The Honorable Martin Gruenberg  
Chairman, Federal Deposit Insurance Corporation  
550 17th Street, NW  
Washington, DC 20429

Re:  **Resolution of Systemically Important Financial Institutions:**  
The Single Point of Entry Strategy

Dear Chairman Gruenberg:

We commend the FDIC for its efforts to implement the Orderly Liquidation Authority (OLA) established under Title II of the Dodd-Frank Act and for seeking public comment to strengthen and improve its preparations. We also recognize the steady progress the agency has made in formulating a robust and transparent plan to help avoid many of the uncertainties that contributed to the systemic instability and bailouts during the 2008 financial crisis. Though good progress is being made, the agency highlights a number of significant questions and outstanding items about the resolvability of potentially systemic financial institutions (SIFIs). These issues go to the very heart of too big to fail and financial stability and we support and encourage the agency’s efforts to address them head on.

**Single Point of Entry (SPOE)**

We understand that the FDIC’s proposed SPOE strategy has important advantages for speeding, and simplifying, the resolution of potentially systemic financial institutions. Most large, complex financial institutions in the U.S. are centrally owned and managed at the holding company level, with thousands of interconnected legal entities that would be difficult, if not impossible, to disentangle quickly in a failure. By seeking to resolve a firm at the holding company level the SPOE approach provides a single and less complex plan that the FDIC can implement relatively quickly, even for different types of large and complex financial institutions. Unfortunately, the SPOE approach also carries with it, a number of potential risks that must be addressed for OLA to achieve the goals for which it was intended.

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1 The independent non-partisan Systemic Risk Council was formed by CFA Institute and the Pew Charitable Trusts to monitor and encourage regulatory reform of U.S. capital markets focused on systemic risk. The statements, documents and recommendations of the private sector, volunteer Council do not necessarily represent the views of the supporting organizations. The Council works collaboratively to seek agreement on all recommendations. This letter fairly reflects the consensus view of the Council, but does not bind individual members. [www.systemicriskcouncil.org](http://www.systemicriskcouncil.org)
Eliminate Gaming Opportunities. By applying losses at the holding company level – and leaving subsidiaries open and functioning – the proposed SPOE approach risks (1) a resolution scenario where individual holding companies lack sufficient loss absorption capacity and inflict costs on other financial institutions, or worse, taxpayers;\(^2\) and (2) the creation of gaming/moral hazard opportunities at the operating subsidiary level. To its credit, these risks have been highlighted by the FDIC.

As we previously noted in a letter to the Chairman of the Federal Reserve,\(^3\) to address these risks, regulators must take steps now (before a failure) to ensure that large, complex holding companies have and maintain sufficient loss-absorbing capacity so that a resolution does not cause systemic risk or otherwise pass costs onto other financial institutions. Where SPOE could be used, enough equity and senior, unsecured long-term debt must be issued at the top level holding company. It is important to eliminate a banking organization’s ability to game the requirements by redirecting its debt issuance to its insured depositories or other operating subsidiaries. In addition, to limit the contagion risk, this debt (and any synthetic versions of it) must not be an eligible investment for any other bank or potentially systemic firm (or a set of firms that together could constitute a systemic problem). Without this protection, large institutions and their counterparties can game the SPOE approach, by issuing debt at the subsidiary level, and push the risk of loss onto others. In light of the importance that the SPOE strategy places on capital at the holding company level, it is puzzling that the Federal Reserve Board has proposed that holding companies be subject to lower Tier 1 leverage ratios than subsidiary depository institutions.

It is particularly important that “loss-absorbing” debt be large relative to the obligations of all operating subsidiaries, including through their derivative transactions.

These gaming risks would also be mitigated by progress on establishing the credibility of bankruptcy under Title I of Dodd-Frank (discussed in more detail below). If large institutions and their counterparties view traditional bankruptcy as a most likely outcome, they will be less likely to try to game the OLA failsafe. If, however, OLA becomes the only realistic option for an institution, gaming and moral hazard become much more likely.

Clarify Derivatives Treatment. Effective resolution is also put at risk by existing derivative contracts that do not recognize the FDIC’s authority under OLA to act as receiver. This uncertainty could affect market confidence in a crisis, undermining the FDIC’s efforts to sustain the stability of the financial system.

\(^2\) Under the Dodd-Frank Act, any losses that exceed – will be borne by assessments on other large, financial institutions (“eligible financial institutions”).

While we commend the FDIC and other international regulators for raising this issue, it remains unresolved.

This raises serious questions about firms’ resolution planning and living will compliance. The Dodd-Frank Act requires that designated firms submit living wills that show they can credibly fail, in bankruptcy, without causing systemic risk. How can the agencies assess a firm’s resolvability or conclude that a firm has a viable, credible resolution plan if it has billions (if not trillions) of dollars of uncertain derivatives contracts outstanding?

- **Reduce the Number of Potentially Systemic Firms.** While we understand and support the need for the OLA backstop, making firms less systemic and avoiding OLA altogether should be a central policy goal. Not only should it inform prospective regulation, but also it should play a central role in any OLA resolution and eventual recapitalization.

Accordingly, no systemic firm that fails and requires OLA resolution should exit OLA as a potentially systemic firm.

Any Newco borne from OLA should not only be resolvable in bankruptcy, it should be reorganized into pieces so small and simple that there is no doubt whatsoever that it is new, different and wholly non-systemic. To the extent a failed firm engaged in an essential systemic “activity” the resolution process should take every step to break it into several competing pieces, each with sufficient excess capacity to allow markets to function even if others fail.

