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A legal update from Dechert's Financial Institutions Group

Living Will Requirements Come into Focus

The FDIC Board of Directors has adopted a final rule setting forth the requirements for the "living wills" to be filed by large bank holding companies ("BHCs") and systemically important nonbank financial companies under Section 165(d) of the Dodd-Frank Act ("Act"). With limited but important modifications, the final rule generally follows the rule proposed in April 2011. The final rule does reflect the agency's responsiveness to many comments made by the public, by adding greater flexibility to the requirements based on the size and nature of the covered company. The FRB also must adopt the final rule. That action has not been scheduled as of this date. *See* our article in *American Banker*, "Living Wills Could Pit U.S. Stability Against Duty to Shareholders," August 29, 2011.

The FDIC Board of Directors also approved an interim final rule setting forth the requirements for the resolution plans to be prepared by large insured depository institutions. The interim final rule was modified from the proposal first put forward in May 2010 in order to coordinate its requirements more closely with the Act's living will requirements.

The Living Will Requirement

The Act requires each BHC with assets of $50 billion or more and each nonbank financial company supervised by the FRB (which are yet to be designated by the Financial Stability Oversight Council ("FSOC")) to report periodically on its plans for its rapid and orderly resolution in the event of its material financial distress or failure. That information, as revised periodically, will be available to assist regulators to evaluate balance sheet risk, understand foreign operations and develop a comprehensive and coordinated cross-border resolution strategy. It will also provide a roadmap for the FDIC to the extent that it needs to prepare for the orderly liquidation of the covered company under Title II of the Act.

Living wills must include a strategic analysis of how a covered company can be resolved under the U.S. Bankruptcy Code in a way that would not pose systemic risk to the financial system. A covered company also must map its core business lines and critical operations to its material legal entities and must analyze its corporate structure; credit and other material exposures to risk; funding, capital and cash flows; the domestic and foreign jurisdictions in which it operates; and the information systems that support its core business lines and critical operations.

Flexibility Added to the Process

The Act and the proposed rule made no distinctions in the application of the living will requirements based on the size or scale of the covered company, and many companies pointed out the impracticality of that in their comments. Foreign banks that are BHCs or are treated as BHCs under the International Banking Act expressed concern that the requirements were excessive when applied to foreign banks that have $50 billion or more in global assets but only a limited U.S. presence. Similarly, BHCs whose bank subsidiaries

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encompassed most of their assets argued that their living wills would be generally meaningless because their resolution would be largely dictated by the FDIC as receiver under the Federal Deposit Insurance Act (FDI Act). The FDIC made important concessions in these areas:

- While confirming that all foreign banks that are BHCs or are treated as BHCs are subject to the $50 billion asset threshold regardless of where their assets or operations are located, the final rule provides that a foreign-based company may restrict the strategic analysis and informational elements of its resolution plan to its subsidiaries, branches, agencies, critical operations and core business lines that are domiciled or are conducted in whole or in material part in the U.S. However, the description and mapping of interconnections and interdependencies must include the foreign-based covered company and its foreign affiliates.

- A covered company with less than $100 billion in total nonbank assets and whose insured depository institution subsidiaries account for at least 85% of its total consolidated assets (or, in the case of a foreign-based covered company, whose U.S. insured depository institutions and U.S. branches and agencies account for at least 85% percent of its U.S. total consolidated assets) can submit a "tailored" resolution plan. Such a plan may include a strategic analysis and address organizational structure, corporate governance, management information systems and supervisory and regulatory information only with respect to the covered company's nonbanking operations. However, interconnections and interdependencies must be described and mapped for both its banking and nonbanking operations. Covered companies with more than $100 billion in nonbank assets are not eligible to submit tailored plans, regardless whether they satisfy the 85% criterion described above. FDIC staff has indicated that 34 covered companies will be eligible to file tailored plans.

