

# **FDIC Chairman Jelena McWilliams remarks to the Institute of International Finance (IIF)-Bank Policy Institute (BPI) Cross Border Resolution & Regulation Colloquium, London, England July 1, 2019**

## **Introduction**

Good afternoon. I am pleased to join you today. Since this event brings together many resolution experts from around the world, I will focus on resolution planning for large institutions in a cross-border context, and specifically, where we are and the important work that still lies ahead.

## **Goals of Resolution Planning**

The fundamental goal of resolution should be the same for institutions large or small: to enable failure in the least-disruptive manner. That may sound too negative, but enabling orderly failure is critical. 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 make sure 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. This is no easy task because a large institution's failure can have a tremendous impact on the market and third parties.

This is the core challenge surrounding failure – a challenge that the FDIC and resolution authorities around the world must continue working to address.

## **Resolution Planning in the United States**

After the global financial crisis, it was clear that the greatest untested resolution challenge involved managing a failure of the largest, most complex banking institutions.

When we think of resolution, our goal for these institutions is that they are able to fail; therefore, our first priority is preparing to facilitate orderly resolution of these firms in bankruptcy. In the United States, the largest U.S. bank holding companies and certain foreign banking organizations (FBOs) are required by law to submit resolution plans outlining how they can fail, in an orderly way, under the U.S. Bankruptcy Code. These Title I plans, known as “living wills,” describe each firm’s strategy for rapid and orderly resolution in the event of material financial distress or failure of the company, and include both public and confidential sections.

### **Progress of G-SIB Resolution Planning in the United States**

Through the resolution planning process, U.S. G-SIBs 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 a bankruptcy proceeding. As part of this process, they have made a number of structural and operational changes to address key obstacles and impediments.

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

Similarly, certain FBOs also submit resolution plans. The FDIC and the Federal Reserve review the plans and engage with the FBOs on their

resolution planning requirements and progress. As host authorities, we recognize the importance of continued home-host cooperation and we are mindful of the preferred outcome for these FBOs in a resolution scenario: a successful home country resolution that prevents risks to financial stability in the United States.

Though progress has been made, SPOE remains untested, the challenges to successful execution of an SPOE strategy are notable, and there is still work to do. The FDIC and the Federal Reserve 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 that their resolution strategies will actually work if, and when, they are needed.

### **Updating Our Resolution Planning Approach**

Resolution plans have been a valuable tool for improving resolvability. The planning process has helped to ensure that firms understand and simplify their legal structures, work through their internal governance processes, and address core obstacles to orderly resolution. We recognize these changes, and are making changes over on our side as well. While we need to do such advanced planning, after several cycles of reviewing these comprehensive plans and providing feedback, we recognize that we can do so in a more-targeted and efficient manner.

Accordingly, the FDIC and the Federal Reserve have been reviewing our resolution planning regulations. We have taken steps to address specifically who should file resolution plans, what should be included in the plan, and how often the plans should be filed.

In terms of who should file resolution plans, we recognize that the resolution planning process can impose meaningful costs on the firms and, frankly, the Agencies. The U.S. Congress recognized this when it raised the statutory threshold for the Title I resolution planning requirement from \$50 billion to \$250 billion, while also giving the Federal Reserve the authority to apply the requirement to firms below the threshold under certain conditions. To implement this requirement, the FDIC and the Federal Reserve solicited public comment in a proposed rule in April. The rule proposes a framework

for imposing and tailoring the content of Title I resolution planning requirements based on specified categories and taking into account firms' particular geographical footprints, operations, and activities.

In terms of what should be included, by whom and when, the Agencies took a deliberate, targeted approach. For the U.S. G-SIBs, in 2018 the Agencies solicited public comment on proposed resolution planning guidance and finalized that guidance in December 2018. The guidance 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. In addition, the Agencies have proposed allowing firms to submit "targeted plans," which would focus on the most meaningful components, rather than "full" plans, every other submission.

The proposal would require U.S. G-SIBs to submit resolution plans on a two-year cycle, alternating between full plans and targeted plans, while certain other filers are proposed to file on a three-year cycle. Our Agencies are now reviewing about a dozen comment letters on this proposal as we work towards finalizing the rule.

### **Resolution Planning for Insured Depository Institutions**

Separate from the resolution planning requirements under Title I, the FDIC also engages in resolution planning for insured depository institutions (IDIs). Many of the institutions that fall between the previous \$50 billion and current \$250 billion statutory asset thresholds are IDI-centric, making holding company resolution planning less critical and IDI resolution planning more important for them.

