

FEDERAL DEPOSIT INSURANCE CORPORATION

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SYSTEMIC RESOLUTION ADVISORY COMMITTEE

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MEETING

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WEDNESDAY,
NOVEMBER 9, 2022

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The Advisory Committee convened at 9:00 a.m. EDT in the Federal Deposit Insurance Corporation Board Room at 550 17th Street NW, Washington, DC, Martin J. Gruenberg, Acting Chairman, presiding.

PRESENT:

SHEILA BAIR, Former Chairman, Federal Deposit Insurance Corporation*

SHELLEY C. CHAPMAN, Senior Counsel, Willkie Farr & Gallagher, Former United States Bankruptcy Judge, Southern District of New York*

TIM P. CLARK, Distinguished Senior Banking Advisor, Better Markets, Former Deputy Director of Supervision and Regulation, Federal Reserve Board of Governors

JAY CLAYTON, Former Chairman, U.S. Securities and Exchange Commission (SEC)

H. RODGIN COHEN, Senior Chairman, Sullivan & Cromwell LLP

GARY COHN, Former Assistant to the President Economic Policy and Director of the National Economic Council

ROBERT DRAIN, United States Bankruptcy Judge, Southern District of New York

D. WILSON ERVIN, Former Vice Chairman, Credit Suisse

RICHARD J. HERRING, Co-Director, The Wharton Financial Institutions Center and Professor of Finance, The Wharton School, University of Pennsylvania

DONALD KOHN, Former Vice Chairman, Board of

Governors of the Federal Reserve System and,

Senior Fellow, Economic Studies Program,

Brookings Institution

FRANK LA SALLA, President and Chief Executive

Officer, DTCC, President and Chief Executive

Officer of DTC, FICC and NCSS

TIMOTHY J. MAYOPOULOS, President of Blend, Former

President and Chief Executive Officer of Fannie

Mae

SANDIE O'CONNOR, Former Chief Regulatory Affairs

Officer, JPMorgan Chase & Co.

DOUGLAS L. PETERSON, President and Chief

Executive Officer, S&P Global

JOHN S. REED, Former Chairman and CEO of

Citigroup and Former Chairman, Corporation of

Massachusetts Institute of Technology

MEG E. TAHYAR, Partner and Co-head of Financial

Institutions, Davis Polk LLP

ALSO PRESENT:

MARTIN J. GRUENBERG, Director, Federal Deposit Insurance Corporation, Acting Chairman
ROHIT CHOPRA, Director, Consumer Financial Protection Bureau
MICHAEL J. HSU, Acting Comptroller of the Currency
ELKE K^MNIG, Chair, Single Resolution Board, European Union
JON CUNLIFFE, Deputy Governor for Financial Stability, Bank of England*
SUSAN BAKER, Division of Complex Institution Supervision and Resolution
JOHN P. CONNEELY, Director, Division of Complex Institution Supervision and Resolution
ELIZABETH FALLOON, Office of General Counsel
ANDREW FELTON, Deputy Director, Systemic Risk
JAMES (JIM) MCGRAW, Senior Deputy Director, Division of Complex Institution Supervision and Resolution
ARTHUR J. MURTON, Deputy to the Chairman for Financial Stability
ALFRED SEIVOLD, Deputy Director, Institution Risk, CISR
R. PENFIELD STARKE, Senior Counsel. Legal Division
RYAN TETRICK, Deputy Director, Resolution Readiness, Division of Complex Institution Supervision and Resolution
JENNY TRAILLE, Division of Complex Institution Supervision and Resolution
DAVID WALL, Deputy General Counsel (Acting), Resolution and Receivership Branch

***Present via video teleconference**

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1 P-R-O-C-E-E-D-I-N-G-S

2 9:04 a.m.

3 ACTING CHAIRMAN GRUENBERG: Well, good
4 morning, everybody. Welcome to the FDIC. We
5 haven't seen you all for a while. So it's nice
6 to be together.

7 I actually checked the calendar. The
8 last time this committee met virtually was in
9 October of 2020. And the last thing this
10 committee met in person hard to believe was
11 December of 2018. So it's been four years since
12 we've actually seen you all.

13 And we're going to do our best not to
14 let another four years pass without seeing you
15 again. And we're going to try to resume annual
16 meetings of this committee which really has
17 enormous value to us in an area that is of vital
18 importance to the FDIC. At the end of the day,
19 our ability to manage the orderly failure of a
20 systemic financial institution is probably --
21 will probably be the ultimate credibility test
22 for our agency.

1 And how our agency is viewed will be
2 determined by how we handle that challenge. And
3 our preparations to carry out that responsibility
4 are absolutely central to what we do. And our
5 ability to meet with you on a regular basis to
6 share with you the work we're doing and to get
7 your input really has enormous value too.

8 So we thank you for being here. And
9 so it's a large committee. It may get larger.
10 So we're a little bit cramped, but I hope you
11 bear with us. We wanted to take advantage. Let
12 me begin by introducing some of the new members
13 who have joined up, Tim Clark who is the
14 distinguished senior banking advisor of Better
15 Markets. And some of you may know him as the
16 former deputy director of Supervision and
17 Regulation at the Federal Reserve.

18 Tim was definitely a partner in crime
19 with us. It was really our partnership with the
20 Tim and the Fed that allowed us to make the Title
21 I resolution plans into meaningful tools for us
22 to use to enhance the resolvability or largest,

1 most systemic global financial institution. So
2 the fact that we were able to entice Tim to join
3 this committee was a big plus for us.

4 And let me also introduce Frank La
5 Salla, the president and CEO of the Depository
6 Trust Clearing Corporation, DTCC. One of our top
7 priorities at the FDIC and it's an international
8 priority as well is making progress on the
9 resolution of central clearing counter-parties.
10 They in some ways define what systemic risk is.

11 And in all the areas in post-crisis
12 resolution, I think it's arguable that we've made
13 the least progress in regard to CCP resolution.
14 So that is a top priority for us here at the FDIC
15 and domestically here in the United States. And
16 it's a major priority internationally for the
17 Financial Stability Board. And we're going to
18 have a discussion around that later this morning.

19 In addition, we've been joined by
20 several other distinguished new members. This
21 will be their first meeting, Jay Clayton, the
22 former chairman of the Securities and Exchange

1 Commission, Margaret Tahyar, partner and co-head
2 of financial institutions at Davis Polk, and
3 Wilson Ervin, former vice chairman at Credit
4 Suisse who played a formative role in helping
5 define thinking around the issue of systemic
6 resolution. And if I may introduce a special
7 guest who's joining us this morning, Elke K"nig
8 who many of you may know she is the chair of the
9 Single Resolution Board for Europe.

10 Elke is the founding chair of the
11 Single Resolution Board. There was no resolution
12 authority in Europe before Elke. And there is
13 now a viable, robust institution, really the
14 first institution of its kind in the European
15 community with a capacity for resolving large
16 financial institutions.

17 Elke is finishing her second term as
18 chair next month. And she'll be required to set
19 down the limit of her service. And she's
20 graciously agreed to join this committee after
21 she steps down as chair of the SRB. She'll be an
22 invaluable addition to us.

1 And let me recognize if I may four
2 former members whose terms expired and have left
3 the committee, Bill Donaldson, former chair of
4 the SEC, Peter Fisher, former Undersecretary of
5 the Treasury and now a senior fellow with the
6 Tuck School of Business at Dartmouth, Gary Stern,
7 former president and CEO with the Minneapolis
8 Fed, and Michael Bodson, president and CEO of
9 DTCC. And we now have the benefit of his
10 successor serving on the committee. We have a
11 full agenda, so I'm not going to take more time.

12 But we've really broken the morning
13 into three sessions that I think will be of
14 interest to you. The first session is going to
15 focus on our efforts to integrate our supervision
16 and resolution responsibilities. I think one of
17 the strengths of the FDIC is we have in one
18 institution responsibility for resolution, a
19 significant part of supervisory responsibility in
20 the U.S. banking system as well as the deposit
21 insurance responsibility.

22 Tremendous synergies among those three

1 functions and the importance of close
2 collaboration and integration between supervision
3 and resolution is really fundamental to an
4 effective resolution process. We want to talk
5 about our work from that perspective. In the
6 second session, we're going to focus on our two
7 key resolution priorities, our ongoing work for
8 systemic resolution under Title II of the Dodd-
9 Frank Act and our utilization of the orderly
10 liquidation authority.

11 And we're going to focus in particular
12 on our work around increasing transparency and
13 how we think about Title II resolution and
14 communicating with financial markets as well as
15 the public to try to establish better
16 understanding of what we do. And that is really
17 not a simple task as you all probably understand
18 better than most. So we want to talk about that
19 issue.

20 And then also what is a key priority
21 for us which is enhancing our ability to manage
22 the failure of large banking organizations below

1 the GSIB level. It's really a very distinct
2 resolution challenge for us from the GSIBs in
3 many ways as great as the GSIB challenge. And
4 because we were so obsessed with developing a
5 capability to manage the failure of GSIBs, that
6 was not the first thing we turned to was not the
7 large banks.

8 And then we woke up and realized the
9 failure of one of these large banking
10 institutions could really be an enormous
11 challenge with financial stability implications.
12 So we devoted a lot of time. That's a priority I
13 think for all three of the U.S. banking agencies,
14 the Fed, and the OCC as well as the FDIC.

15 And as you may know, the FDIC and the
16 Fed issued a joint advanced notice of proposed
17 rulemaking to see public comment and the
18 possibility of establishing a long-term debt
19 requirement for our largest banking organizations
20 below the GSIB level to facilitate a capacity for
21 orderly failure. So we'll talk about all of that
22 work. And then finally, we're going to have a

1 session on the issue I mentioned previously, the
2 challenges relating to the resolution of a
3 central counter party.

4 Central counter parties as you all
5 well know were a systemic consequence before the
6 2008 crisis. And then as a result of one of the
7 key reforms after the crisis of mandating
8 clearing for derivatives, if anything, we
9 expanded the systemic footprint of CCPs. And
10 it's not clear that the resolution capacities
11 here in the United States or internationally
12 really evolved to deal with the enhanced systemic
13 risk that a failure of a CCP could present.

14 So we've been spending a lot of time
15 on that here at the FDIC. It's a big priority
16 and focus of attention internationally within the
17 Financial Stability Board and within other
18 jurisdictions. So we're going to continue that
19 discussion here, and we have a special guest
20 joining us virtually who some of you may know,
21 Sir Jon Cunliffe who's the Deputy Governor of
22 the Bank of England for financial stability.

