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IMPROVING CROSS-BORDER RESOLUTION TO BETTER PROTECT TAXPAYERS AND THE ECONOMY

HEARING

BEFORE THE

SUBCOMMITTEE ON
NATIONAL SECURITY AND INTERNATIONAL TRADE AND FINANCE

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE ACTIONS OF THE FDIC TO IMPROVE CROSS-BORDER RESOLUTION OF ANY FAILING, GLOBALLY ACTIVE FINANCIAL INSTITUTION

MAY 15, 2013

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C O N T E N T S

WEDNESDAY, MAY 15, 2013

WITNESSES

IMPROVING CROSS-BORDER RESOLUTION TO BETTER PROTECT TAXPAYERS AND THE ECONOMY

WEDNESDAY, MAY 15, 2013

U.S. SENATE,
SUBCOMMITTEE ON NATIONAL SECURITY AND INTERNATIONAL TRADE AND FINANCE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee met at 2:06 p.m., in room SD–538, Dirksen Senate Office Building, Hon. Mark R. Warner, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF CHAIRMAN MARK R. WARNER

Chairman WARNER. I call to order this hearing of the National Security and International Trade and Finance Subcommittee, titled "Improving Cross-Border Resolution to Better Protect Taxpayers and the Economy". I appreciate Senator Kirk's willingness to join me in calling this important hearing today.

I said, Senator Kirk, to the witnesses before you got here that I can think of very few issues that have more potential dramatic effect upon the international financial standings and trying to make sure that we do not see a repeat of the crisis that took place back in 2008.

I also see that since it is a relatively complex issue, we have managed to scare away all of our colleagues and the press and everyone else. But we are going to pursue what I think is a very important issue here.

I have got an opening statement, and then I will call on my friend and colleague Senator Kirk, and then we will get to the witnesses.

Resolving a failing, globally active financial institution in real time—and I cannot stress enough the requirement of thinking about this in real time—across multiple jurisdictions without triggering systemic risk or a Lehman-style domino effect remains perhaps the most outstanding concern after the passage of Dodd-Frank. I think all of us remember those dark days in the fall of 2008 when the collapse of Lehman and the bailout of AIG triggered global panic. It froze our capital markets and reverberated throughout the economy, causing a spike in unemployment not seen since the Great Depression and, frankly, a spike in unemployment that we have still not recovered from.

Filing on a Sunday evening, Lehman was put into bankruptcy. Anyone observing this process, including the thousands of American customers who were still waiting for the access to their approximately $50 billion in assets, knows that status quo approach of putting that internationally complex institution into bankruptcy on a Sunday night was not a model we want to see repeated.

The crisis also demonstrated the critical need for enhanced coordination between regulators of our world's largest economies. Obviously, Lehman and some of these other institutions reflect the fact that these major significant financial institutions are not by any means limited in terms of their national status.

In the aftermath of the global crisis, Congress moved to overhaul the regulatory structure, updating regulations for the 21st century economic landscape. Now in Title I and Title II of Dodd-Frank, which I was proud to work with my friend Senator Corker on, we tried to design a system that would ensure taxpayers are protected from losses caused by the failure of large global institutions.

Now, our design—and this was something we spent a lot of time on back during those days of debate of Dodd-Frank—was to try to ensure that bankruptcy would remain the preferred resolution approach, and that is again where we put in part of Title I the requirement that the living wills—or funeral plans, depending on your perspective—provision, I think it is extraordinarily essential. And one of the questions I look forward to asking our witnesses today is: Have those plans and the process of implementing those living wills, has that met our goal of trying to make sure that these large complex institutions on the vast majority of cases are prepared and organized in a structure that could allow them to go through a bankruptcy process?

But we also recognize that particularly in the event when there was a crisis coming with an extraordinarily complex institution that could be systemically important not just to our economy but to the global economy, that we might need in effect a Plan B. And Dodd-Frank offers regulators another procedure to put a failing, globally active institution out of business via Orderly Liquidation Authority in Title II.

Now, Congress made clear that these authorities were to be used only in instances involving a threat to the financial stability of the U.S. economy. Even then, Dodd-Frank laid out multiple steps before this liquidation authority could be invoked.

One was that routine regulators—one route regulators are discussing to resolve systemically important financial institutions, if they were to use this OLA, or this resolution authority, involves a so-called single point of entry which would have the FDIC enter a financial institution at the holding company level and be able through that top-down approach, rather than coming at all the various branches, through that top-down approach transfer the good assets, those assets that are systemically important to not disrupting the overall United States or international economy, allow those good assets to be transferred to a new entity while keeping equity and some debt in the old entity.

Now, again, let me be clear, at least in terms of my views, and I think Senator Corker's views. We wanted to make sure that resolution would be such a dreadful process that no rational management team would ever prefer that option, so we ensured that if the regulators were forced to use the Title II resolution authority, the shareholders would be wiped out, culpable senior management fired, and the new entity would be recapitalized by converting long-term debt to equity.

Now, after taking writedowns, creditors of the old entity would still have a claim on the new entity, which would continue to operate to avoid a Lehman-esque freeze in the marketplace, which, again, as we know, proved to be very much of a disorderly dissolution. The critical element in this process must be accomplished, and let me stress this, without exposing taxpayers to liability.

Now, as the FDIC considers the orderly liquidation process, it must coordinate with foreign regulators to efficiently implement the wind-down for these financial institutions. In December, the FDIC published a joint paper with the Bank of England outlining a united approach to resolution, and, again, I think it is important for the record to note that in excess of 80 percent of American banks' foreign operations are based in the U.K. So if we can get the U.K. and the United States on the same page, we take a giant step forward in this process.

Among other things, Bank of England officials stated they would be comfortable with allowing the FDIC to resolve an American bank's subsidiary operations in London in the event of failure. Again, an important good first step.

This is obviously a huge move forward, which, if properly accomplished, will create certainty for the marketplace, and I hope this progress can continue with other jurisdictions. I look forward to hearing from Treasury as well as other witnesses on the progress of this coordination.

A couple final points. In mid-December, the Federal Reserve proposed new rules to govern the operations of foreign banking organizations in the United States. Again, we have to think about not only American banking operations abroad but those large foreign-based operations with their operations here in the United States.

Under the proposed rules, the largest foreign banks would be required to create an intermediate holding company, essentially creating a structure to how U.S. banks operate under a bank holding company, trying to make sure that we can, in effect, if we had to do a resolution of a foreign-based operation here in the United States, there would be a similar structure. Foreign banks in the U.S. would be required to hold the same level of capital as American banks, and the foreign banks with assets in excess of $50 billion will be required to undergo heightened prudential regulations, such as stress testing, just as American banks are required to do.

Another important step would be to ensure that—this would be very important, I think, to ensure that those foreign banks, should they have to go through resolution, that American interests are protected.

Again, I am eager to hear from our witnesses today about how this rule interacts with the broader efforts of the FDIC to pursue a single-point-of-entry mechanism and what further progress we need to make not only with the U.K. but with our other foreign nations.

This is an issue of enormous importance if we are going to avoid the potential disorderly process that we saw in 2008, and I look forward to hearing from all of our witnesses today.

So, with that, I will ask Senator Kirk if he would like to make an opening statement.

STATEMENT OF SENATOR MARK KIRK

Senator KIRK. Thank you, Mr. Chairman. I am thrilled that you are convening this hearing, and this is my first appearance as a Ranking Member. I believe I am the only Senator who was a former employee of the World Bank Group and very much care about the issues under the jurisdiction of this Subcommittee. And I have pledged to work with you to recall the role of the international financial institutions as Washington, DC, employers to make sure that that little-known role of Washington, DC, as a financial center, where I do not think most people realize how many countries' fates are decided in the boardrooms of the World Bank and IMF right here in town.

Chairman WARNER. Absolutely. Well, I appreciate that, Senator Kirk, and let me assure you that no one brings a better appreciation of the interconnectedness of our financial institutions than somebody with Senator Kirk's experience, and he and I are friends, and we are going to be good partners on this Subcommittee. I again look forward to working with you.

I have a lot of questions. I know Senator Kirk does as well, so let us get to the witnesses. Our three witnesses, I will introduce each of you, and then we will go down the row.

Jim Wigand is the Director of FDIC's Office of Complex Financial Institutions and overseas contingency planning for resolving and the resolution of systemically important financial companies. Prior to assuming this position in December 2010, Mr. Wigand was Deputy Director for Franchise and Asset Marketing Division of Resolutions and Receiverships, FDIC, and oversaw the resolution of failing insured financial institutions and the sale of their assets. Mr. Wigand, welcome.

Mr. Michael Gibson is the Director of Banking Supervision and Regulation at the Federal Reserve Board. As Division Director, he oversees the Fed's Department of Bank Regulatory Policy and its supervision of banking organizations. He represents the Fed on the Basel Committee on Banking Supervision and works closely with officials from U.S. and international Government agencies on bank oversight issues. Welcome, Mr. Gibson.

And Mr. William Murden has been the Director of the Office of International Banking and Securities Markets at the U.S. Department of Treasury since September 1996. He is responsible for developing and proposing policies to senior Treasury officials on a wide range of international regulatory matters, including financial stability and reforms to the international financial regulatory system. Mr. Murden has served as a negotiator for all six G20 summits. Welcome, Mr. Murden.

So, with that, I will get our witnesses started. Mr. Wigand, you are first up.

STATEMENT OF JAMES R. WIGAND, DIRECTOR, OFFICE OF COMPLEX FINANCIAL INSTITUTIONS, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. WIGAND. Chairman Warner and Ranking Member Kirk, thank you for holding this hearing on the important subject of cross-border issues involved in the resolution of a systemically important financial institution with international subsidiaries and affiliates. The hearing is timely, and I appreciate the opportunity to update the Subcommittee on the progress we have made with our foreign counterparts in addressing many of these issues.

The financial crisis that began in late 2007 highlighted the complexity of the international structures of many of these large, complex financial institutions and the need for international cooperation if one of them became financially troubled. The Dodd-Frank Act requires the FDIC to coordinate, to the maximum extent possible, with the appropriate foreign regulatory authorities with respect to the resolution of systemically important financial institutions having cross-border operations, or G–SIFIs.

The FDIC, working with our foreign colleagues, has made substantial progress in one of the most challenging areas of the financial reforms adopted in the Dodd-Frank Act. Cross-border issues presented by the prospect of or the occurrence of a G–SIFI failure are complex and difficult. The authorities granted to the FDIC under Title I and Title II of the Dodd-Frank Act provide a statutory framework to address these important issues.

In mid-April, 2013, the FDIC and Board of Governors issued guidance to institutions that filed resolution plans under Title I of the Act in 2012. The guidance makes clear that, in developing their 2013 plans, the institutions must consider and address impediments to the resolution in a rapid and orderly manner under the Bankruptcy Code, including cross-border issues. Firms will need to provide a jurisdiction-by-jurisdiction analysis of the actions each would need to take in a resolution to address ring fencing or other destabilizing outcomes, as well as the actions likely to be taken by host supervisory and resolution authorities.

Title II provides a backup authority to place a holding company, affiliates of an FDIC-insured depository institution, or a nonbank financial company into a public receivership process if no viable private sector alternative is available to prevent the default of the financial company and a resolution through the bankruptcy process would have serious adverse effects on financial stability in the United States.

The FDIC's single-point-of-entry strategy for conducting a resolution of a SIFI under Title II would provide for such an orderly resolution of one of these entities. Under this strategy, shareholders would be wiped out, unsecured debt holders would have their claims written down to absorb any losses that shareholders cannot cover, and culpable senior management would be replaced. At the same time, critical operations provided by the financial company would be maintained, thereby minimizing disruptions to the financial system and the risk of spillover effects. This strategy is consistent with the approaches under consideration by a number of our foreign counterparts.

As I detail in my written statement, we are actively engaged in bilateral discussions with key jurisdictions that cover 27 of the 28 G–SIFIs. For example, the FDIC and the Bank of England have been working to develop contingency plans for the failure of G–SIFIs that have operations in both the U.S. and the U.K. Approximately 70 percent of the foreign-reported activity of the eight U.S. SIFIs emanates from the U.K.

