Keynote Remarks by FDIC Chairman Jelena McWilliams at the 30th Special Seminar on International Finance; Tokyo, Japan

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Introduction

Good afternoon. Thank you for inviting me to join you here today.

For more than 85 years, the FDIC has served as the resolution authority in the United States. The agency has resolved more than 2,700 banks since it was established, including 489 resolutions during the recent financial crisis. And I am proud to report that no depositor has ever lost a penny of insured deposits.

In spite of our successful track record, resolution is never easy. Each bank failure – and each financial crisis – presents new challenges that force us to reassess our processes and improve our preparedness. Over the years, we have adapted our approach to resolution in light of new financial products and services, new congressional mandates, and other shifts and trends in the banking system.

Goal of Resolution Planning

In the midst of all these changes, the fundamental goal of resolution remains the same: to enable failure in the least disruptive manner. Markets work best when risk-takers are held accountable for both their gains and losses. When institutions benefit from the upside of their gains, but taxpayers bear the burden of their losses, the result is 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 to ensure that market discipline is real and imposed.

Large institutions must be able to fail like small institutions, without taxpayer bailouts and without undermining the market's ability to function.

Resolution Planning for the Largest, Most Complex Banking Institutions

After the global financial crisis, the greatest untested resolution challenge – one that we all face – involves managing the failure of one of the largest, most complex banking institutions. The FDIC has invested substantial time and effort to prepare and strengthen our capabilities for this type of event.

In the United States, the largest U.S. bank holding companies and certain foreign banking organizations submit resolution plans outlining how they can fail, in an orderly way, under the U.S. Bankruptcy Code. Through this process, institutions have implemented significant structural and operational improvements to enhance their resolvability. These changes include simplifying their legal structures, working through internal governance processes, and addressing other core obstacles.

After several cycles of reviewing these comprehensive plans and providing feedback, the FDIC and the Federal Reserve Board recently updated our approach to ensure that resolution planning continues in a targeted and efficient manner.

Consistent with statutory changes signed into law last year, the agencies adopted a final rule in mid-October that streamlines, clarifies, and improves the resolution plan processes and timelines. The final rule retains the underlying standards for reviewing resolution plans. It also ensures the largest firms provide rigorous resolution plans on a timely basis, gives the firms and the agencies sufficient time to prepare and review plans, and reduces the burden institutions face in developing plans.

The rule also introduces the concept of targeted plans, which require firms to focus on the most material topics identified by the agencies, including capital and liquidity, and any material changes to the firm since the last plan submission.

Going forward, certain institutions will be required to submit plans every two years, alternating between full plans and targeted plans. Other institutions will be required to submit alternating plans every three years. And between plan submissions, the agencies have the authority to require interim updates.

Resolution Readiness for Larger Firms

The FDIC has substantial experience resolving small banks. We have resolved thousands of them over the years. We have less experience resolving larger institutions, which can present a unique set of resolution challenges. These challenges arise, for example, from their funding structure, relative size, complexity of operations, and relationships with affiliates, counterparties, and the larger economy.

Unlike their smaller peers, the size and funding structure of such banks can affect the timing of a resolution and limit the availability of resolution options. Specifically, they may be less likely to be resolved through an acquisition by a larger institution and more likely to be resolved through the use of a bridge bank. In such a case, the FDIC is tasked with continuing the failed bank's operations to avoid disruptions to depositors and to maximize value to the receivership in the ultimate disposition of the bridge bank.

Such was the case when IndyMac Bank, F.S.B., a California thrift, failed in June 2008. IndyMac failed with assets of about $31 billion, roughly 30,000 depositors, and a large number of trust accounts. There were many accounts for which the insurance status could not be immediately determined, and our staff had to ask customers for more information. This created delays and uncertainty, which added to customer anxiety, and which contributed to lines of anxious depositors that formed at each of the bank's branches.

During the first two weeks after IndyMac's failure and the creation of the FDIC bridge bank, there was an unprecedented run on deposits that led to the withdrawal of almost $3 billion from the institution. The deposit run likely reduced the bridge bank's franchise value and signaled a much deeper lack of trust in the financial system.

The FDIC quickly launched a public education campaign on deposit insurance and the role of the FDIC. And, after a few weeks, the withdrawal rate at the bridge bank slowed and the deposit base stabilized.

Nevertheless, this failure cost the Deposit Insurance Fund $12.4 billion – the most expensive failure in FDIC history.

IndyMac taught us a number of important lessons, and the FDIC has taken several steps to address the unique challenges associated with large bank resolution.

For example, we implemented recordkeeping requirements with respect to large banks' derivatives, securities lending, and repurchase agreements contracts. This will enable the FDIC to make efficient and informed decisions as to whether to transfer some or all of such contracts.[1]

We also adopted a rule that requires insured depository institutions (IDIs) with two million or more deposit accounts to meet recordkeeping standards and maintain systems capabilities.[2] This will improve our ability to ensure timely access to insured deposits.

The FDIC also engages in a resolution planning process for IDIs. The so-called "IDI Rule" is intended to address how the FDIC, as receiver, could resolve an institution under the Federal Deposit Insurance Act. As with all resolutions, our goal would be to resolve the IDI in an orderly manner that enables prompt access to insured deposits, maximizes the return from the sale or disposition of the failed IDI's assets, minimizes losses realized by creditors, and deploys a strategy that is least costly to the Deposit Insurance Fund.

Through the experience of reviewing these IDI resolution plans, the FDIC has learned which aspects of the resolution planning process are most valuable, and has come to a better understanding of the costs and burdens involved in developing these plans. We are currently engaged in a rulemaking process to reevaluate ways to make the IDI resolution planning process more tailored, targeted, and efficient, while continuing to build on the FDIC's resolution readiness.