1 And Jon is also chairing the committee
2 on payments and market infrastructure of the BIS.
3 He's been focused on payment issues
4 internationally and in particular the supervision
5 and resolution of CCPs. He's really been an
6 international leader on this issue, and we
7 thought we could benefit from a conversation with
8 Jon.

9 So that's our program for this
10 morning. Thank you all for being here. We have
11 the privilege of being joined by our other Board
12 members, acting controller Mike Hsu and director
13 of our Consumer Financial Protection Board --
14 Bureau -- it's still early in the morning I got
15 to tell you -- Rohit Chopra. Mike, would you
16 have any comments?

17 DIRECTOR HSU: Just to say it's great
18 to be here to see a lot of familiar faces, to
19 meet some new folks. These issues are very near
20 and dear to my heart. So I just look forward to
21 jumping right in. Thank you.

22 ACTING CHAIRMAN GRUENBERG: In his

1 previously life, Mike was also a partner in crime
2 with Tim Clark over at the Fed.

3 DIRECTOR CHOPRA: Partner in
4 compliance.

5 (Laughter.)

6 DIRECTOR CHOPRA: Well, let me just
7 thank all of you for being here. And I want to
8 echo it's good to be with people in person again.
9 The staff has prepared a lot to make sure that
10 they can solicit feedback from all of you.

11 I'm just going to echo a couple of
12 things that the acting chairman discussed that
13 are issues of concern for the Board, for me, for
14 others. And as Marty mentioned, obviously the
15 failure of a domestic systemically important
16 financial institution would be quite challenging.
17 The FDIC has some good experiences, bad
18 experiences, and learning from this. And I think
19 it's no surprise that a CFPB director is worried
20 about the failure of an institution with an
21 enormous footprint in consumer and retail
22 banking, a very large number of accounts and the

1 regional impact or national impact of its
2 failure.

3 And I think as he mentioned, there has
4 been a proposal, an ANPR by the FDIC and the Fed
5 about ways to prevent that and remove from the
6 play book of simply selling it to a GSIB. I'll
7 also add a couple of other points of concern for
8 me. One is obviously the undesignated non-bank
9 systemically important financial institutions.

10 The Financial Stability Oversight
11 Council has not designated any in quite some
12 time. And I think many experts agree they exist.
13 And we do not have resolution plans for them.
14 That would make resolution very challenging and
15 create an enormous amount of complexity.

16 And of course, the work that the
17 acting chairman has mentioned about the GSIBs,
18 there's no victory to be declared. There are
19 still a number of complexities that of course
20 U.S. law requires us to evaluate those resolution
21 plans based on whether they can be credibly
22 completed in a Chapter 11 bankruptcy which I

1 think many of us know is a fairytale right now.
2 So there's so much work I think we need to do.
3 The markets have obviously changed quite a bit
4 since the last time you met together. So really
5 looking forward to the discussion.

6 ACTING CHAIRMAN GRUENBERG: Thank you,
7 Rohit. Let me turn the program over to John
8 Conneely, the Director of the FDIC's Division of
9 Complex Institution Supervision and Resolution.
10 John?

11 MR. CONNEELY: Thank you, Chairman
12 Gruenberg. Good morning and thank you all for
13 joining us today. I am John Conneely, the
14 Director, as Marty said, of the Division of
15 Complex Institution Supervision and Resolution,
16 although it's much easier to say CISR. So we'll
17 stick with that.

18 I'm joined at the table by the
19 panelist for our first session, Senior Deputy
20 Director Jim McGraw, Deputy Directors Andy Felton
21 and Alfred Seivold, and our legal counsel, David
22 Wall. Before we get started, I just

1 unfortunately need to take care of a couple of
2 administrative matters. First, our legal staff
3 has asked I provide two statements for today's
4 meeting.

5 The first is a statement regarding the
6 Sunshine Act. So I'll read that. We have all
7 members of the FDIC Board of Directors in
8 attendance today as we begin the advisory
9 committee meeting.

10 The government in the Sunshine Act
11 imposes notice and access requirements whenever a
12 quorum of the FDIC's Board of Directors meets to
13 conduct or determine agency business. This
14 meeting is not held for such purposes and does
15 not constitute a meeting under the Act. The
16 Board members present will only engage in general
17 or preliminary discussions that do not relate to
18 specific proposals for action pending before the
19 FDIC.

20 Any specific issues for official Board
21 resolution remain open for full consideration by
22 the Board following the conclusion of the

1 meeting. The second statement -- excuse me --
2 regards the advanced notice of proposed
3 rulemaking, or ANPR which was mentioned,
4 concerning potential new resolution related
5 resource requirements for large banking
6 organizations which was approved by the FDIC
7 Board of Directors on October 18th, 2022 and also
8 approved by the Board of Governors of the Federal
9 Reserve System and is currently open for comment.
10 Staff will not respond substantively to any
11 comments on the ANPR and generally will be in
12 listening mode and not indicate the direction the
13 agencies are likely to take with respect to NPR
14 or Final Rule.

15 In addition per our regular practice,
16 the FDIC will publish a summary of this meeting
17 relating to the ANPR on our public website. The
18 summary will generally include a list of
19 participants and a high level summary of the
20 discussion. And if you have questions on either
21 of those statements, we have our FDIC legal staff
22 who would be happy to answer.

1 (Laughter.)

2 MR. CONNEELY: Just a couple of
3 technical notes, if you'd like to speak, just
4 press the green lights on your microphone. Or
5 for those who will be participating remotely, you
6 can use the Webex raise hand function. But
7 there's really no need to be so formal.

8 And in the meeting, please jump into
9 the discussion at any time. I'm sure people are
10 not shy here. So I'd also like to remind
11 participants that the meeting is public and is
12 being livestreamed.

13 So I appreciate the opportunity to
14 provide a few introductory comments today. And
15 today we'd like to provide the committee with an
16 update on work being done with respect to
17 systemic resolution along with some of the
18 challenges that we continue to face. And we look
19 forward to the committee's input to help further
20 our work in these matters.

21 And so let me just take a minute to
22 set the stage for today, particularly for new

1 members. As you know following the 2008
2 financial crisis, Congress established new
3 authorities for the FDIC to manage the orderly
4 resolution of large complex financial
5 institutions whose failure could threaten U.S.
6 financial stability, most notably Titles I and II
7 of the Dodd-Frank Act. Shortly thereafter in
8 June 2011, then FDIC chairman Sheila Bair
9 convened the first meeting of this committee,
10 noting that the knowledge and expertise brought
11 to bear by members of the committee would greatly
12 enhance the corporation's efforts to develop and
13 implement these tools.

14 In the seven meetings held since then,
15 a wide range of systemic resolution issues have
16 been brought to the committee in order to test
17 thinking and solicit your feedback. The first
18 meetings obviously focused on core aspects of the
19 systemic resolution, including the establishment
20 of the orderly liquidation authority and the
21 development of the foundational single point of
22 entry strategy. Subsequent meetings discussed

1 various structural reforms to operationalize the
2 SPOE strategy such as long-term debt --
3 requirements for long-term debt, clean holding
4 companies, orderly transfer of QFCs.

5 And more recently, the committee has
6 discussed their work on cross border engagement,
7 bankruptcy challenges, Title I reviews,
8 capabilities testing which we'll hear a little
9 bit about today, broker-dealers, and other
10 developments. And thanks to the input from you
11 all on these issues. The FDIC has really made
12 significant strides in systemic resolution
13 planning.

14 Yet challenges remain which brings us
15 to the agenda for today. And I know Chairman
16 Gruenberg went through some of the agenda. I
17 just want to elaborate on a couple of points, and
18 I'll just walk through. And on Slide 4, we have
19 the agenda.

20 The first session really will be just
21 a brief update by risk staff on recent work in
22 CISR to integrate supervisory and resolution

1 responsibilities. I'm sure many of you remember
2 during the financial crisis the coordination
3 challenges that we faced between the agencies,
4 between supervision and resolution. And a lot of
5 work has been done since then to bridge these
6 gaps.

7 And we look forward to your thoughts
8 on the directions we're taking here in CISR in
9 that regard. So as Jim and Andy and Alfred go
10 through their presentations, we'd like you to
11 think about your experiences and the challenges
12 you've faced and share them and maybe identify
13 ways that we could do this better. The second
14 session which is really the heart of the meeting
15 today, our resolution staff will discuss two
16 topics, GSIB resolution planning under Title II
17 and the need for public transparency and the
18 challenges and options for resolving non-GSIB
19 large banks.

20 Here as the chairman mentioned, we'll
21 introduce and discuss the topic of transparency.
22 The FDIC has a long record of fostering public

1 confidence. Everybody knows if you walk into the
2 bank and see that FDIC sign, your deposits are
3 safe.

4 And we really want to build on that
5 level of confidence around the execution of our
6 Title II authorities. In essence, what we're
7 looking for from you is who needs to know what
8 and when about our efforts to help build our
9 credibility and confidence. The second topic,
10 the resolution of large banks that are not GSIBs
11 is new for consideration by the committee.

12 In this session, we'll seek your input
13 about the work we're doing and the challenges
14 this work presents which are formidable, whether
15 it's for the FDIC or the financial system. And
16 then the third session as mentioned, we returned
17 to a topic that we briefly discussed with the
18 committee in 2020 which is the challenge of
19 resolution of CCPs. This topic is one that is on
20 a lot of policy makers' minds globally and a lot
21 of work is being done and warrants continued
22 consideration by the committee.

1 And we look forward to hearing from
2 our guest speaker, Sir Jon Cunliffe, and from you
3 all on how we should go about being prepared and
4 prioritize these challenges that we have. Are
5 there any questions on the agenda before I move
6 on? No? Okay.

7 So then as a kickoff to our first
8 session, let me just -- which is on the
9 integration of supervision resolution, let me
10 just take a couple minutes to reintroduce CISR
11 which is the division primarily responsible for
12 executing the FDIC's supervision and resolution
13 responsibilities for the largest and most complex
14 financial institutions. You'll see on slide 3
15 the mission of CISR. And it's pretty
16 straightforward: to protect and maintain
17 stability in the U.S. financial system by
18 avoiding and if necessary managing the failure of
19 a large complex financial institution.

