Statement by
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on the
Credibility of the 2013 Living Wills Submitted
By First Wave Filers
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The Dodd-Frank Act through Title I and the process of Living Wills seeks to end reliance on government-funded bailouts when the largest, most complicated financial firms fail. By having a well-developed and realistic plan for resolving a financial firm that can be implemented with confidence when necessary, Title I establishes bankruptcy as the means to resolve or restructure failed firms. In doing so, it also assures a more resilient financial system where rules apply equally to all who operate within it.

Today, as we consider the matter of Living Wills and their credibility, I first want to acknowledge that there are a host of factors that influence whether the above goals can be achieved. Among them are strong management and capital, as well as the effective examination and supervisory oversight of these firms. Under this supervisory role, Dodd-Frank requires that the FDIC judge the credibility of each firm's Living Will.

Unfortunately, based on the material so far submitted, in my view each plan being discussed today is deficient and fails to convincingly demonstrate how, in failure, any one of these firms could overcome obstacles to entering bankruptcy without precipitating a financial crisis. Despite the thousands of pages of material these firms submitted, the plans provide no credible or clear path through bankruptcy that doesn't require unrealistic assumptions and direct or indirect public support.

In coming to this conclusion, I recognize that subjecting these most complicated firms to bankruptcy is no simple task and will require enormous effort to accomplish. This is particularly the case today given that these firms are generally larger, more complicated, and more interconnected than they were prior to the crisis of 2008. They continue to combine commercial banking, investment banking, and broker-dealer activities. The eight largest U.S. banking firms have assets equivalent to 65 percent of GDP. The average notional value of derivatives for the three largest U.S. banking firms at year-end 2013 exceeded $60 trillion, a 30 percent increase over their level at the start of the crisis. There have been no fundamental changes in their reliance on wholesale funding markets, bank-like money market funds, or repos, activities that have proven to be major sources of volatility. And, when failure is imminent, no firm has yet shown how it will access private sector "debtor in possession" financing, a critical element in restructuring a firm.

In addition, while these most complicated firms may have added some capital as a funding source, they have only marginally strengthened their balance sheet to facilitate their resolvability, should it be necessary. They remain excessively leveraged with ratios of nearly 22 to 1 on average. The remainder of the industry averages closer to 12 to 1.

Thus, the margin for error and time to default for the largest, most systemically important financial firms is nearly half that of other far less systemically important commercial banks. Thus, there would be little time to prepare for unexpected events that might threaten the viability of any individual firm or firms.

Despite ongoing efforts at international cooperation, capital flows within multinational financial firms and information flows among authorities remain opaque. For example, should a financial crisis erupt, uncertainty around derivatives continues to be a disruptive force. Uncertainty also persists about the reliability of cross-border flows of funds for any one firm let alone an industry. Under such circumstances, it would be foolish to assume that countries will not protect their domestic creditors and stop outflows of funds when crisis threatens. "Ring fencing" assets will be the norm not the exception.

The Living Wills before us fail to fully acknowledge these issues and ignores other operational issues. They demonstrate little ability to cope adequately with failure without some form of government support. The economy would almost surely go into crisis.

Some parties nurture the view that bankruptcy for the largest firms is impractical because current bankruptcy laws won't work given the issues just noted. This view contends that rather than require that these most complicated firms make themselves bankruptcy compliant, the government should rely on other means to resolve systemically important firms that fail. This view serves us poorly by delaying changes needed to assert market discipline and reduce systemic risk, and it undermines bankruptcy as a viable option for resolving these firms. These alternative approaches only perpetuate "too big to fail."

I also am sometimes told that regulators have not provided sufficient guidance to firms preparing plans. I disagree and would note that besides regulators, the bankruptcy law itself provides guidance. I also would note that many of the firms being required to provide Living Wills are the same firms that employ teams of experts that prepare acquisition and restructuring plans for clients, corporations, and financial companies across the globe. There is every reason to expect a credible plan from these firms.

Finally and importantly, a greater part of these plans should be made available to the market, providing it an opportunity to judge whether progress is being made toward having credible plans.

In theory, Title I solves too big to fail. However, in practice, it's not the passage of a law but rather its implementation that determines whether the issue is resolved.

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