In addition, the FDIC is coordinating closely with authorities of the European Union and Switzerland. We also have been engaged in discussions with resolution authorities in Japan and Hong Kong and have been actively engaged in a number of multilateral initiatives on resolution planning.

Through these efforts, we have made substantial progress in establishing mechanisms for the sharing of information and for coordination with respect to the resolution of G–SIFIs operating in our respective jurisdictions. Bilateral and multilateral engagement with our foreign counterparts in supervision and resolution is essential as the FDIC develops resolution plans for individual U.S.-based G–SIFIs. Cross-border cooperation and coordination will facilitate the orderly resolution of a G–SIFI.

Thank you again for the opportunity to discuss the FDIC's efforts to address the issues regarding the failure of a large, complex financial institution with international operations. While much work remains to be done, the FDIC is better positioned today to address the failure of one of these institutions, and we remain committed to the successful implementation of this important objective of the Dodd-Frank Act.

Chairman WARNER. Thank you, Mr. Wigand.

Mr. Gibson.

STATEMENT OF MICHAEL S. GIBSON, DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. GIBSON. Chairman Warner, Ranking Member Kirk, I appreciate the opportunity to testify today on cross-border resolution. My written testimony discusses the improvements that have been made in the last few years in the underlying strength and resiliency of the largest U.S. banking firms. I would like to focus my oral remarks on what has been and remains to be accomplished in facilitating a cross-border resolution.

Congress and U.S. regulators have made substantial progress since the crisis in improving the process for resolving systemic financial firms. We saw in the crisis that policy makers, when faced with a systemically important firm approaching failure, needed an option other than a bailout or a disorderly bankruptcy. In response, Congress created the Orderly Liquidation Authority, OLA, a statutory mechanism for the orderly resolution of a systemic financial firm.

In many ways, OLA has become a model resolution regime for the international community, as shown by the "Key Attributes of Effective Resolution Regimes" document that was adopted by the Financial Stability Board in 2011. Thanks to OLA, the United States already meets the core requirements of this new global standard for special resolution regimes.

The Federal Reserve supports the progress made by the FDIC in implementing OLA, including in particular by developing a single-point-of-entry resolution approach. The single-point-of-entry approach is now gaining traction in other major jurisdictions.

The Dodd-Frank Act requires all large bank holding companies to develop resolution plans and submit them to supervisors. The first wave plans were submitted to the Federal Reserve and the FDIC last summer. These plans are useful supervisory tools. They have helped the firms find opportunities to simplify corporate structures and improve management systems in ways that will help the firms be more resilient and efficient as well as easier to resolve.

Internationally, the Federal Reserve has been an active participant in the Financial Stability Board's many committees and technical working groups focused on cross-border resolution. The Federal Reserve has responsibility for convening U.S. and foreign prudential supervisors and authorities to form crisis management groups for the eight globally systemically important banks that are U.S. companies. These firm-specific crisis management groups meet regularly and work to identify and mitigate cross-border obstacles to an orderly resolution of these firms.

Last year, the Federal Reserve sought public comment on a proposal that would generally require foreign banks with a large U.S. presence to organize their U.S. subsidiaries under a single intermediate holding company. The proposal would significantly improve our supervision and regulation of the U.S. operations of foreign banks and enhance the ability of the United States as a host country regulator to cooperate with a firm-wide global resolution of a foreign banking organization led by its home country authorities.

Despite the meaningful progress that is being made internationally within the Financial Stability Board and in our domestic efforts with the FDIC, we still have more work to do to overcome the obstacles to a successful cross-border resolution of a systemic financial firm. There are several such obstacles, but perhaps the most important is that many other countries are still working to adopt a statutory resolution regime for their systemically important firms.

Thank you for your attention, and I am pleased to answer any questions you may have.

Chairman WARNER. Mr. Murden.

STATEMENT OF WILLIAM C. MURDEN, DIRECTOR, OFFICE OF INTERNATIONAL BANKING AND SECURITIES MARKETS, DEPARTMENT OF THE TREASURY

Mr. MURDEN. Chairman Warner, Ranking Member Kirk, Members of the Committee, as a civil servant who has been with the Treasury Department for over 30 years, it is a distinct privilege and honor for me to have the opportunity to testify here today. I am also pleased that my children, Robert and Mariah, have joined me today and are sitting several rows behind me.

Chairman WARNER. I am sorry you only got one Senator, but it is an important issue, and we are glad you are here.

[Laughter.]

Mr. MURDEN. Yes. But my children are here I think both to see how the topic is of interest to Congress as well as trying to figure out what their father does for a living.

The financial crisis demonstrated that instability can result from the failure of global financial institutions. As a result, G20 leaders agreed in 2009 to develop frameworks and tools to effectively resolve these institutions and turned to the Financial Stability Board, or FSB, to oversee this effort.

The FSB in turn laid out an approach that consisted of the three key elements:

First, a new international standard for resolving both global systemically important financial institutions, known as G–SIFIs, as well as other financial institutions;

Second, an assessment process to ensure that countries implement the new international standard consistently;

And, third, a framework to resolve G–SIFIs that includes individual crisis management groups, or CMGs.

The FSB established a Resolution Steering Group, chaired by Bank of England, to oversee the development and implementation of this framework. I represent the U.S. Treasury on this group and am joined by representatives from the Federal Reserve and the FDIC.

Much progress has been made on this framework, and I would like now to quickly summarize that.

One, the Resolution Steering Group developed a new international standard, called the "Key Attributes of Effective Resolution Regimes for Financial Institutions", which the G20 leaders endorsed in November 2011. The key attributes provide over 100 specific recommendations, including resolution authorities and powers, recovery and resolution planning, resolution funding, segregation of client assets, cross-border cooperation, and information sharing.

Two, assessment. The IMF and the World Bank, as Senator Kirk mentioned earlier, in cooperation with the FSB, have launched a pilot project to test the key attributes in two jurisdictions. The FSB has recently completed its first peer review to measure its members' progress in implementing the key attributes. This peer review found that while the United States is leading the globe in implementing its resolution regime, progress is occurring elsewhere, including in France, Germany, the Netherlands, Switzerland, the U.K., and Japan. The European Union is also working to finalize its own bank resolution regime, which all 27 member States will then have to implement. The experience with the recent bank failures in Cyprus has refocused attention within Europe on the importance of a banking union with an effective resolution framework.

Three, national authorities have also made important progress in enabling the resolution of individual firms. CMGs have been established for all 28 G–SIFIs. Each CMG is developing recovery and resolution plans for its G–SIFI and is negotiating cooperation agreements among the national authorities that oversee its institutions' important operations.

While much has been accomplished, there is still more to do: first, encouraging foreign jurisdictions to implement effective resolution frameworks to facilitate cross-border resolution; second, finalizing resolution cooperation agreements between the key national authorities that are relevant for the G–SIFI; and, third, establishing strong lines of communication among relevant national authorities.

So, in conclusion, the financial crisis made clear that the failure of large, international financial firms can result in systemic damage that crosses national borders. The FSB is playing a vital role in bringing domestic and foreign regulators together to build the capacity, trust, and communication necessary to make possible the effective resolution of systemic financial institutions.

Thank you again for the opportunity to testify before the Committee today, and I welcome any questions the Senator and Chairman may have. Thank you.

Chairman WARNER. Well, thank you, and I look forward to raising questions with all of you, but also perhaps, Mr. Murden, some questions that will further elucidate to your kids what you do.

[Laughter.]

Chairman WARNER. Let me just start with you, Mr. Gibson, and this is not exactly on topic, but a bit of an editorial comment but related. Obviously, one of the things we have to do as we think about our American SIFI institutions is the fact that those institutions need to have either more capital or convertible debt at the holding company level to make sure that in the event of a failure, there are appropriate assets there to absorb losses and protect taxpayers through a resolution process. And if we are going to do the single point of entry through the bank holding company, the bank holding company has got to have enough assets at that top layer to have that.

Now, can you give us a little bit of update on how far the Fed is coming on formulating those requirements for the bank holding company level?

Mr. GIBSON. Sure. We have identified that for the single-point-of-entry resolution strategy to be effective, there does have to be enough debt at the holding company level that could be converted into equity and used to recapitalize the company after the resolution. So we have discussed the fact that we are considering making such a proposal, and right now what we are working on is the technical details that would make it a specific proposal. Obviously one question is how much would be the minimum requirement, and really there the question is how much is necessary to really give confidence to the market and the foreign regulators as well as domestic regulators that it is enough.

Also, what type of debt, should it be subordinated debt, should it be senior debt, should it be explicitly tagged as convertible debt? Or should we just identify a complete tranche of, say, senior unsecured debt? So these are the parameters that we are discussing internally.

We are also discussing with our foreign counterparts the idea that it might make sense for other countries to institute a similar requirement. If we are all going to be using the single-point-of-entry strategy as one of our preferred resolution strategies, then we all have the same need to have enough debt at the holding company level. And so we have begun those discussions with our international counterparts, and the timing of whether we in the U.S.

propose something or whether we work a little bit more internationally is still a little bit uncertain. But that is what we are working on right now.

Chairman WARNER. Well, I would just say that a number of my colleagues—and I will be sending you some correspondence on this matter as well—continue to believe that for our largest institutions they need to have sufficient capital standards, perhaps increasing above what has been proposed so far, and kind of a cousin to that is this additional debt held at the holding company level, again, to help absorb—if we are going to use the single point of entry, there has got to be enough assets up there to get us through this period until whatever succeeding institution or entity can continue. So I will be anxious and be watching on how you go forward on that.

Just again following up with you, Mr. Gibson, but also Mr. Murden or Mr. Wigand, you may want to weigh in as well, I think it is a—it seems to me a rational approach that you have proposed for trying to create for foreign operations kind of a U.S. equivalency with this sense of that holding company structure with enough, again, debt at the American sub-holding company so that American interests can be protected. I guess I would have the question for any of the panel, but also Mr. Wigand on this: Do you see any potential conflict if the FDIC is actually going to be doing the mechanics of the resolution with the proposal for the foreign banking operations? And kind of a corollary to that is, if we ask our foreign partners to put more debt at their American sub-level, you know, I would imagine we would also have to be prepared for then our foreign parties to require more debt from our American institutions in their responsive host countries. So if you could take both of those on?

Mr. GIBSON. Sure. So maybe I will start. In what we proposed in our foreign bank proposal in December, we proposed that foreign banking organizations in the U.S. would have to set up an intermediate holding company for their U.S. subsidiaries, and we proposed that we would apply the same capital requirements that we currently apply to U.S. bank holding companies. So it would be equal treatment within the U.S.

We have not proposed that there would be any extra layer of debt for the U.S. intermediate holding company. We have not proposed that for the U.S. firms yet either. Currently our thinking is the extra layer of debt to facilitate the single point of entry would have to be at the top-most level only. So depending on how the foreign companies are structured, they may not need that extra layer of debt at their U.S. intermediate holding company as long as they have enough capital and liquidity to meet the requirements that we have proposed.

Mr. WARNER. But are you saying that—does that not additional layer of debt have to be inside the American sub at some point? Or can it still be left over abroad?

Mr. GIBSON. There are many different ways to do it, but one way that we are actively considering is to make sure that as long as the foreign regulator has enough debt at their parent and as long as we have the assurance that the U.S. operations will be protected in a global single-point-of-entry resolution, then we might not require it to be in the U.S. as long as we have the comfort and cooperation with the foreign regulator. If we did not have that, then we might very well need more——

Mr. WARNER. At the American?

Mr. GIBSON. At the American.

Chairman WARNER. And, Mr. Wigand, does that pose any conflict or problem for you from the resolution piece?

Mr. WIGAND. No, it does not. We view the Fed's proposal as being primarily a supervisory tool which facilitates the ability of the Federal Reserve to oversee the operations of these companies, which have significant operations outside of the U.S. And, accordingly, the ability for the Fed to see clearly the interconnections between the U.S. operations and the home jurisdiction is facilitated with the ability to maintain asset and liquidity domestically. The collateral benefit of that is it may, of course, avoid the need for the U.S. operation to have to go through a resolution process because of the maintenance of adequate capital and liquidity within the hosted operations here in the U.S.