20 So this mission statement clearly sets
21 out a focus on the use of both supervisory and
22 resolution authorities to address financial

1 stability. And the focus and approach really has
2 been driven by the evolution of the banking
3 industry. The growth over the past 35 years and
4 the actual and relative size and the result and
5 complexity of the nations' largest banks along
6 with the broadened systemic resolution powers
7 that have been provided under Dodd-Frank really
8 has caused the FDIC over time to adopt new and
9 more sophisticated approaches to its supervision,
10 resolution, and insurance functions.

11 The changes were naturally
12 incremental. And over time, the FDIC had
13 specialized staff working on very similar issues
14 throughout the organization. There were a lot of
15 challenges in coordination. Supervisors don't
16 like to talk a lot about failure. And resolution
17 specialists like to talk about nothing but
18 failure.

19 (Laughter.)

20 MR. CONNEELY: So we had a bridge that
21 we needed to cross and bring together. So an
22 important part of this evolution was the creation

1 in 2019 of CISR really to consolidate all those
2 resources and adopt a more integrated approach
3 that leverages both our supervisory and
4 resolution responsibilities. As the need to plan
5 for the resolution of these institutions starts
6 long before the stresses begin.

7 We have to start well into BAU. So we
8 work, CISR works proactively early on to fully
9 understand the firm's unique characteristics and
10 activities, the degree of complexity, their
11 resiliency, very important on the resiliency, the
12 level of risk, and the their potential impact on
13 financial stability. And to accomplish this, we
14 build cross disciplinary teams that integrate
15 professionals throughout the division:
16 resolution, supervision, lawyers, economists,
17 pretty much anything you can think of.

18 And we work also closely with our
19 other divisions and our sister agencies. And
20 we've done a lot of work -- a lot of good work
21 with the OCC and the Fed on this topic. We also
22 engage in active cross border coordination

1 through our work of our supervisory colleges and
2 crisis management groups which really are now
3 part of our BAU activities to build and maintain
4 our readiness.

5 And we had both, the supervisory
6 colleges and the crisis management groups, which
7 are looking at the same institutions from two
8 different perspectives. And we look at them with
9 staff from both sides. So in taking this
10 approach, we're hoping to achieve several
11 overarching objectives.

12 One is to improve our coordination,
13 our consistency, and our accountability.
14 Secondly is to foster a collaborative and
15 interdisciplinary approach to these issues. And
16 third and really most importantly, we want to
17 insure the information, resources, and expertise
18 are shared in advance and readily available in
19 the event of a crisis situation. So with that, I
20 will turn -- well, I'll just stop for a moment if
21 anybody has any questions before I move on.

22 (No audible response.)

1 MR. CONNEELY: Okay, great. So then
2 I will turn it over to Jim McGraw. He will
3 expand on our efforts to better integrate
4 supervision and resolution. Thank you.

5 MR. MCGRAW: Thanks, John. So good
6 morning and welcome to the advisory committee
7 members and the guests here in the room and those
8 who are joining us online. My name is Jim
9 McGraw. I'm the senior deputy director of the
10 FDIC's Division of Complex Institution
11 Supervision Resolution or as I will refer to it
12 going forward, as John said, CISR.

13 So this morning, I'm going to briefly
14 discuss the unique organizational structure
15 within CISR where we have brought together within
16 one division the supervision or risk expertise
17 and the resolution expertise. The communication,
18 the collaboration, the cooperation, sharing of
19 information, sharing of expertise between
20 supervision and resolution within CISR really is
21 one of the fundamental benefits of having both
22 disciplines in one division. So within CISR, we

1 have three business line branches.

2 We have institution risk, systemic
3 risk, and resolution readiness. We also have a
4 fourth branch, the operations branch which
5 supports the other three business line branches.
6 Institution risk provides our firm specific
7 onsite supervisory work focusing in on key risk
8 vulnerabilities, resiliency, the adequacy of risk
9 management practices within the firm.

10 Systemic risk is focused on systemic
11 and emerging risks within our portfolio firms and
12 looking at it more horizontally across the firms
13 and then also look at those risks within the
14 financial industry itself. Also systemic risk is
15 responsible for supporting our supervisory
16 programs, for developing and monitoring policy,
17 developing our quantitative analytical tools.
18 There's a lot of information that comes in, a lot
19 of data from these firms and there's a lot of
20 analytical tools that we build out to help us in
21 both our risk and our resolution work.

22 And they also oversee our

1 international coordination which I'll talk about
2 in a little more detail in a few minutes. And
3 then we've got the resolution readiness branch
4 which formulates in the event of a failure would
5 be responsible for leading the execution of a
6 strategy to resolve a large complex financial
7 institution, either under the FDI Act or Title II
8 of the Dodd-Frank Act. The flow of information
9 and analysis between these branches is critical.

10 Knowing where the key risks and
11 vulnerabilities and risk management weaknesses
12 exist within specific business lines, material
13 entities, critical services, critical operations.
14 Where those are located within the firm,
15 understanding the interconnectedness within the
16 firm, ultimately understanding where a firm
17 stands on the crisis continuum from a risk
18 perspective is critical in determining where
19 resolution readiness resources need to be
20 focused. And also knowing the information needs
21 on the resolution readiness side helps inform our
22 supervision side when they're prioritizing and

1 developing their supervisory plans.

2 But the risk and readiness branches,
3 we have regular structured discussions. We have
4 ad hoc discussions. We have information sharing
5 programs.

6 We have an interdivisional committee
7 made up of executive managers from all three
8 branches that meets to oversee and ensure that we
9 have appropriate supervisory and resolution
10 strategies in place that complement each other.
11 Within CISR, we have an escalation protocol
12 process which is a collaborative process between
13 risk and readiness where firms are evaluated and
14 placed into priority focus buckets based on risk
15 profile perceived probability of default. And
16 then that is able to serve as a guide as we
17 develop steps that can be taken to better prepare
18 for a potential resolution of that.

19 I mentioned the international
20 coordination within the systemic risk branch.
21 The crisis management groups John mentioned,
22 CMGs, are a significant part of that

1 coordination. They exist to facilitate cross
2 border cooperation among both supervisory and
3 resolution authorities, representing home and
4 host jurisdictions for the systemically important
5 financial institutions.

6 We have firm specific information
7 sharing and cooperation arrangements that support
8 this cross boarder crisis planning activity. And
9 then the members maintain regular dialogue. We
10 have formal generally on an annual basis meetings
11 where we build and maintain relationships between
12 the different authorities, exchanging information
13 relevant to resolution planning to ensure that we
14 have a rapid resolution response in a time of
15 stress.

16 I'll also mention that the CMGs have
17 really enhanced our internal CISR coordination
18 between all the branches as over the last couple
19 of years all of the disciplines, risk and
20 supervision, have worked together in planning and
21 preparing for these CMG meetings. And bringing
22 the onsite supervisory perspective into these

1 meetings has really enhanced their effectiveness
2 from a resolution planning standpoint. Cyber
3 risk, I'm just going to mention this quick.

4 It's just an example of a risk where
5 the coordination and communication between
6 supervision and resolution is key. Understanding
7 where cyber risk vulnerabilities are within the
8 firm, within the business lines, material
9 entities how it could impact different critical
10 services, critical operations is key when
11 assessing and planning for resolution risk.

12 Slide 7. I'll mention for Title I Planning.

13 Again, the presence of our onsite
14 supervisory staff monitoring the condition and
15 the risk management of large complex financial
16 institutions, the knowledge gained through
17 examination participation and in our offsite
18 analysis, it's a valuable resource that we have
19 to leverage as part of the Title I plan review
20 process. Onsite supervisory staff have access to
21 specific information that can supplement the
22 information that the firms provide in their Title

1 I plans and should be incorporated into our
2 overall plan assessment. Information learned
3 through supervisory programs can be critical in
4 understanding a firm's Title I capabilities
5 which, in turn, informs from a Title II
6 perspective as well.

7 Supervisory programs should be used to
8 help us to test assumptions and capabilities and
9 assertions that firms put within their Title I
10 plans. I'll point out the drafters of original
11 165(d) rule actually recognize the value of
12 incorporating supervisory programs into Title I
13 plan review where it states in the rule that the
14 Board and the corporation will rely to the
15 fullest extent possible on examinations conducted
16 by or on behalf of the appropriate federal
17 banking agency for the relevant company. Related
18 to recovery plans, CISR staff from both
19 resolution readiness and risk have been working
20 closely with the other banking agencies to plan
21 for and participate in in-depth reviews of
22 recovery plans submitted by firms subject to the

1 OCC's recovery plan rule.

2 And again, this work has considerable
3 overlap with Title I and Title II. Finally, I do
4 want to note and this has already been mentioned
5 by Chairman Gruenberg and by John. But my
6 comments up to this point have focused on banks
7 and bank holding companies where we have the
8 supervisory insight and the Title I work that
9 we're able to use that to support a robust
10 resolution preparation for those institutions.

11 However, we also have responsibility
12 for resolving nonbank financial companies if
13 their failure threatens U.S. financial stability.
14 And the work associated with the nonbank
15 financial companies is more difficult given we
16 don't have nearly the same resolution tools or
17 resolution engagement and insight with those
18 firms. A common challenge that we discussed with
19 you back in 2020 was the fact that the FDIC
20 didn't have access to certain data that would be
21 needed in the runup to or during a resolution
22 event for one of these companies.

1 Another more specific challenge which
2 Jenny Traille will talk about later this morning
3 is the fact that the nonbank financial companies
4 are not required to submit Title I resolution
5 plans. And as we've mentioned, Title I plans
6 provide the FDIC with direct access to key
7 information that would be useful in supporting a
8 Title II resolution. So to address those
9 impediments to nonbank financial company
10 resolution planning, we do work closely with the
11 other regulatory agencies, both domestically and
12 internationally, to help sharpen our
13 understanding what the FDIC might need to
14 undertake a successful resolution of one of these
15 firms.

16 We've also put in place data sharing
17 arrangements for the FDIC to receive material
18 nonpublic information from the firm supervisors.
19 But I will say even with the best efforts, it's
20 still difficult to address the root challenges
21 that we face in thinking about a Title II
22 resolution of a nonbank financial company. And

1 again, we devoted a whole segment on the agenda
2 to CCPs later this morning where I'm sure we'll
3 have a very robust discussion on that topic. So
4 with that, I'll stop and just open it up if
5 anyone has any questions or comments. Yes, John.

