Keynote Remarks

by

Jelena McWilliams
Chairman, Federal Deposit Insurance Corporation,

to

2018 Annual Conference of The Clearing House (TCH) and Bank Policy Institute (BPI)

November 28, 2018

Introduction

Good afternoon. I am pleased to join you for today's conference.

The FDIC has a long and proud history as a resolution authority for banks and insured depository institutions. During its 85 years, the FDIC has resolved more than 2,700 institutions with assets of more than $1 trillion and almost $800 billion in deposits. It has developed and adapted its strategy over time – repeatedly updating its procedures as needed to address each bank failure and each crisis, since 1933.

The FDIC has continued to refine its resolution tools as it confronted two banking crises in the past four decades, first in the 1980s and early 1990s, when the agency resolved more than 1,600 institutions, and then recently, from 2008 to 2013, when the FDIC resolved almost 500 failed banks and thrifts.

These crises resulted in the FDIC adding new tools, ranging from bridge banks to loss-sharing arrangements, while also adapting to new requirements, such as the mandate that we resolve banks at the least cost to the Deposit Insurance Fund. And across all these years and thousands of resolutions, no depositor has ever lost a penny of insured deposits.

Though the agency has a long, established record of successfully handling smaller bank failures, we recognize the differences and unique challenges associated with resolving larger institutions, particularly the most complex, globally active financial institutions.

The purpose of my speech today is to discuss our approach to large institution resolution planning, how we are working to strengthen and streamline this process, and the path forward.

The Goals of Resolution

When framing out an issue like this, it is important to be direct and specific about our goals. The fundamental goal of resolution should be the same for institutions large or small: enable failure in the least disruptive manner.

That may sound too negative – or too dark – but failure is critical. Markets work best when risk takers are held accountable: accountable for their gains and accountable for their losses.

If institutions can benefit from the upside of their gains, but put taxpayers on the hook for their losses, that results in market failure and moral hazard. In such circumstances, institutions – and their shareholders and counterparties – benefit not from their business decisions but from political decisions.

Resolution should work to break this cycle and make sure that market discipline is real.

Institutions that are big must be able to fail just like institutions that are small: without taxpayer bailouts and without undermining the market's ability to function.

This is no easy task because a large institution's failure can be so impactful on the market and innocent third-parties, but it remains *the* core challenge surrounding large institution failure and one the FDIC must address.

SIFI Resolution in the United States

The greatest untested resolution challenge comes from the largest, most complex institutions.

Because our fundamental goal for these institutions is that they are able to fail, our first priority needs to be taking the steps necessary to facilitate orderly resolution of these firms *in bankruptcy*.

In the United States, the largest bank holding companies are required by law to submit resolution plans outlining how they can fail, in an orderly way, under the Bankruptcy Code.

Progress

Through this process, U.S. global systemically important banking organizations – or GSIBs – have made strides and implemented significant structural and operational improvements that have enhanced their resolvability in bankruptcy.

They have developed a single-point-of-entry (SPOE) resolution strategy that, if successful, would enable the functioning of critical operations at the key subsidiaries while the parent enters what is akin to a prepackaged bankruptcy proceeding. These firms have established clean holding companies and issued long-term debt to the market so that market participants – and not taxpayers – bear the risk of loss; and they have identified mechanisms for measuring, maintaining, and making available timely liquidity to fund operations during this period. They have taken steps to modify their contracts with service providers and counterparties, and they have worked to simplify their structures and funding lines to facilitate their strategy.

There have been some indications that markets have reacted positively to these developments. Some studies suggest we have seen improved debt pricing at the largest banks. While we should be cautious in drawing conclusions based on such data, it is nonetheless encouraging.

Still, though progress has been made, SPOE in bankruptcy remains untested, and there is still work to do. The agencies have identified several key areas in need of further clarity – and firms should continue work developing, testing, and operationalizing their systems and capabilities to make sure their resolution strategies will work if and when they are needed.

Hopefully, long after my term as Chairman has ended.