Updates to our Approach to Supervision and Resolution Readiness

While the FDIC has adapted its resolution processes in response to lessons learned in the past, we are also taking proactive measures to improve our preparedness with respect to large, complex financial institutions.

For example, we recently established a new Division of Complex Institution Supervision and Resolution that brings together specialized supervisory and resolution teams from across the FDIC.[3] The staff of this new division understands the complex institutions, their internal operations, unique risk profiles, and potential market impact over a continuum from business-as-usual to resolution. Aligning FDIC's skills and operations in this area will improve our ability to effectively supervise and, as required, resolve these institutions.

Central Counterparties (CCPs)

Although the FDIC's resolution responsibilities are predominantly bank-focused, the agency could be called upon to resolve non-bank entities, such as central counterparties, if their failure threatens U.S. financial stability. Central counterparties, or CCPs, play an important, stabilizing role in the financial system, but they also introduce risk in a number of areas.

CCPs generally do not hold pre-funded, gone-concern, loss-absorbing resources that can be used to recapitalize critical operations in the event of default losses. Instead, CCPs rely on margin, limited guarantee funds, and assessment waterfalls from clearing members to supply loss-absorbing funds.

Because CCPs are not banks, FDIC's resolution planning tools are much more limited. The Commodity Futures Trading Commission and the Securities and Exchange Commission require CCPs to prepare recovery and wind-down plans, but central counterparties do not file resolution plans with the FDIC. Therefore, there is no formal review process through which the FDIC can identify deficiencies and have them remedied.

Central counterparties have a history of stability. But, given their role in the financial system, it is critical that CCPs are able to function with confidence during periods of financial stress and, if necessary, to fail in an orderly fashion.

The FDIC continues to work to better understand the risks presented and faced by central counterparties and to identify resolution options. Because many CCPs conduct significant international business, we also coordinate with authorities in other jurisdictions and through international groups. This work, though at an early stage, has been meaningful.

Cyber Threats

Another systemic challenge we face is cyber risk. This risk is continually evolving and ever increasing. It can produce consequences that spread by the minute or the second, rather than by the hour or the day.

A bank failure driven by a cyber-incident would be unprecedented and would present a number of unique resolution challenges.

- First, a disruption caused by a cyber-incident would likely be very abrupt. This would compress the ordinary recovery and resolution planning timelines.

- Second, there would likely be a degree of uncertainty about the severity of the attack and its scope, as well as about the prospects and timing for restoration of systems or data.
- Finally, a cyber-attack could compromise the reliability and accessibility of information that we ordinarily rely on to conduct a resolution.

To help banks strengthen their operational resiliency in the event of a cyber-attack, the FDIC has developed a number of resources. Our Cyber Challenge Tool, for example, offers a set of scenarios and questions to help banks understand and anticipate the potential impact of a cyberattack on banking functions.

In addition, the FDIC and the other U.S. federal banking regulators have published a Cybersecurity Assessment Tool that financial institutions can use on a voluntary basis to assess their cybersecurity preparedness.

These are just two of a number of tools that financial institutions can use to improve their cybersecurity preparedness.

International Coordination

The global interconnectedness of the financial system – and the risks and challenges we face – demands that we build strong relationships with our international counterparts. We must present a united front to ensure that, should a systemically important institution or entity fail, we are not working at cross-purposes.

For many years, the FDIC has worked closely with colleagues around the world – including the Bank of Japan, the Financial Services Agency, the Deposit Insurance Corporation of Japan, and many others who are represented here today – on a range of issues, perhaps the most significant being resolution planning for internationally active banks.

We host annual crisis-management group meetings that bring together home and host authorities to discuss resolution planning for large, internationally active U.S. banks, and we participate in similar meetings for large foreign banks operating in the United States.

We have developed information-sharing arrangements and have engaged in a number of international operational exercises to test and improve our readiness. We also regularly coordinate with foreign jurisdictions through multilateral venues, and we have built a solid foundation for cooperation and planning with resolution authorities around the world.

Much of the current bilateral and multilateral work focuses on cross-border planning for operational readiness, such as the positioning of cross-border resources, approaches to the wind-down of cross-border derivatives portfolios, and facilitating continued access to financial market infrastructures. This reflects a progression from policymaking to implementation as work on resolution planning matures.

I expect this approach will gain momentum as we continue to build the cooperative relationships that underpin our operational readiness.

Conclusion

It has been more than a decade since the onset of the financial crisis. We have used this time to study the crisis in depth, including the lack of adequate planning for the failure of large banks and their affiliates.

While it is essential that we learn from prior crises, it is crucial that our regulatory framework is sufficiently flexible to address a future crisis. A number of post-crisis regulatory changes have been in effect for several years now and we must examine how these new requirements are working. We must consider modifications that can improve our agility and preparedness and help us identify and address new challenges.

I have seen first-hand what happens when financial systems are unable to withstand shocks and crisis. I was coming of age as civil war broke out in Yugoslavia, the financial system collapsed, and my elderly parents' life savings disappeared overnight.

This formative experience is a constant reminder of why our ongoing preparedness work is so important. It does not mean that we are rooting for a crisis. It means that we have done the hard work to prepare in advance so that our response is orderly, maintains market discipline, protects taxpayers by holding risk-takers accountable for their losses, and preserves the confidence that our insured depositors have in the FDIC, regardless of the circumstances.

Under my leadership, the FDIC will continue to work to support the stability of our financial system. And I look forward to continuing our work with you to achieve this shared goal.

Thank you.

[1] *See* 12 C.F.R. Part 371.

[2] *See* 12 C.F.R. Part 370.

[3] For the FDIC, large complex financial institutions (LCFIs) include banks above $100 billion, their holding companies, and nonbank financial companies whose failure could threaten U.S. financial stability.