6 MEMBER REED: Jim, impressive how
7 you're coordinating all of this yourselves. What
8 about the interaction with the institutions
9 themselves? Obviously, supervision can be pretty
10 formal. Do you have informal sort of
11 interactions with the targeted companies
12 themselves that would allow you to flesh some of
13 your work and their sort of response to it?
14 Because to some extent, you're part of their
15 immune system.

16 MR. MCGRAW: I mean, on the
17 supervisory side, we have daily --

18 MEMBER REED: Sure.

19 MR. MCGRAW: -- contact with our
20 onsite presence. Through the CMGs, we have
21 access and discuss the resolution topics with the
22 firms during those meetings. And then during the

1 recovery plan review work, we'll have discussions
2 with the firms there. On Title I, we have
3 discussions with the firms. So we are able to
4 build into a lot of our interaction with the
5 firms, the resolution issues and concerns that we
6 might have.

7 MEMBER REED: So there isn't a barrier
8 that's making your job harder?

9 MR. MCGRAW: I would say that the
10 whole purpose behind the formation of CISR was to
11 break down that barrier. And I think we've done
12 a good job getting that in place. There's still
13 more work to be done. But the integration of the
14 supervision and resolution is much stronger now
15 than prior to the formation of CISR.

16 MEMBER ERVIN: A question that goes
17 back to something that John mentioned. I used to
18 run a credit department in a former life. And
19 one of the tensions was how to deal with the
20 credit officers who thought the credit was good
21 and would sometimes fall in love with it as it's
22 going down to a difficult path.

1 And how do you discover that dance of
2 when to turn to recovery? You don't want to move
3 too early. But you also don't want to be too
4 late. So as you've integrated these two teams,
5 how do you deal with that issue to make sure that
6 people don't fall in love and think of this as a
7 black mark if I turn it over to resolution, I
8 failed as a supervisor?

9 MR. MCGRAW: I think that's a really
10 good question. And I would say and others can
11 chime in too. I would say the formation of CISR,
12 we've tried to -- that's been one of the purposes
13 of that is to bring them together where we're not
14 thinking this as, okay, this all belongs to
15 supervision.

16 And now -- oh, now we got to turn it
17 over to resolution. We're all one team working
18 on this together. And the development when I
19 mentioned the escalation protocols, that's work
20 that's done collaboratively between supervision
21 and resolution where we're looking at firms and
22 we're discussing the risk profile of the firm.

1 How well is the risk being managed?
2 What is a perceived probability of default on
3 that firm? And we have a lot of really honest,
4 frank discussions in those committee meetings as
5 far as where should firms be placed within these
6 priority risk buckets.

7 And so I would say our conversations
8 on a daily are integrating both supervision and
9 resolution. And we've hopefully done a good job
10 getting rid of -- it belongs to the supervisory
11 side until everything has already hit the fan and
12 now we're heading it over to resolution.

13 MR. CONNEELY: Yeah, I'll just add
14 that really is an excellent question. And there
15 is a lot of tension. And there's even tension on
16 the supervisory side. You always want to make
17 sure examiners are objective and independent.

18 And that's a struggle sometimes if
19 they're at the institution a lot. But I think
20 one of the things that I see, for example, that
21 is really heartening is we have supervisory staff
22 onsite that will be monitoring the institution

1 and see something that they're doing. And now
2 it'll trigger thoughts as to that might have
3 implications in resolution.

4 I should talk to my ready staff
5 (phonetic). And so we're addressing those issues
6 up front rather than getting to the end and then
7 I didn't realize this. So I think it's a really
8 great question. There is a lot of tension. But
9 I think having the discussions really works.

10 MR. MCGRAW: Yeah, we had -- actually,
11 John and I sat through a briefing two weeks ago
12 where one of the supervisory staff was on an
13 examination. And there was some issues that were
14 discovered that really created a lot of
15 questions. This could really make a resolution
16 really difficult.

17 And so we sat and we talked about
18 that. So somebody who's an examiner by trade but
19 was thinking about the implications that these
20 issues were uncovered during an exam would have
21 on a resolution situation. Yeah, Richard?

22 MEMBER HERRING: I was intrigued by

1 the cultural difference you noted that inspired
2 the formation of this integrated group. And I
3 think it does make a lot of sense. But I also
4 noticed that internationally we really still have
5 this strong separation between the supervisory
6 colleges and the crisis management groups.

7 I'm wondering how much of an overlap
8 in membership there actually is and whether other
9 countries actually have the ability to join the
10 two approaches as you do because you have both a
11 supervisory responsibility and a resolution
12 responsibility. My guess is Elke doesn't have
13 such easy access to supervision, but I don't
14 know. But it does seem logical that those two
15 entities -- and there are all sorts of privacy
16 concerns and disclosure of information that would
17 have to be dealt with. But I'm curious about how
18 broadly you think the model can be applied.

19 MR. CONNEELY: Well, I think the FDIC
20 really is in a unique position in this regard.
21 We have statutory supervisory in a backup role,
22 authorities on the supervisory. And plus we

1 insure, so we have responsibilities and
2 authorities on the insurance and deposits.

3 We're also a resolution authority. So
4 I don't think there's too many entities that have
5 that combination of authorities. And it puts us
6 in a unique position which I think we're trying
7 to leverage.

8 MS. KTMNIG: I think you spotted the
9 right problem, and that's the problem to make
10 sure that supervisor who holds onto his child
11 doesn't hold on to the child far too long. And
12 in Europe, we are trying to solve it in our
13 institutional framework a bit similar to what you
14 do. We are participating in discussion of the
15 supervisor which for the banks in our realm, it
16 is Frankfurt under the ECB.

17 And at the same time, we have them
18 participating in our discussion. But I think
19 it's a topic that you always need to keep just on
20 your mind because it's a bit -- it's my problem
21 and the White Knight is just around the corner to
22 avoid that kind of debate. Now you're in a

1 better position because you also have supervisory
2 powers.

3 We have formally the chance to do
4 onsite inspection of the deep dives. But we
5 would always be a bit in a situation are we
6 doubling up to what the supervisor does because
7 we are not the supervisor. But in principle,
8 it's the same idea that you have between putting
9 this into one group to say we need a very
10 constant dialogue also with a supervisor. And
11 over the eight years, we have developed out of
12 the discussion on why do you need to know. We
13 have now full access to their information on the
14 supervisory side.

15 MEMBER PETERSON: You mentioned that
16 you have supervisors on site, but that's only a
17 few people. Have you changed your expectations
18 of the role of internal audit as well as the
19 audit committee of the boards?

20 MR. MCGRAW: I would say, no, we
21 haven't changed our expectation. I think the
22 expectation is still the same. But we do have a

1 small number of onsite given that we're backup
2 supervisory. The OCC and the Federal Reserve
3 numbers exponentially are higher than ours. And
4 so we do work closely with them.

5 And we do look at audit and where
6 audit is considered to be reliable is strong.
7 We'll look at that as far as thinking about have
8 issues been remediated at the firm. If audit is
9 credible, then that'll go a long way with us to
10 see what their findings are as they look at
11 different issues that the firm has addressed.

12 MR. CONNEELY: I would just add -- I'm
13 sorry. I would just add that it's not a shift or
14 difference. But there is an extension now.
15 Audits now focus on resolution issues, and we
16 leverage off of that.

17 And so that's a good development in
18 the firms and the banks is that they're auditing
19 resolution issues. They're auditing their
20 calculations and their capabilities so we can
21 leverage off of that. And so it's an extension,
22 but it is relatively new.

1 I too was thinking about the tension
2 between the supervisors and the resolvers here,
3 the potential tension. Now a lot of resolutions
4 are triggered by liquidity runs, right? So then
5 the supervisor has no choice, right?

6 But the key would be trying to get in
7 before the run and the fire sale. That would be
8 really a stabilizing intervention. So could you
9 talk -- and the data coming in on what the actual
10 capital of the institution is, is very lagged and
11 incompletely and asset prices are changing very
12 rapidly. Could you talk a little bit about what
13 would trigger the resolution before the liquidity
14 run?

15 MR. MCGRAW: Yeah, I would say again
16 for us it's having those conversations. We bring
17 resolution as a part of the process throughout.
18 So if we're starting to even notice that a firm
19 is starting to experience some stress well before
20 you get to an actual liquidity event, we've got
21 our resolution people on board.

22 Again, through that escalation

1 protocol process, we'll meet. And okay, there's
2 more risk here. We're seeing some stress. We're
3 going to move this firm down.

4 And then that triggers resolution
5 readiness starts doing more to start preparing.
6 So there's not a, well, there's an event now.
7 We've got to prepare. All the preparation is
8 going to be done up front prior to that event
9 actually taking place.

10 MR. CONNEELY: One thing I will add to
11 that is that one of the authorities we don't have
12 is we don't charter institutions. So it would be
13 the Fed or the OCC or the states. And they're
14 the ones who would make the decision as to
15 whether or not to pull the keys. But having
16 people there, we're doing the monitoring so we're
17 real time.

18 MR. FELTON: If I could jump in. It
19 might also be worth mentioning that one of the --
20 the real benefits of the Title I review work over
21 the last decade really has been improved internal
22 governance mechanisms, quantitative triggers, the

1 improvement. And this is also from the
2 supervisory side, internal modeling, capital
3 stress testing, liquidity stress testing so that
4 even if the regulatory capital numbers don't come
5 to us for four weeks that the firms are expected
6 to have as close to a real time view of that as
7 possible and that they have internal governance
8 mechanisms to start engaging in actions as
9 necessary.

10 MEMBER KOHN: And they share that view
11 with you.

12 MR. FELTON: Yes.

13 MEMBER TAHYAR: In the GSIB SPOEs,
14 right, there's our language is liquidity
15 execution need which is calculated daily. It's
16 shared with the supervisors. It's never been
17 tested, so we can't say it's perfect or that it
18 would work in real life.

19 But it's massively better and
20 different from what we had in 2008. So I think
21 that if a GSIB were to go into resolution, itself
22 it would be pushed into the bankruptcy far before

1 the chartering authority pulls the plug. And our
2 line is what is going to tell you to do that.

3 MEMBER O'CONNOR: Just one other
4 question to ask. To what extent or how are you
5 working or integrating the evolution of markets,
6 particularly the Treasury markets into your
7 analysis given that the liquidation of collateral
8 is so foundational to both recovery and
9 resolution for banks, nonbanks, CCP in every
10 structure out there?