Though the FDIC expects that any systemic firm emerging from a Title II resolution will be broken into non-systemic pieces resolvable in bankruptcy, the morass of interconnected legal structures which typify U.S. SIFIs cast doubt on whether the FDIC could realistically accomplish this objective. Rather, without further progress under Title I to require U.S. SIFIs to simplify and rationalize their legal structures, the most likely outcome of the SPOE approach will be to replace one systemic firm with another. While this new firm will be “different” in many respects from the one it replaced, it could still have the same name, many of the same employees, and pose the same external risks to the system. The OLA process must credibly ensure that institutions emerging out of Title II resolution will no longer be systemic.

**The Importance of Bankruptcy (Title I)**

Though we support SPOE as a viable near term strategy, ending too big to fail requires that large complex financial institutions be able to follow the same rules as all other companies – including when they fail. If certain institutions – and their counterparties –

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5 The Dodd-Frank Act, Section 165(d)(4).
can presume preferential treatment, they will logically change their funding structure to take advantage of those differences. For example, if large institutions, investors and counterparties expect that large, complex financial institutions will be resolved under OLA instead of bankruptcy they will logically seek out any advantages that might derive from expectations of OLA treatment rather than bankruptcy. This could provide funding advantages – both in normal times and during periods of financial stress – and incentives for institutions to become large, complex and unresolvable in bankruptcy. The Dodd-Frank Act recognizes this risk and establishes OLA, as an emergency backup with traditional bankruptcy as the default approach.

Moreover, to improve large institution resolvability in bankruptcy, Section 165 of the DFA specifically requires that potentially systemic firms submit living wills that show they can credibly fail in bankruptcy without causing systemic risk – and provides the regulators with tools for helping to ensure that they can. If individual firms cannot credibly fail in bankruptcy, then the FDIC and FRB have authority to make them simpler and more resolvable in bankruptcy. This is the DFA’s policy goal and will ultimately illustrate if policymakers have ended too big to fail.

To meet this goal, policymakers should seek to address, directly, the impediments to bankruptcy for these types of firms. Not only could these firms be far simpler and more transparent, but structural impediments such as derivatives preferences and cross-border challenges should not be ignored.

**Consider Subsidiarization**

As noted in the proposal, U.S. SIFIs are generally “organized under a holding company structure with a top-tier parent and operating subsidiaries that comprise hundreds, or even thousands, of interconnected legal entities that span legal and regulatory jurisdictions across international borders and share funding and support services. Functions and core business lines often are not aligned with individual legal entity structures.” The SPOE approach, in some respects, is a reaction to this highly complex and interconnected reality.

One common-sense reform that could dramatically improve the workability of bankruptcy or OLA would be to require simpler and more transparent corporate structures. One option: “subsidiarization,” would have large institutions organize their legal entities along business lines and jurisdictions – with sufficient capital to manage and resolve each. Not only would this approach make large institutions far easier to sell-off, split up and sever in bankruptcy or OLA, but also a streamlined and transparent corporate structure would better position management and investors to make informed decisions about their own corporations’ size, riskiness and mix of activities.

A branch structure, while no doubt cheaper for SIFIs during periods of stability, would not provide these same benefits in times of market stress. It would be folly to allow large institutions to use branches, instead of subsidiaries, on the theory that this would allow “the organization to transfer funds from healthy affiliates to others that suffer losses” as
stated in the discussion draft. During periods of market turmoil, it is likely that all affiliates will need to preserve capital and liquidity. It is also likely, that capital and liquidity will be subject to ring-fencing by foreign authorities and thus not available for transfer. Moreover, as we saw during the crisis, the “healthy institutions” most likely in a position to support unhealthy affiliates will be FDIC-insured institutions, putting a strain on the deposit insurance fund.

**Transparency**

Improving public transparency, particularly surrounding SIFI “living wills” can also dramatically improve market dynamics – and public confidence – surrounding resolution. Living wills are not only essential tools for enabling the Board and the FDIC to assess the impact of, and plan for, the potential failure of a large, complex financial institution, but also they should enhance market discipline. They should disclose information to help investors, counterparties and others make more informed market decisions. Not only can these disclosures improve the pricing and allocation of resources across institutions, but they can enable the public to assess the extent of progress being made in ending “too big to fail.”

Unfortunately, the public portions of living wills have been highly disappointing. They are not comparable, lack crucial data for understanding a SIFI’s business and structure and are little more than selective, idiosyncratic reiterations of existing public information. This significantly reduces the potential value of these disclosures in helping markets and the public assess these firms and the progress that the FDIC and Federal Reserve have made in reducing the complexity of these institutions. There are significant gaps and differences among firms regarding the information they disclose and even the extent to which they disclose the existence of very large legal entities within the organization. This information gap fuels skepticism about the end of too big to fail, perpetuating bad market dynamics and, appropriately, more political pressure.

To the extent the Agencies continue to permit meaningful living will information to remain private, we believe accountability requires that the Agencies inform the public of their findings regarding each resolution plan (on a company by company basis), including whether the plan is credible and would “facilitate an orderly resolution of the company under bankruptcy” and what, if any, impediments exist to achieving that goal.

**Conclusion**

If policymakers believe certain institutions may be too complex or interconnected to fail in bankruptcy – then they should act now to ensure a reduction in complexity and interconnectedness. While we appreciate the agency’s efforts to implement OLA, we should also remember that our ultimate goal is for OLA to be an unneeded contingency, not a first and only option. Toward that end we urge the FDIC – and other federal banking agencies – to continue their progress and implement strong reforms so policy

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makers are never again put in a position where they must choose between taxpayer bailouts or financial collapse.

Sincerely,

[Signature]

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