In the event that the parent company has to go into a resolution process, the requirements that would be imposed under the Fed proposed rule would in many respects facilitate the home jurisdiction's ability to conduct a single-point-of-entry resolution because the capital and liquidity requirements of those hosted operations here would already be satisfied. The Federal Reserve and another supervisor domestically would not need to impose additional requirements during this period of distress.

As far as a resolution process goes, to the extent that we need to implement any type of domestic resolution proceeding, whether that be a bankruptcy process, an FDI Act process, an OLA process, a State receivership process, we believe that the rule does not negatively impact and may facilitate the ability of that authority to actually go through that process.

Chairman WARNER. Well, we have got to be sure that there is enough at the foreign holding company level to protect the American interest as well so that they are not simply taking care of their own respective domestic challenges in a preference over American creditors.

Mr. WIGAND. And that is, I believe, what is behind the capital and liquidity requirements or net asset maintenance requirements specifically associated with the proposal.

Chairman WARNER. And, Mr. Murden, this may be a chance for you to weigh in on are there concerns from kind of the Treasury standpoint and from your activities with the G20 that there may be reciprocal requirements from our—on American institutions who have large holdings in foreign nations?

Mr. MURDEN. Our perspective on that is that many countries in Europe have already implemented stronger capital requirements, Switzerland in particular. U.K. has proposals that would strengthen capital requirements for all their banks, including their subs of U.S. financial institutions. Germany has authorities to require additional capital for their foreign subs. They have already taken that action in relation to Italy.

So I think if you look at what Europe has in place, I am told by my foreign regulator counterparts in Europe that they have decided to impose Basel requirements on broker-dealers, whether they are owned by U.S. firms or by European banks or stand-alone. So they have the provision already to take stronger measures.

The Financial Stability Board has also endorsed a framework proposed by the Basel Committee that would permit host countries to impose higher capital requirements on all banks, including foreign banks in their jurisdictions.

Chairman WARNER. So there has not been any pushback from American institutions saying this is going to require them to deposit more debt at their foreign sub-level in a Spain, in an Italy, in——

Mr. MURDEN. I have not heard that particular complaint from U.S. financial institutions.

Chairman WARNER. OK. One of the things I find curious is that even before we see the completion of the living wills process, which I share, again, some frustration that we are 4 years after the fact and the process is not completed, and I understand it is complex, but that some of our colleagues, particularly in the House, are talking about, you know, doing away with Title II, doing away with this potential resolution authority. And I just am curious whether any of you think within the current state of bankruptcy law, whether we would be prepared under existing bankruptcy law to resolve any of these large institutions without the threat of a Lehman-style freeze-up with the current status quo. Again, I would be happy to take each of your comments.

Mr. WIGAND. Of the companies that have to submit living wills and that are subject to the provisions of Title I, the vast majority of them actually should be resolvable through bankruptcy. However, there is a significant subset of those—the largest, most complex firms—where bankruptcy poses significant obstacles.

In the 2013 guidance the Federal Reserve Board and the FDIC issued to these companies for their resolution plans, we specifically are asking the institutions to address how through the bankruptcy process these obstacles, or we refer to them as "benchmarks," can be overcome. Among those issues, obviously cross-border, the subject of this hearing today, is a significant issue. However, one has to consider, as one observed in the Lehman insolvency process, multiple competing insolvencies, which are likely to take place in differing jurisdictions.

We have to consider also the operational and interconnectedness challenges within an enterprise as different subsidiaries of one of these large, complex institutions will be dependent on other affiliates for the provision of services or perhaps liquidity.

Additionally, we have concerns associated with the actions of counterparties, the termination of derivatives contracts and massive close out and fire sale of collateral that we observed. Finally, there is a significant challenge associated with the funding and liquidity requirements that one would see in the bankruptcy process, as well as might occur in an OLA type of resolution. In order to mitigate the fallout or systemic consequences arising from the insolvency proceeding, liquidity has to be provided so that the critical operations that financial firm provided to the financial system can be maintained and continuity of services can basically be provided.

We are requesting these firms to address these issues specifically, and given the differing business models that we observe with these companies—and we have universal banks, for example, we have broker-dealers, we have processing banks. Each one of these firms is going to have to take a look at these issues and address them in a manner that makes a credible argument that bankruptcy can be applied to an insolvency process—and which does not result in the type of negative consequences to the financial system that we observed with Lehman. Those particular impediments we are using as benchmarks to make that type of assessment, at the end of the day has to be an institution-by-institution analysis.

Mr. GIBSON. I think the premise of your question in focusing on existing bankruptcy laws means that my answer has to be, as I said in my statement, that we need a choice between existing bankruptcy laws and bailout, which the OLA provides. That does not mean that the changes we are pushing the firms to make through the living will process to improve their ability to be resolved, those changes, many of them will make them more resolvable under bankruptcy as well can be stabilized under Title II OLA. I still think there will be a need for a backstop of the OLA in those perhaps unforeseeable circumstances in the future where, even if we might expand the range of circumstances where bankruptcy is a viable option, there can always be a more severe crisis or a more severe situation where having that backstop of OLA will be an important option.

Chairman WARNER. Mr. Murden.

Mr. MURDEN. From an international perspective, I think I would like to say that when the Resolution Steering Group started developing the key attributes, working on those in the fall of 2010, there was considerable interest in Title II OLA and how that process worked. There was a lot of discussion with the Chairman of—the Bank of England Chairman and other countries on that group. And so they were very interested in adopting the key features of Title II OLA into the key attributes. So if you look at the key attributes today, there are many features that are similar that align with OLA. So the U.S. in that sense is leading from a position of strength in developing Title II OLA and is setting a model for other countries in the development of their resolution framework.

Chairman WARNER. So it is safe to say, Mr. Murden, that if we look at our partner nations around the world who have also extraordinarily complex financial institutions, they are going the route as well of saying let us look at what we have done in Title II, use that as a model, not saying let us reject that and go to simply a bankruptcy-only process in their respective countries. Is that correct?

Mr. MURDEN. That is right. I think that I would say they have adopted the notion that they need to have a special resolution regime for banks and are working to try to implement the key attributes in their countries along those lines.

Chairman WARNER. And, again, while we want to get bankruptcy as far down the path as possible, we want to simplify these firms as much as possible to get them bankruptcy suitable. You know, I think we have all—or at least I believe, and I guess I would ask each of you, that by the nature of a designation of a SIFI, you are talking about something that is an institution that may have component parts that are important enough to the overall financial system that some component part needs to continue, and if it needs to continue, you need to have some ability to both have the funding to have that continued, and even should you ever have to call upon—again, we hope never to be the case—some funding, that funding is then replenished not from the taxpayer but from the other SIFI firms. Is that not correct?

Mr. WIGAND. That is correct, and I need to be clear—the expectation of the FDIC is that in using the single-point-of-entry process and the creation of a bridge financial company, which is well capitalized due to having an adequate amount of unsecured debt which would provide market confidence, that the ongoing operations that come out of this process would be viable. The use of the liquidity facility that is provided for the in the Dodd-Frank Act, the Orderly Liquidation Fund, would really only be a backstop. Our expectation is that the bridge financial company will borrow in the private market. It may have to pay a premium to do that, but that would be our expectation. The private markets would be a source of liquidity as well as to the extent that customary sources of liquidity were provided to the financial firm, those would be available as well. Only in the event of private sources and customary sources not being available to the bridge financial company would we then go to the Orderly Liquidation Fund as a source of liquidity to ensure the continuity of those critical operations to the financial system. Given the authority of the statute, we believe that just the issuance of guarantees probably would be sufficient, so then the bridge financial company could issue guaranteed debt which would be guaranteed by the OLF, or Orderly Liquidation Fund, similar to the debt guarantee program that was observed back in 2008 and 2009, where financial companies issued debt that was guaranteed by the FDIC, but the market was very receptive to purchasing that type of debt. We believe that that would be also a preferable recourse to direct borrowing from the OLF.

Chairman WARNER. Right. Which again, just to reiterate, that only comes to pass after shareholders are wiped out, after management is expunged, after, you know, long-term debt and unsecured creditors may be converted, and then, in effect, the remaining assets are borrowed against with a backstop guarantee; but, you know, to me that does not sound like a bailout.

Mr. WIGAND. We would also ensure that any type of OLF borrowing is fully secured. Our expectation would be, as the law requires, any OLF borrowing is fully repaid from the assets of the firm, and there would be an overcollateralization requirement with that borrowing. In the highly unlikely event that the collateral was insufficient, then you go to the assessment of the industry. But at no one time would taxpayers be at risk.

It is also important, as you noted, Chairman Warner, that this is a liquidity facility. It is strictly for the provision of liquidity. It is not for the provision of capital support. It is not to enhance the position of any former creditors of the failed institution. It is strictly a liquidity facility that we would expect to use as a backstop to private sector or customary sources.

Chairman WARNER. A liquidity event to keep those—not the whole institution, but that is simply that critical component of that institution that is critical to the overall financial system. I really do wish that more of my colleagues and maybe some of my House colleagues could hear this presentation. Maybe we could encourage them to hold a similar hearing because I think it might clear up some of the misunderstanding that I understand even was this morning a subject of a hearing on the other side of the body.

Does anybody want to add anything else on that subject? Mr. Gibson.

Mr. GIBSON. The only thing I would add is that we can work to make firms more resolvable under bankruptcy, but we can never foretell what the macroeconomic or financial sector conditions are going to be at the time one of these firms gets into trouble. So bankruptcy might be a good option for Firm A if financial markets are relatively calm, but we might need the extra assurance of the OLA process with the FDIC overseeing that if financial conditions are really disorderly.

Mr. WIGAND. To reiterate a point Mike is making, it is important to avoid the two choices that the Government had in 2008 of—a disorderly resolution process through—for example, a bankruptcy framework, or bailing out companies. Those two very negative——

Chairman WARNER. Bad and badder.

[Laughter.]

Mr. WIGAND. ——choices really should never be a situation in which policy makers find themselves again. Having a backstop option to a bankruptcy process such as OLA is important so that market discipline can be imposed onto the stakeholders of the firm and certainly OLA provides through its authority and, more importantly, through the strategic approach we have adopted at the FDIC, a single point-of-entry, where the shareholders and creditors of the firm that are at the top holding company level, that elect the board of directors, that appoint the management, that have allowed the firm to operate in the way it does, they bear the first consequences of those actions through the loss absorption and the writedowns that they are going to have to take. Culpable management, of course, is held accountable. The law specifically requires that culpable management cannot be retained. In addition to that, we are actually going one step further and looking at not only what would be deemed culpable management in terms of the law, but also what is necessary to move the company forward, or its parts forward, in a manner such that the market is confident that whatever comes out of this process as a going operation—and there might be multiple operations that come out of this process. We should not just think of this as a single company that emerges. There might be several——

Chairman WARNER. It sure as heck would not be the single—what comes out at the other end would not be the entity that goes in on the front——

Mr. WIGAND. Correct, absolutely.

Chairman WARNER. This is the roach motel analogy we continue to use. You may check in, but whatever is checking out is not the same institution.

Mr. WIGAND. It will be a different company or companies that come out of this process.

Chairman WARNER. Companies, with different chances or different sets of shareholders, different sets of management.

Mr. WIGAND. Correct. The market has to be comfortable that whoever is in control or operating those entities will basically be able to move forward and did not cause the problems.

Chairman WARNER. And the preface to all this, again, of course, will be—I am going to come to this. It is great not having any other Members here. I get to ask all my questions, which is that we are going to have a living will process set up so that those institutions that were so complex that the—again, our preference is bankruptcy, but that in the last crisis, bankruptcy just was not able to be used. If we do our job well on the front end with the living will process, the more rational choice for any entity will be to go through an orderly bankruptcy process. Our hope would be.

Mr. WIGAND. We believe that is the case, that there are actually incentives associated with the bankruptcy process as compared to OLA, one actually being the provision or provisions associated with management that would incent a company to go forward with a bankruptcy process prior to the need for the Government to recognize the OLA as basically a backstop or last resort alternative.