Bankruptcy Legislation

While I re-emphasize *again* the expectation that any failure should be dealt with through bankruptcy, we should also acknowledge that the Bankruptcy Code was not written with large, complex financial institutions in mind. Over the past few years, a number of bills have been introduced in Congress that would establish a more tailored, transparent process for large financial firms. Such legislation has passed the House of Representatives in the past on a strong bipartisan basis. I strongly support such efforts. The FDIC stands ready to work with Congress and hopes to see such a measure signed into law.

OLA

Additionally, we are considering whether refinements could be made to improve the Orderly Liquidation Authority (OLA), including ways to bring more certainty and more transparency to the process. The Treasury Department has offered several good suggestions regarding OLA that we are looking at closely.

International/Cross-Border Considerations

Given the cross-border implications, we also need to be cognizant of our role – not only as a home authority for U.S. institutions – but as host authority as well. U.S. firms operate overseas, and foreign firms operate within the U.S., and regulators need to make sure we are not pulling firms in different directions or working at cross purposes. The good news is that we have strong working relationships with our foreign counterparts.

We host annual crisis management group meetings that bring together home and host authorities to discuss resolution planning progress for each U.S. GSIB – and we participate in similar meetings for foreign GSIBs operating in the United States.

We regularly coordinate with foreign jurisdictions through multilateral venues, and we have built a solid foundation for cooperation and planning with other resolution authorities around the world, including the Bank of England and the Single Resolution Board.

I think we have a very good foundation for building a better understanding and process, but here too, I think there is still important work to do.

165(d) Resolution Plans

While I have mostly focused so far on the GSIBs, the FDIC has also engaged in resolution planning for the regional banks. Section 165(d) of Dodd-Frank originally required all bank holding companies with $50 billion or more in total consolidated assets to complete resolution plans which, as I mentioned, must outline how a firm can be resolved through bankruptcy.

Resolution plans have been a valuable tool for improving resolvability through bankruptcy. The planning process has helped ensure that firms understand and simplify their legal structures, work through their internal governance processes, and address core obstacles to resolution in bankruptcy.

At the same time, the process has imposed meaningful cost and burden on the firms and, frankly, the agencies. Congress recognized this earlier this year when it raised the statutory threshold for the resolution planning requirement from $50 billion to $250 billion, while also giving the Federal Reserve Board the authority to apply the requirement to firms below the threshold under certain conditions.

In light of this Congressional mandate, and because it is good government to regularly revisit what is working and what is not working, the FDIC and the Federal Reserve have been reviewing the resolution planning regulations for bank holding companies. For the GSIBs, we recognize the progress that has been made, and we are exploring how to make these plans more targeted. For regional banks, we recognize the considerably lesser threat posed to U.S. financial stability. We expect to publish for public comment a proposal to amend the rule in the coming months, and we look forward to public engagement.

We are also working to improve transparency around the 165(d) resolution plan review process. For the past several years, the FDIC and the Federal Reserve have been publicly issuing various components of the resolution planning process, including the 165(d) feedback letters to GSIBs and the framework document that described the agencies' joint review process. We have also enhanced the public sections of the resolution plans. In June, the agencies published the proposed guidance for domestic GSIBs, which addresses the agencies' expectations regarding a number of key issues, including capital; liquidity; governance mechanisms; derivatives and trading activities; and payment, clearing, and settlement activities. We look forward to finalizing this guidance in the near-term.

IDI Plans

Separate from the resolution planning requirement under Dodd-Frank, the FDIC has a separate rule requiring resolution plans for insured depository institutions (IDIs), the so-called "IDI rule." The FDIC proposed this rule shortly before the passage of Dodd-Frank. The initial proposal would have applied to IDIs with at least $10 billion in assets that were owned or controlled by a holding company with more than $100 billion in assets. Following the passage of Dodd-Frank, the FDIC synced these thresholds with the new law so that the requirements generally applied to IDIs with at least $50 billion in assets.

There are a few noteworthy differences between the Dodd-Frank requirements and the IDI rule. First, Dodd-Frank focuses on the entire banking organization, including the holding company and nonbank affiliates, and envisions a resolution under the Bankruptcy Code. By contrast, the IDI rule focuses only on the IDI subsidiary, and envisions a resolution using our traditional resolution tools under the Federal Deposit Insurance Act.