To support this responsibility, the FDIC has a resolution plan rule for IDIs, the so-called "IDI Rule," which traditionally has applied to IDIs with at least \$50 billion in assets.

Through plan review experience, the FDIC has learned which aspects of the resolution planning process are most valuable and has gained an understanding of the resources that IDIs expend in meeting the requirements of the IDI Rule. The FDIC recognizes the costs and burdens involved in developing these plans, which are critical to the FDIC's resolution readiness. We are exploring a more-targeted and efficient approach, including significant changes to the IDI Rule. In April, the FDIC proposed revisiting the current \$50 billion threshold for application of the rule and ensuring that requirements are appropriately tailored to reflect differences in size, complexity, risk, and other relevant factors. We also sought feedback on ways to streamline plan submissions for larger, more-complex firms, and on whether to replace formal plan submissions with periodic engagement and capabilities testing for smaller, less-complex firms that are subject to the rule. In the interim, the next round of IDI plan submissions will not be required until this rulemaking is finalized.

Going forward, our focus will continue to evolve in keeping with our progress and new challenges. For Title I, we expect our planning process will continue to shift more to reviewing core elements and material changes, assessing resolution capabilities and performing exercises to ensure that all of our capabilities work in practice. For IDIs, we are reviewing our approach to maximize the benefits and minimize the burden.

The resolvability of firms will change as both the firms and markets continue to evolve. The FDIC and the Federal Reserve expect all firms subject to resolution planning requirements to remain vigilant in assessing their resolvability.

### **Structural Changes Within the FDIC**

Today, July 1, is the day the 8 U.S. G-SIBs file their most recent Title I resolution plans, which as I noted earlier have led to a number of structural and operational changes. Apropos of that work, I wanted to let you know that we at the FDIC have been doing some "Legal Entity Rationalization" of our own.

As part of our ongoing effort to streamline the FDIC's structure and strengthen our work, just last week I announced the creation of a new division: the Division of Complex Institution Supervision and Resolution. I am also pleased to announce that our colleague, Rick Delfin, will be the first Director.

The new division will bring together the FDIC's supervisory and resolution teams to better implement the FDIC's responsibilities over large, complex banks and systemically important financial institutions. Aligning these related skills and operations within a single division will improve the FDIC's coordination, consistency, and accountability in supervising and resolving these institutions.

These institutions — banks above \$100 billion in assets and other systemic firms for which the FDIC is not the primary regulator — present unique supervisory and resolution challenges. In addition to the Corporation's role as a back-up supervisory authority and longstanding authority for the resolution of failed IDIs, the FDIC is also responsible for administering the resolution framework for systemically important financial institutions (SIFIs) as established by Titles I and II of the Dodd-Frank Act (DFA). This work includes participating in specialized supervisory processes, implementing the 165(d) resolution plan review process for large, complex financial institutions (LCFIs), as well as preparing for and executing a resolution pursuant to the backstop orderly liquidation authority for circumstances when a financial company's failure in bankruptcy could threaten U.S. financial stability.

The FDIC had split these responsibilities — and this specialized expertise — among three separate divisions and offices. Though the agency has made real progress under this model, bringing these teams and functions together will simplify our organizational structure, consolidate specialized skill sets, and foster the collaborative, interdisciplinary approach critical to continuing the FDIC's commitment to world-class supervision and resolution for institutions of any size. The organizational changes that we are making are also designed to improve our supervision and resolution preparedness by ensuring that information, resources and expertise are shared in advance and readily available in a crisis situation.

## Central Counterparties (CCPs)

Although the FDIC's resolution responsibilities are predominantly bank-focused, the FDIC also could be called upon to resolve other institutions if their failure could threaten U.S. financial stability. This could include non-banks such as central counterparties (CCPs) or other financial companies. Accordingly, one area of focus has been CCPs, which play an important, stabilizing role in the financial system by promoting standardization and reducing counterparty risk. Their roles are supported by economies of scale where increasing numbers and types of transactions are cleared. Though there are a number of positives, centralizing clearing also could concentrate risk in a small number of entities that now play a more critical role in the financial system.

Given CCPs' important role in the financial system, we work with domestic and international supervisors and resolution authorities to understand risks and to try to identify resolution options. Since many CCPs conduct significant international business, we also coordinate with authorities in other jurisdictions and through international groups. This work, though meaningful, is at an early stage.

