examine their analysis on the "Least Cost Test." Many firms have struggled to understand the FDIC's "black box" Least Cost Test, and felt they were only in a position to address it at a high level, or based on particular assumptions. We expect the FDIC to want further analysis of firms' approaches to the Least Cost Test, hopefully in exchange for further transparency and a framework for firms to do their analysis. In the meantime, firms may want to consider expanding their discussions around why their CIDI resolution strategy would be less costly than other, rejected strategies, and why the various discretionary actions assumed to be taken by the FDIC in the resolution plan (such as transfers of uninsured deposits or other liabilities to a bridge) create value for both stakeholders and the Deposit Insurance Fund.

5. *Foreign Banking Organizations (FBOs)*

The 165(d) rule requires resolution plans to be based on the current state of legal and policy frameworks. Now that the intermediate holding company ("IHC") rule is final[5] (but with implementation taking place over the next few years), we would not be surprised if FBOs have double duty. FBOs' plans are based on their current legal, capital and operational structures, but likely will need to include significant discussion on how the implementation of an IHC will affect their plans.

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[5] See PwC's *First Take: Enhanced prudential standards* (February 2014).

Conclusion

Category 1 filers are not the only firms facing a deadline, as Category 2[6] filers also have their annual plan submissions due on July 1, 2014. However, Category 2 firms at least have received some feedback on their initial plans, and can look to the April 2013 Guidance to inform them of what areas, issues and additional information are most important to the regulators. The lack of formal plan assessment feedback was also not surprising for the Category 2 firms, since, as with the Category 1 firms initial submissions, there was not an expectation that formal determinations of credibility would be made. We recommend, however, that Category 2 firms assume that their second submissions will be formally reviewed for credibility and resolvability.

With respect to both Category 1 and Category 2 firms, in order for the resolution planning process to be an effective tool in solving Too Big to Fail, the regulators need to provide them with actionable feedback and guidance for next steps. The agencies have taken a very public approach to resolution planning over the past year, starting with issuing the April 2013 Guidance in a public manner, and through speeches and congressional testimony saying that the 2013 submissions would get reviewed for resolvability. While conveying transparency, it also has set expectations that there would be visible, tangible results. The apparent lack of current regulator consensus may come at a substantial cost if 2014 submissions are filed with relatively marginal improvements, and the much needed feedback is delayed as the regulators review another iteration of the plans.

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[6] Category 2 firms generally have between $100 billion and $250 billion in US nonbank assets, and filed their initial resolution plans on July 1, 2013.

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Additional information

For additional information about this Regulatory Brief or PwC's Financial Services Regulatory Practice, please contact:

Dan Ryan
Financial Services Regulatory Practice Chairman
646 471 8488
daniel.ryan@us.pwc.com

David Sapin
Financial Services Regulatory Practice Leader
646 471 8481
david.sapin@us.pwc.com

Armen Meyer
Director of Regulatory Strategy
646 531 4519
armen.meyer@us.pwc.com

Contributors: John Simonson, Sally Neal, and Sharon Haas.

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