More fundamentally, the Dodd-Frank requirement is focused on financial stability and mitigating systemic risk. The IDI plan, by contrast, is focused on the FDIC's ability to resolve a particular firm. This focus includes two critical priorities – first, that we must protect taxpayers and minimize potential losses to the Deposit Insurance Fund, which taxpayers stand behind, and second, that insured depositors have access to their cash in an orderly fashion and as quickly as possible.

To achieve these goals – protecting taxpayers and getting insured depositors their money – we have to plan ahead. The FDIC cannot rely on the availability of an able and willing buyer in the event of the failure of one of these institutions.

At the same time, I recognize the costs and burdens involved in developing these plans. I have seen some of them – they run thousands of pages. While we need to do advanced planning, after several years of renewing these comprehensive plans, we recognize that we can do so in a more targeted and efficient manner.

As a result, the FDIC is planning to propose significant changes to its IDI rule. We plan to issue an Advanced Notice of Proposed Rulemaking (ANPR) in the coming months to solicit feedback from the public. I encourage anyone with an interest in this topic to participate in the process. In advance of the ANPR, here are a few thoughts on what we ultimately plan to propose.

First, the $50 billion threshold currently used in the rule was selected to sync with the Dodd-Frank Act threshold. Now that the law has been changed, it is appropriate that we revisit that threshold. As a result, we will be soliciting comment on which institutions should be subject to the revised rule.

Second, for banks within the scope of the revised rule, we will explore how to ensure that requirements are appropriately tailored to reflect differences in size, complexity, risk, and other relevant factors.

Third, I recognize that some have argued that an IDI plan is unnecessary for firms that have adopted an SPOE strategy, because there should not be a resolution of the IDI under such circumstances. Though I am sympathetic to the argument, as I mentioned earlier, SPOE is untested, and the challenges to successful execution of an SPOE strategy are notable. Still, we will carefully consider all comments as we work on revising the rule.

Finally, for purposes of clarity, the next round of submissions under the IDI rule will not begin until this rulemaking process has been completed. In other words, no institution will need to file an IDI plan until we have finalized the revised requirements.

Lessons Learned

It has been more than a decade since the onset of the financial crisis. The FDIC has devoted considerable time and resources to studying the crisis – including its causes and its consequences. The FDIC even published a comprehensive volume on the topic.[1] I appreciate that there were regulatory gaps leading up to the crisis – perhaps none more important than the inadequate planning for the potential failure of the largest banks and their affiliates.

I also vividly recall desperate calls from consumers during the crisis while I was an attorney at the Federal Reserve Board. I never want to get those calls again.

Meanwhile, Dodd-Frank passed eight and a half years ago, and a number of the post-crisis regulatory changes have been in effect for several years. It is important that we closely examine how these new requirements are working. I disagree with those who believe we should not touch any regulatory requirements until the next crisis hits – we have to continuously monitor and understand the impact of our actions on financial institutions, consumers, and the broader economy.

Additionally, we are also informed by 85 years of experience examining and resolving banks, including through multiple business cycles, market fluctuations, and major changes in industry composition and economic conditions.

We intend to utilize all we have learned as we work towards the next phase of resolution planning.

[1] "Crisis and Response: An FDIC History, 2008–2013," available at https://www.fdic.gov/bank/historical/crisis/crisis-complete.pdf.

Conclusion

In conclusion, I do not like failure. I like success. And the FDIC under my leadership will continue to prioritize working to ensure the success and stability of our nation's banks and financial system. But there is no success without the real threat of failure. It must be okay for *any* bank to fail.

Resolution planning is not rooting for resolution; it is building a process to ensure that failure is possible so that market discipline exists, taxpayers are protected, and insured depositors have confidence they will receive their cash quickly and orderly under any circumstances. I look forward to working with all of you to help achieve these goals.

Some of you may recall a story I mentioned during my confirmation hearing. When the civil war broke out in Yugoslavia, the financial system collapsed, and my parents' life savings disappeared overnight when a local bank failed. My then 68-year-old father was forced to return to work as a day laborer. This is a reminder of why the orderly resolution of financial institutions is so important. No 68-year-old man should need to return to work as a day laborer because his bank failed.

Thank you.