CCPs are *not* banks, and our planning tools are much more limited. Although the CFTC and SEC require CCPs to prepare recovery and wind-down plans, CCPs do not file Title I resolution plans with the FDIC and therefore there is no equivalent process through which the FDIC can identify any deficiencies and have them remedied, as has been the case with G-SIBs. CCPs also generally do not hold pre-funded, gone-concern, loss-absorbing resources that can be used to recapitalize critical operations following extreme default losses. Instead, CCPs rely on margin, limited skin-in-the-game, guarantee funds, and assessment waterfalls from clearing members to supply loss-absorbing funds in tail events. In extreme conditions, some CCPs can also utilize gains-based haircutting of positions and partial tear-up of contracts.

While their rulebook arrangements are “comprehensive” under CPMI-IOSCO’s Principles for Financial Market Infrastructures (PFMIs), many of these tools for extreme events are also untested and do not negate the need for resolution planning. While CCPs have a history of stability, finding ways to enable CCPs to function with confidence during periods of financial stress, and if necessary, to fail in an orderly fashion, is critical given their role in the financial system. On the resolution side, there is still important work to do.

## **Cyber Threats**

In addition to other institutions, we also need to think about new and continually evolving threats, including cyber risk. We now live in a world of ever-increasing cybersecurity risks, which can produce consequences that spread by the minute or the second, rather than by the hour or the day. Addressing risks such as cybersecurity is something that can be done best when communication is open between the bank and regulators. It is also one of many challenges that require coordination amongst the regulators themselves.

The FDIC is actively monitoring cybersecurity risks in the banking industry. FDIC examiners conduct examinations to ensure that financial institutions are appropriately managing their exposure to cybersecurity risk. Our examiners verify that bank management has considered how cyber events could disrupt their operations and that the bank can continue operations in the event of a cyberattack. To support banks in this regard, we recently added two new scenarios to a tool available on our website named Cyber Challenge. Cyber Challenge is a set of ready-to-use scenarios and questions to assist banks as they discuss operational risk and the potential impact of information technology disruptions on banking functions.

In addition, the FDIC and the other U.S. federal banking regulators published a Cybersecurity Assessment Tool that financial institutions can use on a voluntary basis to help identify cyber risk and assess their level of cybersecurity preparedness. This cybersecurity assessment tool, or any of a number of other recognized frameworks, can provide a repeatable and measurable process that financial institutions can use to measure cybersecurity preparedness over time. Notwithstanding these efforts, the



risks posed by cyber threats remain persistent, and the fight against these threats will require continued joint efforts by the public and private sectors.

A resolution driven by a cyber incident likely would be distinct from the historical experience of the FDIC in resolving banks in a number of ways, and would present unique operational, market confidence, and other challenges that we are considering currently. Some of the challenges that we are assessing include:

- First, the potential abruptness of a disruption, and resulting compression of ordinary recovery and resolution planning timelines;
- Second, uncertainties regarding the severity of impact, and prospects and timing for restoration of systems or data after a cyber incident; and
- Third, the reliability and accessibility of information that we ordinarily rely on to conduct a resolution.

Further, even if the conditions for resolution are met, our resolution tool kit is well-suited for handling financial impairments, but might not be as useful when dealing with the underlying operational issues that a cyber incident might cause. Work in this area is critical and ongoing.

## **Lessons Learned**

It has been more than a decade since the onset of the financial crisis. I like to remind people both inside and outside of the FDIC that this is the “best of times.” We are experiencing the longest economic recovery on record and the future will not always be as bright. The FDIC has devoted considerable time and resources to studying the crisis – including its causes and consequences. 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.

At this point, a number of the post-crisis regulatory changes have been in effect for several years. 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. We must, therefore, closely examine how these new regulatory requirements are working and whether modifications are appropriate in order to ensure agility in both the institutions' preparedness and regulators' response.

## **Conclusion**

Orderly resolution is a goal that resonates personally and profoundly with me. When civil war broke out in Yugoslavia and the financial system collapsed, my parents' life savings disappeared overnight. My then 68-year-old father was forced to return to work as a day laborer.

For me, this is a constant reminder of why resolution planning is so important. It does not mean that we are rooting for resolution; it means that we are building a process to ensure that orderly failure is possible, market discipline exists, taxpayers are protected, and insured depositors have confidence that they will receive their cash quickly and orderly under any circumstances. It can help ensure that no 68-year-old will have to go back to work because his or her bank failed.

Under my leadership, the FDIC will continue to work to ensure the stability of our nation's financial system while continuing to engage with our foreign counterparts. I look forward to working with all of you to achieve these goals.

Thank you.