Chairman WARNER. Well, one of the—let us get to kind of drilling down to the next level. One of the things we saw with Lehman, and obviously with AIG as well, was the challenge. Last time, when we get into derivatives of counterparties, basically in the event of a collapse, taking that collateral and heading for the hills, you know, one of the things we put in Dodd-Frank—and I would be curious about each of your reactions to this. And this was a best effort. I am not sure it was the perfect solution set, but we put that 24-hour stay so that there would be some ability to assess things so that we do not have this enormous crisis and flight of collateral.

Right number, you know, less longer, right approach, comments? And, again, anybody on——

Mr. WIGAND. I will stay on this. The 24-hour stay provision is a very important one and mirrors a similar provision under the FDI Act that we have had for depository institutions. Under our single point-of-entry approach, the holding company goes into the resolution process, and the operating subsidiaries, where the vast majority of these contracts reside, of course, maintain their honoring of those contracts because the subsidiaries remain as going concerns. Where this becomes an important issue is if the holding company acted as either a guarantor for those contracts—and there is a default provision upon an insolvency process for a guarantor—or if the contract has a cross-default provision, so that even though the direct counterparty does not go into an insolvency process, it is cross-defaulted to any affiliate of that party or parent if it goes into an insolvency process. That is where the provision comes into utility because we would anticipate that these operating companies would be moved essentially into this bridge financial holding company as part of the overall strategy.

Of course, the law only goes as far as our borders. It does not apply internationally. We have to look at the types of contracts that are originated extraterritorially as to whether or not they reference U.S. law. If they do not, what would the financial incentives be for those counterparties to exercise any type of acceleration and termination provisions on those contracts.

That is a problem for us. It is a problem for any other jurisdiction as well that is looking at resolving systemically important companies that go across borders.

An international effort would serve the global financial community well in this regard. A change to the standard form contract would help if a similar type of provision, such as a 24-hour stay, were adopted so that all financial companies, whether domestic or foreign, had a provision similar to what we observe in Dodd-Frank that would allow basically for the assumption of these contracts by a creditworthy counterparty and avoid immediate termination or acceleration of them.

Chairman WARNER. Mr. Gibson and Mr. Murden, do you want to comment on that? Because I know as well there are some concerns being raised now from some of our foreign friends, the potential reach of Dodd-Frank around this issue and around derivatives, and I would like to get your comments.

Mr. MURDEN. Yeah, I can comment on internationally, this is an important issue, and in the Resolution Steering Group as we were discussing the key attributes, there was a lot of interest from the Bank of England Chair and other members in the Dodd-Frank provision, and so there is a temporary stay, is one of the key attributes that countries have committed to implement.

The European Commission has drafted——

Chairman WARNER. And is there a sense that the 24-hour is the right amount of time? Is that the general——

Mr. MURDEN. They use the same provision from Dodd-Frank, so that is—24 hours is what the consensus was in that group. And, accordingly, when the European Commission drafted their Recovery and Resolution Directive, which is their implementation of a resolution framework, they do have that provision in there. We are monitoring the various stages of that directive as it goes through its legislative process, but it is currently—I am told it is currently adequate in terms of giving it the temporary stay.

Chairman WARNER. Mr. Gibson.

Mr. GIBSON. You are definitely right to identify derivatives as one of the challenges for cross-border resolution being effective, and we do have a multifaceted approach to reducing derivatives risk in our financial reform program. We are requiring that all standardized derivative contracts be cleared through a central counterparty, and that uncleared derivative contracts have margin requirements so that there is some collateral there. Those are both part of the G20 financial reform program, and we expect that those will be implemented worldwide. So that will reduce the scope of the problem of derivatives, although there will still be some remaining.

And as Jim mentioned, there are a couple different approaches that we are pursuing internationally on the cross-border derivatives issues. I would broadly characterize those as changing law or changing the contracts. Changing the law means getting the stay that you cited that we have in our U.S. law, the 24-hour stay, getting that in the foreign resolution regimes that are currently being introduced, and have some mutual recognition, so one country's regime could create a stay globally for that country's failing institution.

The other is change the contract so these cross-default or guarantee from the holding company aspects of the contracts are not there, and then the automatic triggers on the derivatives will not automatically happen.

Right now we are pursuing both strategies, and there is still some work to do to make that effective.

Chairman WARNER. Well, I guess one of the questions I have as well, you know, it sounds like we are proceeding apace. Again, many of us, recognizing the complexity in the variety of jurisdictions—since we cannot even get all of domestic Dodd-Frank regulations out 4 years later, I understand that it is more complex. And it seems—and correct me if I am wrong—that the consensus testimony is, you know, great progress made with the U.K., which, again, takes care of—and I think you said, Mr. Wigand, my number may have been wrong at 80 percent. It may have been more like 70 percent of American-based foreign banking operations in the U.K. And, Mr. Murden, you said other areas are moving forward both on resolution authority, they are modeling themselves after our Title II, not a bankruptcy-only process, growing recognition around this issue of derivatives, which I still have enormous concerns about. But how vulnerable are we or how vulnerable is the international financial system in this interim period before our worldwide colleagues get their resolution authority, get their processes in place?

Mr. GIBSON. We have made a lot of progress not only in having the Title II Orderly Liquidation Authority and the many steps the FDIC has already taken to build that out, but we have a stronger financial system, more capital in our banks, banks generally——

Chairman WARNER. More capital in our banks and hopefully the Fed even moving further on that shortly.

Mr. GIBSON. Strengthening the capital in the banks to make the likelihood of a need for resolution more remote is an important part of what we have done, and that is where we are right now. We still have work to do before we are going to be comfortable, but we have made a lot of progress.

Chairman WARNER. I am not sure that was an answer about how vulnerable—but, still, the question of—I understand the progress we have made, but are we vulnerable from a foreign institution? There are large foreign institutions, European banks that may not have been as well as perhaps our Swiss friends or our British friends who, you know, could have enormous challenges, that are internationally significant if there is not a resolution authority. How high on our alert—I do not want us to go back to the homeland security red, yellow, orange, whatever the other color codes are, but how concerned should we be as policy makers about the fact that we are still in this interim period?

Mr. WIGAND. I would say domestically we have made significant progress with respect to thinking through how we would use the statutory authority we were granted under Dodd-Frank as well as, as Mike indicated, lowering the probability that domestic companies would ever need to be resolved under that authority. By increased capital requirements, to think of Dodd-Frank is that it has provisions that lower the probability that a company would fail and then it also has provisions that lower the cost to the financial system upon that failure. Significant progress has been made domestically on both of those fronts, although there is certainly more work to do.

On the international front, I would characterize the shift in the dialogue regarding resolving systemically important financial companies, whether they are domestic or foreign jurisdiction is the home jurisdiction for the company, as one which has markedly shifted from what it was prior to the crisis to what it is today. Rarely does a week go by in which I do not have contacts with foreign counterparts, either on a supervisory side or resolution authority side, with not just one or two but maybe even three or four foreign supervisors and/or resolution authorities. And that type of dialogue and discussion just did not occur prior to this financial crisis, and those on a bilateral basis. But as Bill indicated, there are quite a few multilateral initiatives which have also improved the dialogue and discussion around this point.

There is a lot of work to be done, but I would also characterize it as the progress has been rather significant from where we were back in 2008.

Chairman WARNER. Mr. Murden, and you may—I would like you to specifically address whether the recent challenges in Cyprus has kind of a little more urgency to this.

Mr. MURDEN. Right, right. So just first to build off what Jim said, you know, we are better placed than we were in 2007, 2008, and I think the fact that all 28 G–SIFIs have a crisis management group now, and when the regulators now know each other, know who they are, so if a major financial—one of these G–SIBs got into trouble tomorrow, you know the foreign regulators account for the bulk of that financial institution——

Chairman WARNER. But can I interrupt just for a second?

Mr. MURDEN. Yes.

Chairman WARNER. I appreciate what you are saying, but if one of these G–SIBs were in a country that did not have a resolution authority, you would know who to call.

Mr. MURDEN. Right.

Chairman WARNER. But would your counterparty in the other country have a process to know how to resolve or deal with the institution?

Mr. MURDEN. So these 28 G–SIFIs, they are from 10 countries. Altogether 16 of them are from Europe and 8 from the United States, 4 from Asia. All of those countries, with the exception of China, have some type of resolution framework in place. It may not be ideal. In the case of the U.K., for instance, they passed theirs in 2009 and it does not apply to nonbanks. Japan is passing theirs, but they have something to address banks.

So in terms of the 28 G–SIBs that are covered, it may not be elegant, but we are covered in that respect in terms of knowing how to resolve it and knowing who your counterparts are.

In other countries, in Cyprus, for instance, which does not have any G–SIBs, but it did have banks that were very important systemically—in fact, Cyprus shows—one of the lessons from that shows what happens when banks become too large. The Cyprus banking system was six times the size of GDP. And it also shows how the structure of banks' liabilities can matter. They had very little sub debt, very little unsecured credit in terms of bailing in. So they ended up initially haircutting insured depositors, which caused panic and runs and capital controls.

And so I think that has rekindled interest in Europe on why an orderly resolution framework is important, and the finance ministers in Europe met just yesterday to make progress on an orderly resolution framework on their Resolution and Recovery Directive.

Chairman WARNER. Are there any benchmark timelines we should look to?

Mr. MURDEN. So I would look to the—June 20th is another meeting of the finance ministers working on the Recovery and Resolution Directive. The European legislative process is very complicated. I do not pretend to be an expert. It actually involves three different groups, not two, as the United States. It involves the European Commission, the European Parliament, and the European Council of Ministers.

Chairman WARNER. It may be the only process that makes the U.S. Congress looks speedy.

[Laughter.]

Mr. MURDEN. That is right. That is right. And so they are—modifications to this legislation have to be resolved in something called the "trilogue," but we expect it to be approved sometime this summer. There is great urgency in Europe to get this in place. This would only be phase one. This would require the 27 member States to adopt legislation in their own countries, and it would create 27 resolution authorities.

I think phase two, as Europe embarks on this banking union, and by summer 2014 has a single supervisor of their large banks, being the European Central Bank, I think they are working right now to try to figure out how to move toward a single European resolution mechanism to make that process more effective.

Chairman WARNER. I really appreciate it. I have only got one more question, and it is going to be more for Mr. Wigand and Mr. Gibson. But we have spent a lot of time about resolution. We have spent a lot of time about challenges cross-border. I do think the notion and the progress made on single point of entry seems to be a logical, rational approach, and it does seem like we are trying to make sure at that holding level, bank holding company level, there is going to be an appropriate asset base to get us through this process.

But we all know, you know, if we get another part of Dodd-Frank fully right, the chances of this will be even further diminished, and that is, using the enormous power that we granted the FDIC and the Fed in using these living will documents to make sure that these institutions are not too big to fail or too big to be put out business in a nonsystemically important way. And I know on April 15th, the FDIC and the Fed published the kind of next iteration, editorial comment, and question, you know, there were many of our colleagues on both sides of the aisle who wanted to come into these institutions and purely on the virtue of size put an asset cap or other tools. I think the majority of us felt that the better way to try to put a price on size in terms of added capital and liquidity requirements, but also a much greater transparency on these institutions so that we could see the enormous interconnectedness of some of these institutions and how they would go through some process of being wound down that would not destroy or harm our financial institutions or our overall economy.

You know, I am personally hopeful that you will use those tools somewhat aggressively and demonstrate that both from a transparency standpoint and if there are examples where these institutions cannot be wound down appropriately through bankruptcy, that, you know, Title I gives you a lot of tools around these living wills. And I just would like to hear from both you gentlemen about, one, what you hope to see out of this next round of—I know you have got, I believe, five specific requirements you asked when we are going to get responses. When will we have this living wills process finished?

Mr. WIGAND. We certainly take this exercise very seriously, and authority that the Congress gave the FDIC and the Fed reviewing these living wills, the resolution plans, funeral plans, and the provisions for consequences of finding these plans deficient and not having plans which would indicate that the company is resolvable in an orderly rapid manner through the bankruptcy process. As you noted, Chairman Warner, that we received the first set of plans in 2012, and that was what I characterized as a learning experience for both the firms as well as the FDIC and the Fed.