11 MR. CONNEELY: I'll start. We
12 recognize that and we have started looking at
13 that. And I don't know if you have anything you
14 want to add to that.

15 But it is an area that we don't
16 naturally -- as supervisors, we don't naturally
17 have insights. We're not the Federal Reserve
18 here. But it is an area where we've seen time
19 and again issues occur and issues that affect our
20 institution. So we are looking now at building
21 up our capabilities in those areas.

22 MEMBER O'CONNOR: So just as part of

1 the advisory board, I would continue to encourage
2 you to look at that interoperability, right?
3 Because we've got shifting credential rules that
4 had implications on markets, on Treasury
5 particularly. And we have that reliance. And
6 this is a circle. So I think those are very
7 important things, and I'm glad you're looking at
8 them.

9 MR. MCGRAW: Yeah, Andy and I have had
10 several discussions over the last several weeks
11 about building that out more within the systemic
12 risk range. Hi, Tim.

13 MEMBER CLARK: Hi, just a quick
14 question. I think the coordination is a great
15 idea. I'm glad to hear it. I hope the
16 interagency coordination was still functioning as
17 well as it was when I was at the Federal Reserve.

18 Focusing on the supervision side, the
19 goal here is really for these firms to be
20 prepared for resolution and frankly prepared for
21 recovery action so they never get to resolution.
22 Plans are great. The finding of credibility of a

1 plan is a challenging issue.

2 Credibility frankly of a plan for one
3 of these firms to be resolved in bankruptcy, it
4 would be a huge challenge. So on the supervisory
5 side, you have an opportunity to really push in
6 areas that can help to make the firms better
7 prepared and more thoughtful internally
8 hopefully. But I wonder. I guess my -- there's
9 a question coming here eventually.

10 (Laughter.)

11 MEMBER CLARK: There's been a lot of
12 discussion about whether the agencies are
13 creating rules through guidance. This has been
14 very prominently raised by the bank policy
15 institute. And it's interest because, of course,
16 guidance has been somewhat undermined a little
17 bit by statements by the agencies over the past
18 few years.

19 I'm wondering if you think that the
20 way that everything is set up right now is the
21 most effective way for you to achieve getting
22 these firms to be better prepared or if you think

1 that possibly strengthening some of this guidance
2 into a more rules-based approach would eliminate
3 some confusion and take away some of the
4 criticism that the agencies have faced for making
5 up rules without actually having a rule which
6 frankly I think is unfair. But it's a long
7 question. Was that clear enough? I can repeat,
8 but it was long.

9 MR. CONNEELY: No, I think it's clear
10 enough. We're the practitioners. We implement
11 and try to implement the guidance, the rules,
12 what have you. I leave it really to policymakers
13 and others to determine whether those should be
14 rules -- guidance should be rules or what have
15 you. But yeah, it's a good question.

16 MR. MCGRAW: We do have a lot of
17 authority in Title I, for instance. And I think
18 there are ways to -- again, thinking about the
19 supervisory side and how that impacts Title I
20 capabilities, et cetera. There's a lot of
21 authority there that can be used and to push
22 firms to get issues fixed that have direct

1 implications on resolution readiness.

2 MEMBER CLARK: Part of my question
3 was, has any of that ability to influence through
4 that manner been undermined by the talk of
5 guidance shouldn't be taken too strongly. I'm
6 just trying to get a sense of how the dynamic has
7 changed given all the discussion about making
8 rules through guidance again I think has been
9 unfairly aimed at you.

10 MR. MCGRAW: I would --

11 MEMBER O'CONNOR: I'd like to hop in
12 here. I think broadly speaking when guidance is
13 given, forget about what the guidance is.
14 Clearly, financial institutions need to take that
15 extremely seriously because of the ultimate
16 assessment of whether or not your plan is
17 credible. And then I think there were
18 discussions broadly around what would the
19 implications of certain types of guidance be. So
20 I think the reality is there can be guidance and,
21 two, yes, it's taken extremely seriously.

22 ACTING CHAIRMAN GRUENBERG: And if I

1 could just add when we implemented Title I and
2 Dodd-Frank, we started with rulemaking. That's
3 detailed and really lays out the framework for
4 implementing the Title I authorities for
5 resolution plans. And we elaborated on the rule
6 as you well know through guidance documents to
7 provide greater detail to the institutions for
8 implementing their requirements established under
9 the rule. So I think it's been actually a pretty
10 functional process.

11 DIRECTOR HSU: Questions for the
12 committee. I think part of what the structure of
13 CISR helps to do is address these twin problems.
14 One is that without that integration, I think
15 resolution risks becoming a paper exercise the
16 way it's kind of set up.

17 And part of that is the second problem
18 which it's very infrequent, right? So I mean,
19 knock on wood. That's the intent. But part of
20 that means that memories are short and people
21 forget.

22 I think on a lot of these resolution

1 issues coming out of the '08 crisis, everyone was
2 moving in the same direction because it was so
3 present. It was omnipresent as an issue, both on
4 the regulatory side and on the bank side. And as
5 we get further and further from that, we've got
6 folks having lived those things, part of the
7 challenge is not having it just live as an ivory
8 tower exercise over here and then you've got kind
9 of day-to-day supervision risk management over
10 here.

11 And I think part of that integration
12 is key. I'd be curious to hear from others.
13 Like, what else needs to be done to keep that
14 front and center? Because I think this gets back
15 to an earlier question about boards and audit
16 committees.

17 That's kind of the daily muscle with
18 an organization. And I think it's very easy to
19 just say, well, that was a long time ago. We've
20 figured this out. It's all good. We can move on
21 from here.

22 I think that's going to be a perineal

1 challenge, especially as we move forward and
2 there's new risks that come up. And I think you
3 guys were talking about that. I don't know if
4 folks have thoughts on that.

5 MEMBER ERVIN: Yeah, I'd share that
6 view. It's one of the problems you have a
7 peacetime Army that doesn't get to fight. And
8 unfortunately when combat comes, you need lots of
9 troops. You need to get them on board yesterday.

10 And that strikes me as one of the
11 fundamental problems that you have in an agency
12 like this. How do you keep some of those
13 memories alive? I teach some classes to kids who
14 think 2008 was a million years ago, right?

15 And there's a generation of people who
16 lived it, and that generation is slowly moving
17 on. So I do wonder if there are training
18 exercises, ways you can kind of throw in. There
19 have been some war games.

20 I remember actually Jay Powell ran one
21 of those things a long time ago which was quite
22 useful. They had a former FDIC chairman

1 pretending to be an FDIC chairman on the panel.
2 But throwing in curve balls and throwing in
3 multiple actions into the market and trying to at
4 least get people to think about that as more of a
5 real time exercise.

6 I think different types of training
7 might be one way that you could preserve that a
8 little longer. It's a tough problem. But I do
9 think your point is very well taken because these
10 things probably don't come in ones and twos when
11 they come. You look at some of the FDIC history,
12 there's some pretty big waves. So I do wonder if
13 there are ways you can use some of those tools to
14 help with that.

15 MEMBER O'CONNOR: I would encourage
16 also the cycle. Keeping the cycle reasonably
17 short, two years, three years for the
18 institutions because systems and approach can
19 atrophy otherwise. So I think that's important.

20 The second important point back to
21 what Wilson was just saying is also on the crisis
22 management groups, really doing play book

1 exercises because again within five to ten years,
2 everybody turns over. So many of us in this room
3 who lived through all of it will not be sitting
4 around those tables. So I think that's equally
5 important because those two things need to come
6 together.

7 ACTING CHAIRMAN GRUENBERG: If I can
8 just add, and it's an important question on the
9 standing Army issue. How do we mobilize in the
10 event of a stress environment? And we perhaps
11 should've had the table -- in addition to these
12 folks who spend their time on the supervision of
13 the largest institution and resolution planning
14 for the largest institution, we have an
15 additional division dedicated to resolving banks
16 on the smaller end of the spectrum but with very
17 significant operational capabilities and frankly
18 large human resources to draw up which also
19 collaborate closely with these complex
20 institution groups.

21 So we actually can bring a lot of
22 resources to the table in the event of a stress

1 scenario. And a large part of the planning of
2 those groups are if we had to mobilize additional
3 resources. You actually have standing contracts
4 with third parties if we need to as well as
5 capabilities to call back retired annuitants. I
6 mean, there are in place a whole set of plans
7 that we --

8 PARTICIPANT: Reservists.

9 ACTING CHAIRMAN GRUENBERG: Yeah, to
10 draw upon. And particularly even now, for
11 example, where we may be facing -- we are facing
12 a change in the economic environment and
13 uncertain outlook of what the next 6, 12, 18, 24
14 months may present. And that triggers a lot of
15 thinking on both the supervisory and on the
16 resolution in terms of additional human resource
17 needs and how we might address them as events
18 unfold.

19 MS. KTMNIG: Perhaps to add and not to
20 get so militant like Army. But we are
21 firefighters.

22 (Laughter.)

1 MS. KTMNIG: We hope there's no fire.
2 But we need to be trained for all kind of fire
3 and not just to believe it's the old chimney that
4 will burn and this is where you know the answer.
5 But what I find incredibly important I think the
6 way you're setting it up, it addresses this is
7 the cooperation then also between the various
8 institutions.

9 Now I come with a European mindset.
10 We have 21 national authorities. So you never
11 know which country will be the one you have to
12 deal with. But I find it incredibly important
13 for any cross border institution that we also
14 train together, have deep dives, have a kind of
15 tabletop so that we all speak the same language
16 and that we all know what we want to do and how
17 would we work together, be it a European
18 institution with a U.S. arm to it or be it a U.S.
19 institution with in our case simply be across
20 European institution. So testing and fire drills
21 are probably the only way I would think of to do
22 so.

1 MEMBER COHN: You're probably going to
2 say the same thing. So look, we're all creatures
3 of our past. So when we go through all this
4 resolution, even though we may be forgetting '08,
5 it still heavily influences everything that we
6 do, that we think.

7 I think one of the things that we
8 should be really careful about is the next crisis
9 won't be '08. I don't know a lot. I just know
10 that. I know that for sure. I know that for
11 sure.

12 So if I was thinking -- if I was
13 sitting in your chair, I would think what is the
14 seismic or systemic crisis that's not '08? What
15 happens if we get a major cyber event? What
16 happens if we get a major cloud event?