- The FDIC also modified the informational requirements of its interim final rule for insured depository institutions. As initially proposed, insured depository institutions with $10 billion or more of assets would be required to prepare resolution plans when they were part of an organization with $100 billion or more in assets. Under the new interim final rule, insured depository institutions with $50 billion or more of total assets must develop plans to facilitate their resolution under the FDI Act. In addition, the informational requirements in the interim final rule track more closely the living will requirements under Section 165(d), and an insured depository institution may incorporate information from its parent company's living will where appropriate.

- A covered company with a material nonbanking subsidiary that is subject to an insolvency regime *other than* the Bankruptcy Code (such as an insurance company subject to resolution under state insurance law) may disregard such a subsidiary when preparing its strategic analysis, unless the subsidiary has $50 billion or more in total assets or conducts a critical operation.

- Commenters also expressed concern that the number and variety of potential scenarios to be addressed in a covered company's resolution plan were unworkable. While not expressly limiting the scope of the final rule, the FDIC stated that a covered company may assume when preparing its initial resolution plan that its failure would occur under the baseline scenario to be used in its annual stress test under Section 165(i) of the Act. If a baseline scenario is not available, then the covered company may develop a reasonable substitute. When revising or updating its resolution plan, a covered company may assume that its failure would occur under the same economic conditions, consistent with the FRB's final rule implementing Section 165(i)(1) of the Act. In addition, the FDIC stated that it expects that the initial preparation of living wills will include an "ongoing dialogue" between the filing companies and the agencies.

Confidentiality

This may be an issue to be fought another day in other forums, but the FDIC has responded to comments that argued that sensitive business information contained in living wills would not be sufficiently protected from disclosure. The FDIC noted that the Act requires the FSOC and its member agencies, including the FDIC and the FRB, to maintain the confidentiality of any data, information and reports submitted under Title I of the Act. It also explained that the FDIC and the FRB expect that "large portions" of the information submitted will qualify for an exemption from disclosure as "trade secrets" under Exemption 4 of the Freedom of Information Act ("FOIA"), or as information "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of" a supervising agency under Exemption 8 of FOIA. The latter protection was not cited in the proposed rule.

On the other hand, the FDIC took note of the policy objectives of the Act to increase transparency and market discipline and stated that certain portions of a living will would be discloseable. The text of the final

rule requires a covered company to submit a properly substantiated request for confidential treatment under Exemption 4 and leaves unaddressed how the agencies will apply Exemption 8. It remains to be seen whether investors, acquirers, insurance carriers and even vendors will seek access to some or all of a living will, and whether the agencies will deny the disclosure of those parts of a living will that constitute examination, operating or condition reports under Exemption 8.

Staggered Submission of Living Wills Based on Size

The final rule also provides some relief by providing for the staggered filing of initial living wills, based on a company's size:

- The largest and most complex covered companies (*i.e.*, any covered company that has $250 billion or more in total nonbank assets, or any foreign-based covered company that has $250 billion or more in total U.S. nonbank assets) must submit their initial resolution plans no later than July 1, 2012;
- Firms with $100 billion or more in total nonbank assets (or, in the case of a foreign-based covered company, total U.S. nonbank assets) must submit their initial resolution plans no later than July 1, 2013; and
- Firms with less than $100 billion in nonbank assets (or, in the case of a foreign-based covered company, total U.S. nonbank assets) must file their initial resolution plans no later than December 31, 2013.

Any company that the FSOC designates for supervision by the FRB, or a BHC that grows organically or by merger or acquisition to more than $50 billion of total assets, will be required to submit its initial living will within 270 days after the date the company becomes subject to the filing requirement, or by the next July 1 following the event, whichever is later. The proposed rule required the initial living will to be filed within 180 days.

To address the possibility that a BHC with total assets near $50 billion may fluctuate as to its covered status, the final rule provides that a company will remain covered until its total assets drop below $45 billion, based on the average of its reported assets for the four most recent quarters. The final rule also liberalized the periodic filing requirements, by allowing a covered company merely to submit a notice within 45 days of any material event and not to address the impact of the event until it files its next annual revised plan. The portion of the proposed rule that required covered companies to file credit exposure reports was deferred, so that it could be coordinated with the rulemaking to be undertaken by the FRB regarding risk concentration limits under Section 165(e) of the Act.

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