As a result of those submissions, we came out with our 2013 guidance, which really sets forth some key benchmarks, difficult benchmarks, for these companies to address. These benchmarks would be applied to their specific business model, whether it be a universal bank, a broker-dealer model, or a processing bank.

These are the key obstacles that would be presented in the bankruptcy process. Our expectation is that progress will be made, that the firms will take the guidance seriously and provide a robust analysis addressing these issues. If they do not, then the law provides provisions for the FDIC and the Federal Reserve Board to impose upon the companies to either minimize the prospect of—if the plans are found deficient, to either minimize the prospect of their failure through additional capital or liquidity requirements, or in the event that the companies still fail to produce a credible plan, ultimately divestiture of some of the business operations. That would occur after the statutory 2-year requirement.

It remains to be seen the amount of progress the firms will demonstrate in their plan submissions from 2012 to 2013, but our expectation is that those key benchmarks need to be addressed, and if they are not——

Chairman WARNER. This year.

Mr. WIGAND. This year, and then if the—the FDIC is certainly prepared—the FDIC Board is prepared to look at its authorities for remediating those.

Mr. GIBSON. I think what a successful living will process would look like would be that, as we saw from 2012 to 2013—2012 was the first year the firms had submitted any plan, so there was, as Jim said, a lot of learning both by the firms and by the regulators as to how that was working.

The guidance that we put out for the 2013 plans did have those five pretty significant things that we wanted the firms to do differently in this year's plans compared with last year's plans, obstacles to address, things where we felt like there was more work needed.

I think success would look like those changes from year to year start to shrink until really the plan is an effective plan for resolution under bankruptcy and we do not have to come in with big changes from 1 year to the next, but actually we feel like that we are comfortable with the plan. We should observe the changes from 1 year to the next being smaller, with the obvious exception of if a firm goes through a merger or significant divestiture, then we would require them to revise their plan to take account of that.

Chairman WARNER. Well, I would just simply say that I think progress has been made. I think this hearing has helped me in terms of also some sense of how we are doing vis-a-vis the rest of the world. I think it has also helped in terms of showing that the rest of the world is actually taking the model that we put forward in Dodd-Frank. I think particularly Mr. Wigand has laid out I think with some additional clarity how the resolution process, again, would not be the choice of any rational management team, that there is not a taxpayer liability, that there is a potential, in effect, credit enhancement to keep liquidity of that components of the firm that are systemically important. I think that is all important and helpful to me. Mr. Murden, I hope you have done a good job with your kids as well in terms of afterwards. But the only caution—and I say this as someone who knows, again, recognizing that our—I think everyone, regardless of what they feel about Dodd-Frank, which acknowledge that our financial institutions look much better than the rest of the world's post-crisis, and consequently we are stronger for that.

But, you know, we are 4 years after the fact, and it seems like we do not go 6 months without another crisis/scandal coming out of the banking industry and a growing concern from a great number of members from both sides of the aisle that, you know, this process is not moving fast enough or has not had enough teeth in it that we do not have both a stronger system, a less concentration—or that we have increased concentration, that we have continued concerns about the basic fairness of our system. And I cannot urge you both enough—and I think I understand to some degree at least the level of complexity of going through this, but I would urge you all due speed, because my fear would be for all the good work that has been done, we could be one scandal away from rash action that might look good politically but might not end up making both a stronger system, a more transparent system, and a system that would continue to allow not just the American economy but the world economy to continue on its recovery.

But I thank all of the witnesses for very good testimony. Again, I wish more of my other colleagues were here. I do hope that we will share this with these colleagues, and some of our colleagues in the House who think a current bankruptcy system only might somehow solve the problem, I just fail to understand that.

And, with that, I thank you again, all the witnesses. The hearing is adjourned.

[Whereupon, at 3:25 p.m., the hearing was adjourned.]

[Prepared statements and responses to written questions supplied for the record follow:]

PREPARED STATEMENT OF JAMES R. WIGAND

DIRECTOR, OFFICE OF COMPLEX FINANCIAL INSTITUTIONS, FEDERAL DEPOSIT INSURANCE CORPORATION

MAY 15, 2013

Chairman Warner, Ranking Member Kirk, and Members of the Subcommittee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding our progress in addressing cross-border issues involved in the resolution of a systemically important financial institution (SIFI) with international subsidiaries and affiliates.

The financial crisis that began in late 2007 highlighted the complexity of the international structures of many of these large, complex financial institutions and the need for international cooperation if one of them became financially troubled. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requires the FDIC to coordinate, to the maximum extent possible, with the appropriate foreign regulatory authorities with respect to the resolution of SIFIs having cross-border operations.

Title I and Title II of the Dodd-Frank Act provide significant new authorities to the FDIC and other regulators to address the failure of a SIFI. All large, systemic financial companies covered under Title I must prepare resolution plans, or "living wills," to demonstrate how the company would be resolved in a rapid and orderly manner under the Bankruptcy Code in the event of the company's material financial distress or failure. Requiring SIFIs to explain their interactions with foreign authorities during a resolution is a key element of the plans.

While bankruptcy remains the preferred option, Title II provides a back-up authority to place a holding company, affiliates of an FDIC-insured depository institution, or a nonbank financial company into a public receivership process, if no viable private sector alternative is available to prevent the default of the financial company and a resolution through the bankruptcy process would have serious adverse effects on financial stability in the United States. Establishing and maintaining strong working relationship with our cross-border counterparts will be critical, should the Title II authorities ever need to be invoked. The FDIC and other regulators have been actively working with our international counterparts to coordinate resolution strategies for globally active systemically important financial companies (G–SIFIs).

My testimony will provide greater detail about the authorities available to the FDIC to address the failure of a SIFI and how they improve our ability to manage such failures on an international basis. In addition, it will describe the significant progress we have made with our foreign colleagues in one of the most challenging areas of the financial reforms adopted since the recent crisis. Although much has been accomplished, more work remains.

Resolving a Systemically Important Financial Firm

Title I—"Living Wills"

Bankruptcy is the preferred resolution framework in the event of a SIFI's failure. To make this prospect achievable, Title I of the Dodd-Frank Act requires that all bank holding companies with total consolidated assets of $50 billion or more, and nonbank financial companies that the Financial Stability Oversight Council (FSOC) determines could pose a threat to the financial stability of the United States, prepare resolution plans, or "living wills," to demonstrate how the company could be resolved in a rapid and orderly manner under the Bankruptcy Code in the event of the company's financial distress or failure. This requirement enables both the firm and the firm's regulators to understand and address the parts of the business that could create systemic consequences in a bankruptcy. The living will process is a necessary and significant tool in ensuring that large financial institutions can be resolved through the bankruptcy process.

The FDIC and the Federal Reserve Board issued a joint rule to implement Section 165(d) requirements for resolution plans—the 165(d) Rule—in November 2011. The plans will detail how each covered company could be resolved under the Bankruptcy Code, including information on their credit exposures, cross guarantees, organizational structures, and a strategic analysis describing the company's plan for rapid and orderly resolution.

In addition to the resolution plan requirements under the Dodd-Frank Act, the FDIC issued a separate rule which requires all insured depository institutions (IDIs) with greater than $50 billion in assets to submit resolution plans to the FDIC for their orderly resolution through the FDIC's traditional resolution powers under the Federal Deposit Insurance Act (FDI Act). This rule, promulgated under the FDI Act, complements the joint rule on resolution plans for SIFIs. The 165(d) Rule and the IDI resolution plan rule are designed to work in tandem by covering the full range of business lines, legal entities and capital-structure combinations within a large financial firm.

The FDIC and the Federal Reserve review the 165(d) plans and may jointly find that a plan is not credible or would not facilitate an orderly resolution under the Bankruptcy Code. If a plan is found to be deficient and adequate revisions are not made, the FDIC and the Federal Reserve may jointly impose more stringent capital, leverage, or liquidity requirements, or restrictions on growth, activities, or operations of the company, including its subsidiaries. Ultimately, the FDIC and the Federal Reserve, in consultation with the FSOC, can order the company to divest assets or operations to facilitate an orderly resolution under bankruptcy in the event of failure. A SIFI's plan for resolution under bankruptcy also will support the FDIC's planning for the exercise of its Title II resolution powers by providing the FDIC with a better understanding of each SIFI's structure, complexity, and processes.

2013 Guidance on Living Wills

Eleven large, complex financial companies submitted initial 165(d) plans in 2012. Following the review of the initial resolution plans, the agencies developed instructions for the firms to detail what information should be included in their 2013 resolution plan submissions. [1] The agencies identified an initial set of significant obstacles to rapid and orderly resolution which covered companies are expected to address in the plans, including the actions or steps the company has taken or proposes to take to remediate or otherwise mitigate each obstacle and a timeline for any proposed actions. The agencies extended the filing date to October 1, 2013, to give the firms additional time to develop resolution plan submissions that address the instructions.

Resolution plans submitted in 2013 will be subject to informational completeness reviews and reviews for resolvability under the Bankruptcy Code. The agencies established a set of benchmarks for assessing a resolution under bankruptcy, including a benchmark for cross-border cooperation to minimize the risk of ring-fencing or other precipitous actions. Firms will need to provide a jurisdiction-by-jurisdiction analysis of the actions each would need to take in a resolution, as well as the actions to be taken by host authorities, including supervisory and resolution authorities. Other benchmarks expected to be addressed in the plans include: the risk of multiple, competing insolvency proceedings; the continuity of critical operations—particularly maintaining access to shared services and payment and clearing systems; the potential systemic consequences of counterparty actions; and global liquidity and funding with an emphasis on providing a detailed understanding of the firm's funding operations and cash flows.

As reflected in the Dodd-Frank Act, the preferred option for resolution of a large failed financial firm is for the firm to file for bankruptcy just as any failed private company would, without putting public funds at risk. In certain circumstances, however, resolution under the Bankruptcy Code may result in serious adverse effects on financial stability in the United States. In such cases, the Orderly Liquidation Authority set out in Title II of the Dodd-Frank Act serves as the last resort alternative and could be invoked pursuant to the statutorily prescribed recommendation, determination, and expedited judicial review process.

Title II—Orderly Liquidation Authority

Prior to the recent crisis, the FDIC's receivership authorities were limited to federally insured banks and thrift institutions. The lack of authority to place the holding company or affiliates of an insured depository institution or any other nonbank financial company into an FDIC receivership to avoid systemic consequences severely constrained the ability to resolve a SIFI. Orderly Liquidation Authority permits the FDIC to resolve a failing nonbank financial company in an orderly manner that imposes accountability while mitigating systemic risk.

The FDIC has largely completed the core rulemakings necessary to carry out its systemic resolution responsibilities under Title II of the Dodd-Frank Act. For example, the FDIC approved a final rule implementing the Orderly Liquidation Authority that addressed, among other things, the priority of claims and the treatment of similarly situated creditors.

Key findings and recommendations must be made before the Orderly Liquidation Authority can be considered as an option. These include a determination that the

[1] "Guidance for 2013 §165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012", *http://www.fdic.gov/regulations/reform/domesticguidance.pdf.*

financial company is in default or danger of default, that failure of the financial company and its resolution under applicable Federal or State law, including bankruptcy, would have serious adverse effects on financial stability in the United States and that no viable private sector alternative is available to prevent the default of the financial company. To invoke Title II, the following would be required:

1. a recommendation addressing the eight criteria set out in the Dodd-Frank Act and approved by two-thirds of the members of the Federal Reserve Board of Governors;
2. a recommendation by either two-thirds of the members of the Securities and Exchange Commission (if the financial company or its largest U.S. subsidiary is a securities broker or dealer), in consultation with the FDIC; or the Director of the Federal Insurance Office (if the financial company or its largest U.S. subsidiary is an insurance company), in consultation with the FDIC; or two-thirds of the members of the FDIC Board of Directors (in the case of all other financial companies) also addressing the eight statutory criteria set out in the Dodd-Frank Act; and
3. a determination by the Secretary of the Treasury, in consultation with the President, covering the seven statutory criteria set forth in section 203(b) of the Dodd-Frank Act.