17 We could just go through these. And
18 how do we deal with those events. And '08,
19 whether we like it or not, there was a sign,
20 there was a windup, there was a pitch, there was
21 a swing, there was a ball flying out. There were
22 a lot of balls that went out of the stadium. We

1 sat there and watched them.

2 The next event, there might not be a
3 sign, a windup, a pitch, and a ball. It just
4 might happen. And so in many of these things, I
5 think we've got to accelerate our thinking
6 because we live in a highly accelerated world.
7 We also live in binary outcome events. And the
8 event mostly likely will affect multiple
9 institutions simultaneously.

10 MEMBER CLAYTON: Yeah, look, I agree
11 with what Gary said. And a question related to
12 that, I think March 2020, it was sort of all
13 hands on deck for a little bit with a little bit
14 of -- but not the same as '08. I'm curious.
15 When was the last time it was sort of all hands
16 on deck for a resolution even as an exercise?
17 And I think that's -- if it's been a long time,
18 it's a good reason to give it a try.

19 MR. CONNEELY: Well, I think 2020 was
20 all hands on deck. I think the market events
21 that we've had was all hands on deck. The
22 geopolitical events we've had all hands on deck.

1 Some of the instances that we're going
2 to share with you today any one of these -- to
3 your point before, any one of these could cause a
4 crisis amongst our banks. We need to be ready
5 all the time, and we really don't know when it's
6 going to come. And it could come very fast.

7 So we do maintain a heightened state
8 of readiness. We do exercises both internally
9 and with other agencies and globally. We have
10 protocols and committees set up to constantly
11 work through some of these things.

12 We can't predict it, and we try to
13 build our resolution tools so that they're
14 functional and they'll work in any sort of
15 environment. But we really don't know what's
16 going to happen. But we try to maintain a
17 heightened state of readiness.

18 MEMBER CLAYTON: And just to follow up
19 on what Gary was saying, unfortunate experiences,
20 every time we go through one of those, you're
21 like there's something I wished that I had. And
22 it would be interesting to get updates on what

1 those things you identify that we didn't have
2 this going in but we could use it the next time.

3 MEMBER O'CONNOR: Yeah, just to
4 amplify those comments as well, I think you have
5 two things here to add. Big picture, how do we
6 horizon scan in a more effective way? And how do
7 we contemplate an economy that is substantially
8 more open, right?

9 You don't have the banking industry
10 writ large as a choke point for the bulk of
11 financial services delivery anymore. You've got
12 open technology architecture. You've got open
13 nonbanks. You mentioned that a little bit. So
14 as you think about continuing to shore up this
15 section which is super important, it's sort of
16 like a balloon.

17 And the answer may or may not be
18 regulate more, expand powers. But how do you
19 think about -- how can we think about under the
20 powers that you all have in collaboration with
21 the other agencies to identify and address these
22 types of risks as they emerge? Because in the

1 end, people are going to care about was the
2 economy impacted by financial instability
3 regardless of where it came from.

4 MEMBER COHEN: John, you had mentioned
5 right in your introductory remarks that the last
6 time we met, we did not have -- you did not have
7 the data which you needed for nonbank financial
8 institutions. This is what the chairman
9 generally mentioned about nonbank financial
10 institutions. In the beginning, I gather you
11 don't -- you still don't have -- I got to believe
12 that this creates a problem not only for the -- I
13 mean, you have no ability with the nonbanks. I
14 would think it adversely affects your ability to
15 really supervise and plan for the regulated
16 sector. So if all of that is still correct and
17 to go to what Jay said, we've got a gaping hole
18 and the nonbank sector grows.

19 Now I want to take a radical
20 approach, suggestion, and go back to something
21 the director mentioned again in his opening
22 remarks and that is FSOC. There are huge

1 problems with designated and regulating nonbank
2 institutions under FSOC. Why could not FSOC
3 designate just for the purpose of providing data,
4 requiring data to come to you to give you a
5 better overview of what's going on?

6 ACTING CHAIRMAN GRUENBERG: I think
7 these guys are going to find that question over
8 their head.

9 (Laughter.)

10 ACTING CHAIRMAN GRUENBERG: But I
11 think you raise an important question, Rodgin.
12 And I think this is a subject obviously I think
13 all three of us are concerned with as members of
14 the FSOC. I think it's been a focus of attention
15 if I may say for the Secretary as well. And it's
16 a subject we're hoping to address.

17 DIRECTOR CHOPRA: So of course, the
18 tools to get firm specific data to the extent
19 there is a -- I don't think this will be that
20 helpful but some state regulators that have some
21 insight. But there's also the Office of
22 Financial Research which has certain authorities

1 to compel and collect data that has been used in
2 a fairly limited fashion.

3 But it's also important to underscore
4 the legal mechanics of using -- of invoking Title
5 II. For a nonbank, it requires, I believe, super
6 majorities of the Fed Board, the FDIC Board, and
7 sometimes maybe even the SEC has to be involved,
8 consent of the Treasury Secretary, maybe even
9 consultation with the President and with no real
10 insight as to what is happening other than market
11 signals. And to be able to go in again without a
12 supervisory relationship, without a plan. And
13 yeah, tough.

14 But I don't know what we've -- what
15 Jim, John, and others, if you want to share the
16 thinking you have put into that scenario of how
17 to navigate something like that. Obviously, it's
18 like what Gary said. You don't even know. What
19 are you even going into?

20 MR. CONNEELY: Yeah, it's a difficult
21 question. I mean, we do try -- it's difficult.
22 Honestly, it's so vast, both the authorities.

1 They're very broad authorities, and we don't know
2 where the boundary is fully drawn yet.

3 I mean, there is some parameters that
4 companies would have to meet. But we're in a
5 dynamic environment. And then as far as what the
6 decisions are going to be made at the time,
7 there's going to be several parties involved and
8 they're always going to have their own
9 perspective.

10 And we'll have to deal with those
11 facts and circumstances at that time. It's hard
12 to plan for that. We do hold conversations,
13 though, with all the key turners to make sure
14 everybody understands their roles and talk about
15 issues. But it's difficult.

16 DIRECTOR HSU: I want to maybe try to
17 tie together Gary, Jay, and Sandie's comment
18 because I do believe that this challenge of how
19 to prep for the next and not fight last year's
20 war, right? It's kind of a perpetual challenge.
21 The exercises that we're talking about earlier
22 are really valuable. They're extremely time

1 intensive.

2 And you have to pick wisely. And I
3 think this is one of the challenges is, like,
4 where do you drill? And if you pick that spot,
5 then if you miss, then you expended a huge amount
6 of resources.

7 So I think that does argue for
8 something a bit more modular, smaller, faster,
9 more nimble. What exactly that is, I think we
10 really need to put some thought into how to do
11 that because I think that is a newer -- because I
12 think the environment requires it. Because
13 change is happening much more quickly and things
14 are not contained within the four walls of the
15 bank anymore.

16 And so that does require kind of a bit
17 more creative thinking on that front. It would
18 be interesting to know what other industries do,
19 kind of what's best practice out there. That's
20 something that, I think, kind of the collective
21 knowledge of folks at this table and your friends
22 have probably some insight into. So that may be

1 something to kind of think about and pursue in
2 the future. Thanks.

3 ACTING CHAIRMAN GRUENBERG: May I just
4 observe, this is really a pretty engaged group
5 here. And I'm looking at the clock and our
6 agenda this morning. And I'll maybe perhaps move
7 to our second agenda item.

8 And I think all of these issues
9 continue into the next. So it's not as if we're
10 leaving them behind. But I actually think these
11 next topics will engender further conversation
12 around these issues. John, if that's reasonable.

13 MR. CONNEELY: No, I think you're
14 absolutely right. We're actually naturally
15 leading into the next panel. Thank you. And our
16 next panel which is going to be the resolution
17 planning update as we noted, Title II and public
18 transparency and large bank resolution planning.
19 And we'll have Deputy Director for Resolution
20 Readiness Ryan Tetrick, advisors Betsy Falloon
21 and Susan Baker, and our legal counsel Pen
22 Starke.

1 MS. FALLOON: Thank you and good
2 morning. I'm Betsy Falloon. I'm a senior
3 advisory in the resolution readiness branch. And
4 I'm here to introduce our Title II topic for
5 today.

6 And chairman and John have mention
7 that what we're interested in here is to talk
8 about transparency and ways that we can tell the
9 story of the way we are planning and the way we
10 intend to approach a Title II resolution in a way
11 that enhances everybody's understanding of it and
12 improves confidence in the process and the
13 outcome. At this point, there's a pretty broad
14 awareness of the single point of entry strategy.
15 I think that people are aware of that approach to
16 resolution which is the one that we think is the
17 most effective.

18 And a lot of steps have been taken to
19 make that approach more actionable, more
20 available in a wider range of scenarios, both in
21 Title II planning area but in Title I as well.
22 The firms have taken steps and the agencies as

1 well to improve the firm's structures or
2 capabilities. And the single point of entry
3 strategy is now a credible option in a much wider
4 range of scenarios.

5 The planning work in Title I has
6 certainly had a lot of benefits and our Title II
7 readiness as well. And sort of the talk about
8 the firehouse or the standing Army, that routine
9 of the resolution planning also helps us because
10 there's always new information and new plans.
11 And we are building upon our planning as the
12 firms build upon their planning.

13 So over the course of my career, I
14 have seen where resolution planning has become a
15 truly full time year round job which is way
16 different than in the early years where we came
17 in and out in good time to do deals and a bad
18 time to do resolution. But we recognize that
19 this is hard. And comments have been made about
20 how it's hard to know exactly what to be ready
21 for.

22 And we certainly know that being ready

1 for the last crisis is not the answer. Although
2 certainly also we need to have learned from the
3 last crisis and remember those lessons and keep
4 that muscle memory but at the same time not be
5 trapped by the expectations of the past. As I
6 mentioned, we use the Title I plans as a
7 foundation for our resolution analysis in Title
8 II.

9 And in Title I reviews, we are now
10 using capabilities testing more so that as part
11 of our Title I review. So to validate the
12 capabilities that the firms have described in
13 their plans and the capabilities that we rely on
14 in Title II for our readiness. Arlen (phonetic)
15 was mentioned, and that's certainly a capability
16 that we think about a lot in Title II readiness
17 as well as in understanding the risks associated
18 with the Title I plans.