Following the culmination of the expedited judicial review process specified in section 202(a) of the Dodd-Frank Act, the FDIC is appointed receiver under Title II. If, however, the covered financial company is itself an insurance company, the resolution is conducted under applicable state law and the FDIC has backup authority to stand in the place of the appropriate state regulatory agency.

Single Point-of-Entry Strategy

To implement its authority under Title II of the Dodd-Frank Act, the FDIC has developed a strategic approach to resolving a SIFI which is referred to as Single Point-of-Entry. In a Single Point-of-Entry resolution, the FDIC would be appointed as receiver of the top-tier parent holding company of the financial group following the company's failure and the completion of the recommendation, determination and expedited judicial review process set forth in Title II of the Dodd-Frank Act. Shareholders would be wiped out, unsecured debt holders would have their claims written down to reflect any losses that shareholders cannot cover, and culpable senior management would be replaced.

The FDIC would organize a bridge financial company into which the FDIC would transfer assets from the receivership estate, including the failed holding company's investments in and loans to subsidiaries. Equity, subordinated debt, and senior unsecured debt of the failed company would likely remain in the receivership and be converted into claims. Losses would be apportioned to the claims of former equity holders and unsecured creditors according to their order of statutory priority. Remaining claims would be converted, in part, into equity that will serve to capitalize the new operations, or into new debt instruments. This newly formed bridge financial company would continue to operate the systemically important functions of the failed financial company, thereby minimizing disruptions to the financial system and the risk of spillover effects to counterparties.

The healthy subsidiaries of the financial company would remain open and operating, allowing them to continue business and avoid the disruption that would likely accompany their closings. Critical operations for the financial system would be maintained. Because these subsidiaries would remain open and operating as going-concerns, counterparties to most of the financial company's derivative contracts would have neither a legal right nor a financial motivation to terminate and net out their contracts.

However, creditors at the subsidiary level should not assume that they avoid risk of loss. For example, if the losses at the financial company are so large that the holding company's shareholders and creditors cannot absorb them, then the subsidiaries with the greatest losses will have to be placed into resolution, exposing those subsidiary creditors to loss.

Under the Dodd-Frank Act, officers and directors responsible for the failure cannot be retained and would be replaced. The FDIC would appoint a new Chief Executive Officer and Board of Directors from the private sector to run the bridge holding company under the FDIC's oversight during the first step of the process.

During the resolution process, restructuring measures would be taken to address the problems that led to the company's failure. These could include changes in the company's businesses, shrinking those businesses, breaking them into smaller entities, and/or liquidating certain assets or closing certain operations. The FDIC also would likely require the restructuring of the firm into one or more smaller nonsystemic firms that could be resolved under bankruptcy.

The FDIC expects the well-capitalized bridge financial company and its subsidiaries to borrow in the private markets and from customary sources of liquidity. The new resolution authority under the Dodd-Frank Act provides a back-up source for liquidity support, the Orderly Liquidation Fund (OLF). If it is needed at all, the FDIC anticipates that this liquidity facility would only be required during the initial stage of the resolution process, until private funding sources can be arranged or accessed. Much like debtor-in-possession financing in a bankruptcy, the OLF can only be used for liquidity and would only be available on an over-collateralized fully secured basis. If any OLF funds are provided, the OLF must be repaid either from recoveries on the assets of the failed firm or, in the unlikely event of a loss on the collateralized borrowings, from assessments against the largest, most complex financial companies. The law expressly prohibits taxpayer losses from the use of Title II authority.

In our view, the Single Point-of-Entry strategy holds the best promise of achieving Title II's goals of holding shareholders, creditors and management of the failed firm accountable for the company's losses and maintaining financial stability.

Cross-Border Issues

Addressing the issues associated with the resolution of G–SIFIs is challenging. Advance planning and cross border coordination will be critical to minimizing disruptions to global financial markets. Recognizing that G–SIFIs create complex international legal and operational concerns, the FDIC is actively reaching out to foreign host regulators to engage in dialogue concerning matters of mutual concern and to enter into bilateral Memoranda of Understanding in order to address issues associated with cross-border regulatory requirements, to gain an in-depth understanding of foreign resolution regimes, and to establish frameworks for robust cross-border cooperation and the basis for confidential information-sharing, among other initiatives.

Coordination With the United Kingdom, the European Union, Switzerland, and Japan

As part of our bilateral efforts, the FDIC and the Bank of England, in conjunction with the prudential regulators in our respective jurisdictions, have been working to develop contingency plans for the failure of G–SIFIs that have operations in both the U.S. and the U.K. Of the 28 G–SIFIs designated by the Financial Stability Board (FSB)[2] of the G20 countries, four are headquartered in the U.K, and another eight are headquartered in the U.S. Moreover, approximately 70 percent of the reported foreign activities of the eight U.S. G–SIFIs emanates from the U.K. The magnitude of these financial relationships makes the U.S.–U.K. bilateral relationship by far the most significant with regard to the resolution of G–SIFIs. As a result, our two countries have a strong mutual interest in ensuring that, if such an institution should fail, it can be resolved at no cost to taxpayers and without placing the financial system at risk. An indication of the close working relationship between the FDIC and U.K authorities is the joint paper on resolution strategies that the FDIC and the Bank of England released in December 2012.[3] This joint paper focuses on the application of "top-down" resolution strategies for a U.S. or a U.K. financial group in a cross-border context and addressed several common considerations to these resolution strategies.

In addition to the close working relationship with the U.K., the FDIC is coordinating with representatives from other European regulatory bodies to discuss issues of mutual interest including the resolution of European G–SIFIs. The FDIC and the European Commission (E.C.) have established a joint Working Group comprised of senior executives from the FDIC and the E.C. The Working Group convenes formally twice a year—once in Washington, once in Brussels—with ongoing collaboration continuing in between the formal sessions. The first of these formal meetings took place in February 2013. Among the topics discussed at this meeting was the E.C.'s proposed Recovery and Resolution Directive, which would establish a framework for dealing with failed and failing financial institutions and which is expected to be finalized this spring. The overall authorities outlined in that document have a number of parallels to the SIFI resolution authorities provided here in the U.S.

[2] The Financial Stability Board is an international member organization established in 2009 to develop and promote the implementation of effective regulatory and supervisory policies.

[3] "Resolving Globally Active, Systemically Important, Financial Institutions". *http://www.fdic.gov/about/srac/2012/gsifi.pdf.*

under the Dodd-Frank Act. The next meeting of the Working Group will take place in Brussels later this year.

The FDIC also has engaged with Swiss regulatory authorities on a bilateral and trilateral (including the U.K.) basis. Through these meetings, the FDIC has further developed its understanding of the Swiss resolution regime for G–SIFIs, including an in-depth examination of the two Swiss-based G–SIFIs with significant operations in the U.S. We have made substantial progress in establishing a strong framework for the sharing of information and for coordination with respect to the resolution of G–SIFIs operating in our respective jurisdictions.

The FDIC has had bilateral meetings with Japanese authorities. In March 2013, FDIC staff attended meetings hosted by the Deposit Insurance Corporation of Japan to discuss the FDIC's resolution strategy under the Orderly Liquidation Authority and the treatment of qualified financial contracts under the Dodd-Frank Act. That same month, the FDIC hosted a meeting with representatives of the Japan Financial Services Agency (JFSA) to discuss our respective resolution regimes. Representatives of the JFSA provided a detailed description of the current legislative proposal to amend Japan's existing resolution regime to enhance authorities' ability to resolve SIFIs. These bilateral meetings, including an expected principal level meeting later this year, are part of our continued effort to work with Japanese authorities to develop a solid framework for coordination and information-sharing with respect to resolution, including through the identification of potential impediments to the resolution of G–SIFIs with significant operations in both jurisdictions.

To place these working relationships in perspective, the U.S., the U.K., the European Union, Switzerland, and Japan account for the home jurisdictions of 27 of the 28 G–SIFIs designated by the FSB and the Basel Committee on Banking Supervision in November 2012. Progress in these cross-border relationships is thus critical to addressing the international dimension of SIFI resolutions.

Multilateral Initiatives

The FDIC also has been active in multilateral initiatives promoting international financial stability through the FSB—and in particular its efforts to establish greater cross-border resolution coordination—through the Resolution Steering Group, the Cross-border Crisis Management Group and a number of technical working groups. Additionally, the FDIC has been the cochair of the Cross-border Bank Resolution Group of the Basel Committee on Banking Supervision since its inception in 2007.

Resolution regimes have been identified as a priority area by the FSB. In April 2013, the FSB published the findings of the first Peer Review on Resolution Regimes.[4] The review, which was conducted by a team led by the FDIC, focused on compliance with international financial principles developed by the FSB and endorsed by the G20 for the key attributes of resolution.[5] The objectives of the review were to encourage consistent cross-country and cross-sector implementation; to evaluate (where possible) the extent to which standards and policies have had their intended results; and to identify gaps and weaknesses in reviewed areas and to make recommendations for potential follow-up (including via the development of additional principles) by FSB members.

The FDIC also has evaluated information and strategies concerning G–SIFI resolution regimes prepared by U.S. and foreign authorities in the course of its involvement with multilateral cross-border initiatives, most notably the Crisis Management Group process established by the FSB, including efforts to develop resolvability assessments for individual G–SIFIs. These ongoing institution-specific resolution planning efforts have underscored the complex structure of the large G–SIFIs that may become subject to the FDIC's Orderly Liquidation Authority.

Conclusion

In conclusion, the FDIC, working with our foreign colleagues, has made substantial progress in one of the most challenging areas of the financial reforms adopted in the Dodd-Frank Act. The cross-border issues presented by the failure of a G–SIFI with international operations are complex and difficult. The new authorities granted to the FDIC under Title I and Title II of the Dodd-Frank Act provide a statutory framework to address these important issues. While much work remains to be done, the FDIC is much better positioned today to address the failure of one of these institutions.

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[4] Financial Stability Board, "Implementing the Key Attributes of Effective Resolution Regimes—How Far Have We Come?" *http://www.financialstabilityboard.org/publications/r__130419b.pdf.*

[5] Financial Stability Board, "Key Attributes of Effective Resolution Regimes", *http://www.financialstabilityboard.org/publications/r__111104cc.pdf.*

PREPARED STATEMENT OF MICHAEL S. GIBSON

DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MAY 15, 2013

Chairman Warner, Ranking Member Kirk, and other Members of the Subcommittee, I appreciate the opportunity to testify today on the challenges to achieving an orderly cross-border resolution of a failed systemic financial firm. In my remarks, I would like to first reflect on the improvements that have been made in the last few years in the underlying strength and resiliency of the largest U.S. banking firms, and then turn to a discussion of what has been accomplished and what remains to be accomplished in facilitating a cross-border resolution.

A Look Back

The recent financial crisis was unprecedented in its scope and severity. Some of the world's largest financial firms nearly or completely collapsed, sending shock waves through the highly interconnected global financial system. The crisis made clear that our regulatory framework for reducing the probability of failure of systemic financial firms was insufficient and that Governments everywhere had inadequate tools to manage the failure of a systemic financial firm.

Since 2008, the United States and the international regulatory community have made meaningful progress on policy reforms to reduce the moral hazard and other risks associated with financial firms perceived to be too big to fail. In broad terms, these reforms seek to eliminate too big to fail in two ways: (1) by reducing the probability of failure of systemic financial firms through stronger capital and liquidity requirements and heightened supervision, and (2) by reducing the costs to the broader system in the event of the failure of such a firm. My testimony today relates principally to the second of these two aspects of reform, but I want to begin by highlighting some of the material achievements we have made to reduce the likelihood of failure of systemic financial firms.

The Basel III capital and liquidity reforms are the foundation of the global efforts to improve the resilience of the international banking system. These reforms are being implemented in the United States and elsewhere. In addition, the Federal Reserve has significantly strengthened its supervision of the largest, most complex financial firms since the financial crisis. For example, the Federal Reserve now conducts rigorous annual stress tests of the capital adequacy of our largest bank holding companies. As a result of these efforts, the overall strength of the largest U.S. banking firms has significantly improved. The aggregate tier 1 common equity ratio of the 18 largest U.S. banking firms has more than doubled, from 5.6 percent of risk-weighted assets at the end of 2008 to 11.3 percent at the end of 2012. In absolute terms, these firms have increased their aggregate levels of tier 1 common equity from just under $400 billion in late 2008 to almost $800 billion at the end of 2012. Higher capital puts these firms in a much better position to absorb future losses and continue to fulfill their vital role in the economy. In addition, the U.S. banking system's liquidity position relative to precrisis levels has materially improved.

Accomplishments to Date on Cross-Border Resolution

Congress and U.S. regulators have made substantial progress since the crisis in improving the process for resolving systemic financial firms. The core areas of progress include adoption and implementation of statutory resolution powers, adoption and implementation of resolution planning requirements, increased international coordination efforts, and the Federal Reserve's foreign bank regulatory proposal.

Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) created the Orderly Liquidation Authority (OLA), a statutory resolution mechanism designed to improve the prospects for an orderly resolution of a systemic financial firm. In many ways, OLA has become a model resolution regime for the international community. The Financial Stability Board (FSB) in 2011 adopted the "Key Attributes of Effective Resolution Regimes for Financial Institutions", a new standard for resolution regimes for systemic firms.[1] The core features of this global standard are already embodied in OLA. By acting early through the passage of the Dodd-Frank Act, Congress paved the way for the United States to be a leader in shaping the development of international policy for effective resolution regimes for systemic financial firms.

[1] *See, www.financialstabilityboard.org/publications/r__111104cc.pdf.*

The Federal Reserve supports the progress made by the Federal Deposit Insurance Corporation (FDIC) in implementing OLA, including, in particular, by developing a single-point-of-entry (SPOE)[2] resolution approach. SPOE is designed to focus losses on the shareholders and long-term unsecured debt holders of the parent holding company of the failed firm. It aims to produce a well-capitalized bridge holding company in place of the failed parent by converting long-term debt holders of the parent into equity holders of the bridge. The critical operating subsidiaries of the failed firm would be re-capitalized, to the extent necessary, and would remain open for business. The SPOE approach should work to significantly reduce incentives for creditors and customers of the operating subsidiaries to run and for host-country regulators to engage in ring-fencing or other measures disruptive to an orderly, global resolution of the failed firm.

The Dodd-Frank Act requires all large bank holding companies to develop, and submit to supervisors, resolution plans. The largest U.S. bank holding companies and foreign banking organizations submitted their first annual resolution plans to the Federal Reserve and the FDIC in the third quarter of 2012. These "first-wave" resolution plans have yielded valuable information that is being used to identify, assess, and mitigate key challenges to resolvability under the Bankruptcy Code and to support the FDIC's development of backup resolution plans under OLA. These plans are also very useful supervisory tools that have helped the Federal Reserve and the firms focus on opportunities to simplify corporate structures and improve management systems in ways that will help the firms be more resilient and efficient, as well as easier to resolve.

Internationally, the Federal Reserve has been an active participant in the FSB's work to address the challenges of cross-border resolutions. For example, the Federal Reserve, together with the FDIC, participated in the development of the "Key Attributes". We are also an active participant in the FSB's many committees and technical working groups charged with developing policy guidance on a broad range of technical areas that affect the feasibility of cross-border resolution. Moreover, as the home-country supervisor of 8 of the 28 global systemically important banks (G–SIBs) identified by the FSB, the Federal Reserve has the responsibility of establishing and routinely convening for each U.S. G–SIB a crisis management group. These firm-specific crisis management groups, which are comprised primarily of the firm's prudential supervisors and resolution authorities in the United States and key foreign jurisdictions, are working to mitigate potential cross-border obstacles to an orderly resolution of the firms.

Last year, the Federal Reserve also sought public comment on a proposal that would generally require foreign banks with a large U.S. presence to organize their U.S. subsidiaries under a single intermediate holding company that would serve as a platform for consistent supervision and regulation.[3] Just as other countries already apply Basel capital requirements to U.S. bank subsidiaries operating in their countries, our proposal would subject the U.S. intermediate holding companies of foreign banks to the same capital and liquidity requirements as U.S. bank holding companies. We believe that the proposal would significantly improve our supervision and regulation of the U.S. operations of foreign banks, help protect U.S. financial stability, and promote competitive equity for all large banking firms operating in the United States. The proposal would enhance the ability of the United States, as a host-country regulator, to cooperate with a firm-wide, global resolution of a foreign banking organization led by its home-country authorities.

Challenges Ahead on Cross-Border Resolution

Despite the progress that is being made within the FSB and in our domestic efforts with the FDIC, developing feasible solutions to the obstacles presented by cross-border resolution of a systemic financial firm remains necessary and work toward this end is under way. The key remaining obstacles include (1) adopting effective statutory resolution regimes in other countries; (2) ensuring systemic global banking firms have sufficient "gone concern" loss-absorption capacity; (3) completing firm-specific cooperation agreements with foreign regulators that provide credible assurances to those host-country regulators to forestall disruptive ring-fencing; and (4) coordinating consistent treatment of cross-border financial contracts.

First, although the United States has had OLA in place since 2010, and the FDIC has made good progress in developing the framework for using OLA over the past

[2] In a SPOE resolution under Title II of the Dodd-Frank Act, the FDIC is appointed as a receiver of the top-tier holding company to carry out the resolution of the company.

[3] *See,* Board of Governors of the Federal Reserve System (2012), "Federal Reserve Board Releases Proposed Rules To Strengthen the Oversight of U.S. Operations of Foreign Banks", press release, December 14, *www.federalreserve.gov/newsevents/press/bcreg/20121214a.htm.*

3 years, most other major jurisdictions have not yet enacted national legislation that would create a statutory resolution regime with the powers and safeguards necessary to meet the FSB's "Key Attributes". Mitigating the obstacles to cross-border resolution will, at a minimum, require key foreign jurisdictions to have implemented national resolution regimes consistent with the "Key Attributes". Therefore, we will continue to encourage our fellow FSB member jurisdictions to move forward with such reforms as quickly as possible.

Second, key to the ability of the FDIC to execute its preferred SPOE approach in OLA is the availability of sufficient amounts of debt at the parent holding company of the failed firm. Accordingly, in consultation with the FDIC, the Federal Reserve is considering the merits of a regulatory requirement that the largest, most complex U.S. banking firms maintain a minimum amount of outstanding long-term unsecured debt on top of its regulatory capital requirements. Such a requirement could have a number of public policy benefits. Most notably, it would increase the prospects for an orderly resolution under OLA by ensuring that shareholders and long-term debt holders of a systemic financial firm can bear potential future losses at the firm and sufficiently capitalize a bridge holding company in resolution. In addition, by increasing the credibility of OLA, a minimum long-term debt requirement could help counteract the moral hazard arising from taxpayer bailouts and improve market discipline of systemic firms. Switzerland, the United Kingdom, and the European Commission are moving forward with similar requirements, and it may be useful to work toward an international agreement on minimum total loss absorbency requirements for globally systemic firms.

Third, we need to take additional actions to promote regulatory cooperation among home and host supervisors in the event of the failure of an internationally active, systemic financial firm. Importantly, OLA only can apply to U.S.-chartered entities. Foreign subsidiaries and bank branches of a U.S.-based systemic financial firm could be ring-fenced or wound down separately under the insolvency laws of their host countries if foreign authorities did not have full confidence that local interests would be protected. Further progress on cross-border resolution ultimately will require significant bilateral and multilateral agreements among U.S. regulators and the key foreign central banks and supervisors for the largest global financial firms. It also may require that home-country authorities provide credible assurances to host-country supervisors to prevent disruptive forms of ring-fencing of the host-country operations of a failed firm. The ultimate strength of these agreements will depend on whether they have adequately addressed the shared objectives, as well as the self-interests, of the respective home and host authorities. The groundwork for these agreements is being laid, but many of the most critical issues can be addressed only after other jurisdictions have effective resolution frameworks in place.

Fourth, we must help ensure that a home-country resolution of a global systemic financial firm does not cause key creditors and counterparties of the firm's foreign operations to run unnecessarily. One of the key challenges to the orderly resolution of an internationally active, U.S.-based financial firm is that certain OLA stabilization mechanisms authorized under title II of the Dodd-Frank Act, including the 1-day stay provision with respect to over-the-counter derivatives and certain other financial contracts, may not apply outside the United States. Accordingly, counterparties to financial contracts with the foreign subsidiaries and branches of a U.S. firm may have contractual rights and substantial economic incentives to terminate their transactions as soon as the U.S. parent enters into resolution. Regulators and the industry are focused on the potential for addressing this concern through modifications to contractual cross-default and netting practices and through other means. The Federal Reserve will continue to support these efforts.

Conclusion

The financial regulatory architecture is stronger today than it was in the years leading up to the crisis, but considerable work remains to complete implementation of the Dodd-Frank Act and the post-crisis global financial reform program. A key prong of that program is making sure that Government authorities in the United States and around the world can effect an orderly resolution of a systemically important, internationally active financial firm. Much has been accomplished in this area, but much remains to be done. In the coming years, the Federal Reserve will be working with other U.S. financial regulatory agencies, and with foreign central banks and regulators, to make an orderly resolution of a global systemic financial firm as feasible as possible.

Thank you for your attention. I am happy to answer any questions you might have.

PREPARED STATEMENT OF WILLIAM C. MURDEN

DIRECTOR, OFFICE OF INTERNATIONAL BANKING AND SECURITIES MARKETS, DEPARTMENT OF THE TREASURY

MAY 15, 2013

Chairman Warner, Ranking Member Kirk, Members of the Senate Subcommittee on National Security and International Trade and Finance, thank you for this opportunity to testify on the subject of cross-border resolutions. This is a complex, but critically important part of the international efforts to promote regulatory reform, and it is a privilege and honor for me to testify at this hearing.

I. G20 and FSB Framework

The financial crisis of 2007–09 and the subsequent European sovereign crisis revealed fundamental weaknesses in some global financial institutions. In the aftermath of a number of noteworthy financial firm failures, ranging from Lehman Brothers in the United States to Northern Rock in the U.K. to Dexia in continental Europe, the G20 Leaders agreed at their meeting in Pittsburgh in 2009 to develop frameworks and tools for the effective resolution of financial groups to help mitigate the disruption from financial institution failures and reduce moral hazard in the future.

The G20 Leaders turned to the Financial Stability Board (FSB) to oversee the implementation of their financial regulatory commitments. The FSB is a unique international regulatory policy body that comprises high-level policy makers from finance ministries, central banks, banking supervisors, and market regulators of all the G20 countries and other key financial centers, plus key international bodies, such as the IMF, World Bank, and the Bank for International Settlements (BIS).

In October 2010, the FSB recommended a policy framework, which the G20 Leaders subsequently endorsed, to address the moral hazard posed by global systemically important financial institutions (G–SIFIs) that consisted of four key prongs:

- a resolution framework to ensure that all financial institutions can be resolved safely, quickly and without destabilizing the financial system and exposing the taxpayer to the risk of loss;
- a requirement that G–SIFIs have higher loss absorbency capacity to reflect the greater risks that these institutions pose to the global financial system;
- more intensive supervisory oversight for financial institutions that may pose systemic risk; and,
- robust core financial market infrastructures to reduce contagion risk from the failure of individual institutions.

Today, I will discuss the first prong—the international resolution framework.

II. The Overarching FSB Framework for Improving the Resolution of Financial Institutions

All countries need to have effective national resolution systems to resolve failing financial institutions in an orderly manner, including a legislative and regulatory framework, legal powers, and institutional arrangements. An effective national resolution system is a necessary prerequisite to an effective cross-border resolution framework. At the same time, national resolution systems must be consistent with one another to facilitate the orderly cross-border resolution of G–SIFIs. Subjecting the same firm to conflicting legal rules, procedures, and mechanisms can create uncertainty, instability, possible systemic contagion, and higher costs of resolution.

Accordingly, following the call by the G20 Leaders, the FSB laid out an approach to resolution that consisted of the following key elements:

- a new international standard that countries would implement to ensure a consistent national resolution framework for G–SIFIs and other financial institutions;
- making the new international standard, and resolution more generally, a top international priority to ensure that countries would devote the necessary resources to legislative, regulatory, and institutional changes to implement the new international standard;
- an international assessment process to ensure that countries would comply with the new international standard and implement it in a consistent manner across jurisdictions; and
- a framework to resolve individual G–SIFIs.