19 We have a systemic resolution
20 framework that we have built out which is sort of
21 our road map for how we think about Title II
22 execution. And we've been working -- at this

1 point, we're building in details. We're building
2 in templates.

3 We're trying to make this framework an
4 actionable set of steps. And an important part
5 of that is internal tabletops and exercises. We
6 try to do a lot of that, both the high
7 investment, high yield ones where if we get it
8 right, it's really good. And we've had a few of
9 those.

10 And also, we try to look for
11 opportunities where we have low cost exercises.
12 We call them Pop Exes, but just a quick, not a
13 lot of buildup, how would you do it if this
14 happened. Take this firm. Take this scenario.
15 Send some staff and go.

16 And those are ways that we can -- I
17 don't want to say build muscle memory because
18 it's not quite true. But create the teams,
19 create the expectation. Keep the knowledge
20 fresh, and also identify where we have gaps and
21 where we need to do additional work.

22 Certainly coordination among all the

1 financial regulatory agencies is critical to our
2 readiness. And I think John mentioned the
3 ongoing work that we do with key turning
4 authorities which is really important. And we
5 also coordinate on a staff level with staff at
6 Treasury to make sure that the liquidation fund
7 which is funded ex post and is a different
8 approach than what we use with the deposit
9 insurance fund that we have a staff level
10 understanding of what it takes to make sure that
11 we're ready to move that money timely and that
12 everybody knows what their job is to accomplish
13 that.

14 And of course, there's been a lot of
15 talk about our cross border engagement. And in
16 CMGs and outside of CMGs, we have a lot of
17 engagement with supervisory and resolution
18 authorities around the world to make sure that we
19 have as much as possible shared understanding of
20 the steps that we might take, the steps that they
21 might take. And that we talk about the work that
22 we've done to keep those issues fresh and to keep

1 those relationships fresh.

2 And all of this really supports
3 readiness and keeps us busy while we're in the
4 firehouse. Next slide, please. So the topic
5 here is transparency. And we are very mindful
6 that confidence is critical to the success of a
7 resolution in any case and in every case but
8 particularly in this case where we would be
9 exercising authorities for the first time.

10 And the key to confidence always is
11 setting expectations. Do stakeholders understand
12 the process? And is it being executed consistent
13 with those expectations?

14 So we have taken steps to build
15 awareness and understanding and are sort of
16 looking for ways to continue to do so. So for
17 instance, we've been very transparent about our
18 Title I resolution planning work. The guidance
19 is published. Q&As are published.

20 Public portions of the plans are made
21 available to the public on the agency's websites.
22 Our feedback letters are open to the public and

1 are also posted on websites. So it's an open
2 process.

3 And I think that there's a lot of
4 information available there. Certainly I've
5 mentioned that we work with other regulators and
6 regulatory authorities to have a shared
7 understanding with those stakeholders. And in
8 2013, we published a notice in the Federal
9 Register about the Single Point of Entry approach
10 to resolution and to make that strategy that we
11 had developed available so the public and other
12 stakeholders would understand and be aware of
13 that approach to resolution.

14 We continue to talk about Title II
15 resolution. There's been speeches about it. We
16 talk about it in a lot of different venues, some
17 of them are in small group venues and some like
18 this one are open to the public and are a way for
19 us to tell our story. But what we want to do and
20 what we want to ask you about is what do we need
21 to do to better set expectations to power our
22 communications and improve confidence when the

1 time comes. And with that, I'll turn it over to
2 my colleague, Susan Baker.

3 MS. BAKER: Hi. As Betsy conveyed,
4 we've done a lot about transparency in terms of
5 resolution planning. It's all out there on the
6 website. What we want to think about and what
7 we're starting to work on now is how to improve
8 transparency about our execution plans for Title
9 II resolution.

10 We've been working on these for ten
11 years now. And we should probably be starting to
12 say more things publicly. So what we want to
13 think about today is what should we be
14 transparent about now that would help improve
15 confidence in the event that we're called to use
16 our Title II authority?

17 So we've been thinking about this
18 across many dimensions. First, we look at who we
19 need to be transparent for. And we have a large
20 number, a list on this slide that you can see.

21 We've done a lot of work with
22 policymakers and regulators around the world as

1 has been said and a lot of engagement with
2 certain parts of the firm. So the sides on the
3 right, we've probably done more on. But what do
4 we need to be thinking about for the stakeholders
5 on the general public, customers, counter-
6 parties, other people like that?

7 We think about what message do these
8 stakeholders need to hear. And it might not all
9 be the same. And then we think about when we
10 need to be transparent.

11 And I know that there's going to be a
12 temptation for us to say -- for people to say
13 FDIC should just lay it all out there. Say what
14 you're going to do every step along the way. And
15 that pre-commitment will help improve confidence.

16 But we also need to be mindful of the
17 need for FDIC to have operational flexibility to
18 adjust to the specific facts and circumstances on
19 the ground. Next slide, please. So the is slide
20 is some topics that we're considering, the what
21 of what we need to be more transparent about.
22 And so what we would like to hear from you is

1 which of these topics or others that might not be
2 on here, thinking about contracting authority
3 which I took off the slide and now maybe I
4 shouldn't have.

5 (Laughter.)

6 MS. BAKER: What are the things that
7 would be helpful to get out in the public domain
8 to improve confidence now? So some of the things
9 we've heard about obviously are what are the key
10 decisions that the FDIC has to make, when would
11 you decide the framework? Is Title I bankruptcy
12 going to work or do we need to turn keys for
13 Title II which basically hinges on the need for
14 liquidity through the OLF I think?

15 How do we decide the resolution
16 strategy? Does the firm have enough capital to
17 make an SPOE work? Or do we need to be thinking
18 about an NPOE?

19 Do we need to be more transparent
20 about how we coordinate cross border? How it
21 would differ if we're a home or a host, for
22 example? We get questions about planning for the

1 bridge as well.

2 Who's going to run this bridge? What
3 assets and liabilities will go into it? And how
4 will the FDIC oversee what's happening at the
5 bridge and maintain that for public confidence
6 perspective as well?

7 We're thinking about creditors. How
8 do you communicate with claimants, including
9 about their claims determination? How will the
10 losses be allocated on the Dodd-Frank hierarchy
11 which is different than under FDI Act and under
12 bankruptcy?

13 And then how with the claimants be
14 compensated? How does securities for claims
15 process work? We mentioned that in the 2013
16 thing that Betsy mentioned earlier.

17 We're also wondering if we need to be
18 more transparent about some of the accountability
19 mechanisms that we have as well for the general
20 public audience. We are required to remove
21 culpable management. How would we go about doing
22 that?

1 Do we need to reemphasize that in the
2 Dodd-Frank hierarchy, that compensation claims
3 are subordinated to general creditors and that
4 prior compensation could even be clawed back if
5 needed. And then finally, there's the funding
6 mechanism. What part of that would be most
7 helpful to provide confidence.

8 I do think that the OLF in using it as
9 the big gift -- it's not a gift, but the big tool
10 that we need in Title II to help provide
11 confidence. But what do people need to know to
12 really get that? How important is it to explain
13 the rules and the mechanics for the OLF, how
14 money will get from point A to point B.

15 How would we use targeted guarantees
16 to allay concerns about excess cash use? There's
17 a lot of questions here. And so there are a lot
18 of things we've been thinking about.

19 And what we want to hear from you
20 today is what you think the priorities would be
21 in order to go about setting expectations
22 appropriately in public about how we would

1 execute Title II so that if an when we do have to
2 have that announcement on Friday -- ideally,
3 Friday night that people are in a position to
4 receive it, understand it, and say, yeah, that
5 works. And we can see how this will happen. Of
6 course, there will be doubters. But there's a
7 lot of things going on. So with that.

8 MEMBER HERRING: First of all, I'd
9 like to praise the FDIC for its unrelenting
10 pressure to have more disclosure under the actual
11 public reports. I think they have been very
12 helpful. Second, I guess I am a bit pessimistic
13 about your ability to communicate with the people
14 who really need to know in terms of a crisis.
15 And this is partly from my experience of teaching
16 this stuff.

17 (Laughter.)

18 MEMBER HERRING: There was a lot of
19 interest just after the crisis. It's dwindled
20 over time. And so people are sort of less and
21 less interested in getting into the nitty gritty
22 and some of the really interesting developments.

1 So I would think your strategy ought
2 to be to disclose as much as possible to people
3 who professionally need to know about it. And
4 that would certainly including the ratings
5 agencies, the people within the banks who are
6 responsible for these judgments. And simply
7 publicly available, a place where people can go
8 if they need to know more because we're dealing
9 with a society where people are getting their
10 information in tweets.

11 There's just no patience, I think, for
12 going through the elaborate and careful planning
13 that has gone on. It should be there. It should
14 be accessible when people need to know. But I
15 don't think you have much hope of reaching a
16 public that doesn't have a professional need to
17 know.

18 MEMBER COHN: I completely agree with
19 that. I almost think you'd scare the public if
20 you put this out. Like, why are they telling me
21 this? Should I be concerned about my bank?

22 Like, my insurance company doesn't

1 tell me what they're doing with my assets if they
2 just assume they're going to pay my claim, right?
3 I think you've got to think of the unintended
4 consequences of taking a public that has more
5 full faith and confidence in the banking system
6 than maybe people in this room do that we want
7 them to have full faith and confidence in the
8 banking system. They know the FDIC insurance is
9 there. They know it works.

10 They put their money in. They're
11 going to get their money out. So there's a
12 select crowd of people that are in the
13 institutional side. And if they won't understand
14 this, they're going to find a way to understand
15 this.

16 There's a bunch of law firms
17 represented in this room. There's a bunch of
18 people that'll charge them by the hour a lot of
19 money to explain this all to them. And I don't
20 have a problem with that, and they all have huge
21 staffs. But I would be careful about the
22 unintended consequences starting to blast too

1 much of this out in the general public.

2 MEMBER TAHYAR: So I'd like to take a
3 slightly different view that may be a middle
4 ground in the center. First of all, I think
5 Susan and Betsy, what you've done and the
6 thoughtfulness here is extraordinary. And I want
7 to give you respect for it.

8 I do think there's more that could be
9 put out in the public, perhaps not just on Title
10 II but also in Title I in a way that isn't scary
11 to folks. I mean, Gary, there's a timing
12 question, right? We're at a delicate moment now.