The FSB's G–SIFI-specific framework, in turn, called for an individual crisis management group (CMG) for each of the G–SIFIs. The FSB has currently identified 28 G–SIFI banks. Each of the 28 corresponding CMGs would have supervisors and resolution authorities from the bank's home jurisdiction, as well as from 3–5 other key jurisdictions where the institution in question has a major presence. These CMGs would be tasked with developing recovery and resolution plans for individual firms and developing cooperation agreements among the relevant regulators to provide an ex ante agreement on how resolutions would be handled. Once planning is complete and cooperation agreements are in place, the CMGs would use a "resolvability assessment" process to determine what other steps are needed to make cross-border resolutions possible.

The above description comprises the G20/FSB's general resolution framework. The FSB established a Resolution Steering Group, chaired by Bank of England Deputy Governor Paul Tucker and with active U.S. participation, to oversee the development of this framework and its implementation.

III. Progress in Completing the New G20/FSB Framework/Strategy

Much progress has been made, reflecting the high priority and considerable time and energy that countries are devoting to the new framework. The FSB's Resolution Steering Group developed a new international resolution standard, called the "Key Attributes of Effective Resolution Regimes for Financial Institutions". The "Key Attributes" offer over 100 specific recommendations in 12 general areas, including resolution authorities and powers, recovery and resolution planning, funding, safeguards, segregation of client assets, cross-border cooperation, and information sharing. In July 2011, the Resolution Steering Group issued the Key Attributes for public comment and, in November 2011, the G20 Leaders endorsed the new standard.

The FSB's Resolution Steering Group is now developing an assessment methodology that independent assessors can use as a yardstick to measure jurisdictions' progress in implementing the "Key Attributes". In cooperation with the FSB, the IMF and the World Bank have launched a pilot project to test the methodology in two jurisdictions. Lessons learned in these pilot assessments will feed into the final methodology. Once this process is complete, we expect that the FSB will add the "Key Attributes" to its list of 12 key international standards and codes. The key standards and codes represent minimum requirements for good practice in areas such as banking supervision, securities regulation, accounting, and antimoney laundering that countries are encouraged to meet or exceed. The FSB has identified these standards as meriting priority implementation by all countries. This, in turn, would mean that the IMF and the World Bank could add the Key Attributes to their regular analysis of a country's financial sector through their Financial Sector Assessment Program, which they apply to 190 or so countries worldwide.

The FSB itself has recently completed the first of many peer reviews to measure progress across its 24 member jurisdictions in implementing the "Key Attributes". FDIC Chairman Martin Gruenberg chaired the FSB's review, which found that the United States is leading the globe in implementing its own effective resolution regime that was created under Title II of the Dodd-Frank Act. The FSB peer review also found that outside the United States, implementation of the "Key Attributes" remains at an early stage, and many jurisdictions still lack the necessary powers and institutions to resolve effectively either G–SIFIs or other financial institutions.

Still, while other jurisdictions lag behind the United States, progress is occurring. In Europe, major jurisdictions, including France, Germany, the Netherlands, Switzerland, and the U.K., have proposed or passed legislation for resolution frameworks that are largely consistent with the "Key Attributes". The European Commission is working to finalize its own Bank Recovery and Resolution Directive in June of this year, which all 27 member States in the European Union would be expected to implement. The European Union is also working on a larger European effort to develop a true banking union, with a single supervisory mechanism and a single resolution authority for the euro area.

In Asia, jurisdictions including Japan, Singapore, and Hong Kong have proposed, or are preparing to propose, resolution reforms, while other jurisdictions are still considering their approach.

In addition to developing the "Key Attributes", the FSB's Resolution Steering Group is continuing to work on specific aspects of cross-border resolution, including the treatment of client assets, the scope and prerequisites for information sharing between different authorities, and the resolution of derivatives central counterparties. The latter is expected to become vital linchpins of the financial system as derivatives reforms begin to take effect in major jurisdictions.

The FSB and national authorities have also made important progress in enabling the resolution of individual firms. Most FSB member countries that are home to G–

SIFIs have developed high-level national resolution strategies and discussed these with key host authorities in their CMGs. To date, CMGs have been established for each of the 28 G–SIFIs, and nearly all CMGs have already met at least once. Each CMG is working to develop recovery and resolution plans for its respective institution and to negotiate cooperation agreements, or "COAGs," among all of its member authorities. Resolvability assessments are scheduled for 2014 to determine what we have achieved so far and what remains to be done to make each G–SIFI resolvable.

IV. Next Steps

While much has been accomplished, there is much more still to do. The United States has 75 years of experience in resolving financial institutions, but many countries have only recently realized the need to implement an effective resolution regime. They must develop and operationalize the principles contained in the "Key Attributes" if the resolution of G–SIFIs with cross-border operations is to be made credible. Our focus is currently on three interrelated efforts: first, finalizing cooperation agreements and building trust between national regulators, so that we can successfully cooperate to resolve large international institutions across borders with minimum disruption to the global financial system; second, encouraging foreign jurisdictions to build more flexibility into their resolution frameworks to allow coordinated resolutions to become feasible; and third, establishing strong lines of communication and information-sharing among relevant national authorities.

In addition, the FSB Resolution Steering Group continues to work in the following areas:

- completing the resolution planning process and finalizing cooperation agreements for each G–SIFI;
- developing supplemental guidance containing clear principles to address: (i) information sharing for resolution purposes; (ii) the protection of client assets in resolution; (iii) the resolution of financial market infrastructures (FMIs); and, (iv) the resolution of insurers;
- finalizing the "Key Attributes" Methodology (public consultation, pilot assessments);
- following up on the recommendations of the peer review on resolution regimes; and,
- planning for a resolvability assessment process for G–SIFIs that should be launched in early 2014.

The experience with the recent bank failures in Cyprus, including an initial proposal to haircut insured depositors, has refocused attention within Europe on the importance of an effective resolution framework. Cyprus had no resolution statute and its parliament was required to draft and approve legislation in only a few days, which in the event did not impair insured depositors. However, this has reinforced the need in Europe to make progress on implementing resolution systems, including a depositor preference regime. It is important that the FSB build on the "Key Attributes" and include specific depositor preference and creditor hierarchy.

V. Conclusion

Keeping our focus on these efforts is vital. The financial crisis made clear that the failure of large, international financial firms can result in systemic damage that does not stop at national borders and can directly impact the day-to-day lives of people around the world. This risk and the complexity of today's global financial system make international cooperation and understanding among national regulators absolutely necessary. The FSB is playing a vital role in bringing domestic and foreign regulators together to build the capacity, the mutual trust, and the communication networks necessary to make possible the resolution of systemic financial institutions without the risk of systemic damage, a risk we now know is all too real.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KIRK FROM JAMES R. WIGAND

Q.1. Dodd-Frank did not specifically enact any new anti-money laundering laws. However, in what ways has the Act impacted existing Federal oversight of AML and BSA compliance in each of your agencies?

A.1. As you note in your question, the Dodd-Frank Act did not enact any new anti-money laundering (AML) laws. For the FDIC, the biggest impact on our oversight of AML and Bank Secrecy Act (BSA) compliance in recent years were the significant changes incorporated into the BSA with the passage of the USA Patriot Act in October 2001. In particular, §327 of the USA Patriot Act addresses the effectiveness of insured depository institutions in combatting money laundering activities specifically when an institution proposes a merger. For practical purposes, the statute requires the agency to consider the existence of any supervisory action that includes BSA/AML provisions when processing a merger application.

Generally, the statute requires that a merger cannot be approved with any of the following outstanding issues:

1. Unresolved BSA/AML program violations or provisions in enforcement actions; such violations would result from failures of any component in the BSA/AML Program requirements, which include:

   a. System of internal controls;
   b. Independent review of the BSA/AML Compliance Program;
   c. BSA Officer responsible for daily BSA/AML activities;
   d. BSA/AML training; and
   e. Customer Identification Program.

2. Pending AML investigations or supervisory actions; or

3. Outstanding AML investigations, actions, or pending matters with other relevant agencies (such as Treasury, FinCEN, or law enforcement).

With respect to large, complex institutions, such as those raising concerns regarding cross-border resolutions, the FDIC's direct supervisory role includes the processing of applications seeking to merge the uninsured entity into an insured institution (for example, merging a mortgage subsidiary into an insured bank). We have noted a nominal increase in the number of such merger proposals, which are governed by Section 18 of the FDI Act and which generally seek to rationalize or consolidate corporate structures. In each case, the FDIC must consider each applicable statutory factor, including the effectiveness of the insured institutions involved in the merger in combatting money laundering activities.

Separately, we note that large, complex insured institutions generally have a full range of cross-border activities and relationships. In terms of off-site analysis and the review of various applications, we evaluate the primary Federal regulator's assessment of the bank's compliance with all aspects of the law and regulations, including the BSA.

Sections 313 and 319 of the USA Patriot Act amended the BSA to prohibit U.S. financial institutions from maintaining accounts in the U.S. for foreign shell banks and require record keeping for certain foreign correspondent accounts. To comply with this regulation, financial institutions need to conduct enhanced due diligence to ensure it knows the owners of the account relationship and the activity in the account corresponds to the U.S. bank's expectations for that relationship.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KIRK FROM MICHAEL S. GIBSON

Q.1. During the Banking Committee's March hearing on money laundering, Governor Powell noted that the Federal Reserve played a key role in developing standards that improved transparency in cross-border payment messages, including the standards adopted by Basel and SWIFT. These standards required the expanded disclosure of the originator and beneficiary on payment instructions sent as part of cover payments. Manipulation of this information not only facilitates money laundering, but also sanctions evasion, as we have seen in numerous cases.

Isn't it true though that, even after about 20 years have gone by, this information is still not actually required to be collected under the Bank Secrecy Act or its "record keeping and travel" rules issued jointly by the Fed and FinCEN?

As stated at that hearing, both the Treasury and the Federal Reserve participate in an AML task force at the principals level. Has this BSA issue been addressed there, yet?

Even if banks may be hesitant, on their own volition, to accept such payment messages without all the fields completed, would such a gap in the law make it difficult to prosecute a violator who abuses the payment instruction? What effect has this on compliance with a Deferred Prosecution Agreement?

A.1. The record keeping and travel rules issued by the Board and FinCEN in 1995 require U.S. financial institutions, at the initiation of a funds transfer, to collect and retain the name of the originator (and, if received with an incoming funds transfer order, the name of the recipient) on funds transfers in excess of $3,000. From a compliance standpoint, U.S. financial institutions routinely screen the payment messages that accompany these funds transfers for compliance with U.S. economic sanctions. Foreign banks that operate in countries without rules similar to those imposed by the U.S. have not always had in place the mechanisms to ensure transactions routed through the U.S. comply with U.S. law.

The Board has a history of taking action against the institutions we supervise as needed to address unsafe or unsound banking practices in this area, including against those who omit, delete or alter information in payment messages or orders for the purpose of avoiding detection of that information by any other financial institution in the payment process. However, the Board does not have the legal authority to impose criminal penalties against financial institutions for violations of U.S. economic sanctions, and does not use Deferred Prosecution Agreements (DPAs). The Department of Justice and other criminal law enforcement authorities have used DPAs as an enforcement tool against banking entities and others that violate the law, and have primary responsibility for monitoring and assessing compliance under such agreements.

Currently, as a member of the U.S. Department of the Treasury's Interagency Task Force on Strengthening and Clarifying BSNAML Framework (Task Force), the Board is engaged in a review of the BSA, its implementation, and its enforcement with respect to U.S. financial institutions that are subject to these requirements. Task Force discussions are at an early stage and findings and recommendations are still being worked on.

As you point out, the Dodd-Frank Act did not enact any new anti-money laundering requirements. The Act has not had a significant effect on the Federal Reserve's supervisory program related to BSNAML compliance.

Q.2. Dodd-Frank did not specifically enact any new anti-money laundering laws. However, in what ways has the Act impacted existing Federal oversight of AML and BSA compliance in each of your agencies?

A.2. Please see response to Question 1.