13 So if it goes out tomorrow, it might
14 have a different impact than if Susan and Betsy
15 do their work and it goes out as we're moving out
16 of the recession. But I'm very big on
17 transparency. I think transparency leads to
18 accountability.

19 The FDIC has to have flexibility. So
20 there are some ways that you could get out some
21 basics which say, we could do this, we could do
22 that. We will be holding these folks

1 accountable. We have these powers. We have
2 these authorities.

3 Without putting too much out there, I
4 get that we live in a tweet world. But you know
5 that 1994 book that the FDIC did on this, I mean,
6 that's a bible, right? And so folks who want to
7 know about it want to know about it.

8 One final thing is I think there's an
9 additional group of stakeholders that exist today
10 that need to know more about resolution planning
11 that didn't exist when we started on this journey
12 and that is the kind of fintech nonbank lenders,
13 money transmitters, digital assets, crypto
14 exchanges, whatever we want to call them. I know
15 you've listed domestic authorities. And I think
16 there are states that are starting to think,
17 should we have a resolution plan?

18 And there's so much learning here that
19 could be of benefit to those who are thinking
20 about different kinds of resolution plans. And
21 they would be very difficult if you could put a
22 little bit out more in public. So I'd go for

1 more, maybe not the whole hog.

2 MS. KTMNIG: Perhaps to build on those
3 comments, I can share we were -- when I go to
4 Parliament, the first question is, when will you
5 become more transparent? The second question is,
6 when are you giving us more information? And
7 then when we published in summer, or first
8 assessment of resolvability, I could count on
9 Germany's paper at least commenting that we
10 published something.

11 Then our gossip magazine, political
12 had a short article and that's it. When I went
13 to Parliament the next time, they said, when will
14 you be more transparent? When I refer to the is,
15 I knew no one had read it.

16 (Laughter.)

17 MS. KTMNIG: But I think the simple
18 argument is -- and I would I full heartedly build
19 on your comment -- you need to probably have on
20 your website and I know you have already a lot on
21 this. How does Title II work? What can you
22 expect from the institutions to do in case of, a

1 bit stylized.

2 And this can go out on a normal sunny
3 day. You need to be mindful that it doesn't go
4 out and everyone is quite sad. Why are they
5 doing it now? But I think a number of the other
6 topics are probably topics for what we would call
7 it guidance paper where you give more detail to
8 those that have either an academic or an
9 institutional desire to know.

10 But they are not really top of
11 priority for the public. Now the one difference
12 between us I have always envied for that is that
13 you have the summaries of Title I plans. We are
14 not talking about any individual banks, so you
15 will find from us a comment on GSIBs. On
16 average, everything is fine. You will find a
17 comment on midsize and the like. But you will
18 never find any detailed bank specific comment, a
19 topic that all Parliament is talking about.

20 MEMBER O'CONNOR: So just to sort of
21 again looping these three together. From my
22 perspective I think when you're going to make --

1 I believe in transparency. But it has to have a
2 meaning.

3 So if the people that are getting the
4 transparency need to be able to do something with
5 it. So for example, when we have a terrorist
6 alert and we give it a color but we don't know
7 where it is, how we respond, that's transparent
8 but not particularly productive except that we
9 should worry. So I think here we've got to do
10 this sort of same sort of thinking.

11 How and what should be used by the
12 general public. And that's sort of minimal and
13 sort of basic framework. And two, what
14 transparency can you provide that will lend
15 stability in a negative outcome?

16 And that's more about not publishing
17 claimant communication. That's going to be more
18 about you're going to come out and say we've got
19 this. We've got a strategy for this. We are
20 confident we can work through it.

21 So that's sort of I think the way that
22 you should be thinking about the communication.

1 And with regard to accountability, yes, that's at
2 some point. That's sort of a stage two.

3 I think you definitely need to do it.
4 But that's not your first order communication.
5 You're first order communication is we've changed
6 managements, right? So those would be sort of
7 the framework that I would offer up to think
8 about which I think you sort of have here.

9 MEMBER ERVIN: I'd like to go back to
10 some of Dick's earlier comments. I do think it
11 is hard to get a lot of demand for transparency
12 right now in the is sort of period of peacetime.
13 But that is going to flip, and it's going to flip
14 probably even faster than we saw in 2008 where
15 the need for communications really quickly in the
16 social media world to avoid disinformation and
17 have some holding patterns for things like I
18 remember in the early days of bailing people
19 saying they're coming for my deposits, right?

20 So just holding communications that
21 you can pull out that are helpful to deal with
22 disinformation, some very simple things, and how

1 quickly you'll be able to deal with different
2 constituencies. For example, liabilities are
3 further up and closer to harm's way. When are
4 you going to be able to give them some comfort,
5 if any?

6 How do you deal with foreign
7 operations? How do you communicate to some of
8 those different groups? I think ex ante
9 preparation for the speed of scaling up and the
10 ability to get information out to avoid rumors
11 taking over the narrative strikes me as probably
12 the place that feels like it's got the most
13 benefit in a world where I think you've done a
14 pretty good job of getting out the basics of
15 Title II and some of the basic resources that are
16 available now.

17 MEMBER LA SALLA: Can I just make a
18 general comment which will be totally unhelpful
19 and unproductive because I don't know the answer
20 to it. But it never stopped me from saying
21 anything like that before, so I'll do it again.
22 Transparency is only helpful and effective if

1 it's accurate.

2 And that sounds obvious. But in my
3 experience with resolution issues, and in this
4 world in interoperability between institutions,
5 it seems to me more times than not the regulators
6 are sort of the quarterback in this. And they're
7 getting bilateral information. But the normal
8 network of institutions that really should be
9 talking to each other to help aren't doing it.

10 And so information becomes
11 disinformation because everybody is waiting for
12 each other to clarify. So my point is to have
13 accurate transparency, it needs to be underpinned
14 by a foundation of a solid normal network within
15 the industry among the institutions who are
16 involved in this. And that's not easy. But I
17 think it's something that we need to really think
18 about and work on because if we don't it's just
19 going to spin.

20 MEMBER CLAYTON: Can I follow up on
21 that? I think -- look, I think this is an
22 incredibly important point. And any statement

1 that's made whether it's made by a regulatory or
2 an institution is going to be tested by the
3 market.

4 And we have to understand that. And
5 I think that just putting the two points
6 together, what you want to have out there today
7 is something that when you make a statement in a
8 time of stress, it provides that underpinning for
9 the statement. And I think that's the way to
10 think about the body of work that you have out
11 there, and it's kind of a dynamic relationship
12 for when you have to make a stabilizing
13 statement.

14 MEMBER KOHN: I wondered whether there
15 are some market tests of whether you're being
16 heard. And I think about TLAC. So TLAC should
17 spread, should respond to good and bad news about
18 the institutions. And it's really important. I
19 mean, it's a little bit conflicted, right? I
20 mean, it's important that people understand they
21 can be bailed in.

22 But you don't want a huge run on the

1 institution. But they're going to be, and it
2 could be an early warning signal to the FDIC and
3 the primary regulators when these things happen.
4 And there may be some other prices -- this is
5 similar to what Jay was saying -- in the market
6 that you can tell whether people understand who's
7 going to be protected, who isn't going to be
8 protected. It would be, I think, an interesting
9 study to look at the evolution of market prices
10 in the situation like March of 2020, for example,
11 and see whether people understood what might
12 happen.

13 DIRECTOR HSU: I might go further than
14 that, Don, because I think that you look at the
15 evolution. I think we have to sit down and talk
16 to long-term debt investors and make sure that
17 they as a stakeholder group fully understand bank
18 debt today is not what it was before. It is not
19 principle protected by design. And I think that
20 expectation, I like how you started off.

21 It's all about expectation setting.
22 And I think that is absolutely critical. If that

1 doesn't hold, this whole thing doesn't hold. So
2 I think it's one area to focus on.

3 I do want to go back to something Jay
4 said about stabilizing statements. In my
5 experience, they're not stabilizing. If you have
6 to make a stabilizing statement, you're in real
7 trouble. And I think that part of that means
8 there's a lot of pre-work that needs to be done
9 such that those statements aren't seen as a
10 reach.

11 Because if they're seen as a reach,
12 the market sniffs that out in two seconds and
13 actually has the opposite impact. And this is
14 one of the big challenges. Like, what can be
15 done ahead of time so that it's all going as
16 planned, hands off the wheel, this is part of
17 what we've been prepared for? Because that's
18 what builds confidence.

19 MEMBER CLAYTON: You just said very
20 well what I was trying to say.

21 (Laughter.)

22 MEMBER PETERSON: So I think the most

1 stabilizing comments have not been coming from
2 the FDIC. They've been coming after the CCAR
3 tests. And so there's been a consistent approach
4 now for over ten years of pronouncements coming
5 out about the banks, about how much capital
6 they're able to return, how much stock they can
7 buy back, what kind of dividends they can pay.

8 And that consistency, the market
9 understands that. Even the common public will
10 understand that. They know how to read those
11 headlines.

12 I think what we've talked about here
13 with the FDIC's role of having this available for
14 institutions, have it available somewhere. The
15 professional markets understand it. But I think
16 right now the more stabilizing factor is that
17 we've had ten-plus years of reports on stress
18 testing, on capital levels, on dividend levels,
19 et cetera.

20 And maybe we should think more about
21 is there a way to make that more transparent or
22 eliminate some of the jargon, et cetera. But

1 what you're doing I think is excellent work. But
2 maybe it should be more for professional
3 investors and available to anybody.

4 MEMBER ERVIN: Just a quick comment
5 back to Mike and Mike's comments about TLAC
6 spreads and Don's as well. I still kick myself
7 for not buying some during the COVID crisis.
8 They went --

9 (Laughter.)

10 MEMBER ERVIN: I feel stupid about
11 that. There have been some events in Europe over
12 the last decade. And TLAC and CoCo spreads have
13 spiked out and come back in on idiosyncratic
14 stuff. So I think the market has generally been
15 behaving as we would hope it to behave. Some of
16 the academic studies I've seen, I know Darryl
17 Duffy (phonetic) and a few people did a big study
18 on some of the too big to fail premium. And it
19 seems to be working okay.

20 Again, we haven't really run the thing
21 through a proper test. I hope we don't have to
22 in the near future. But at least all the ex ante

1 signals about credit market spreads and whether
2 it's systemic or idiosyncratic seem to be sending
3 decent signals from what I can tell.

4 MEMBER HERRING: Following up on that
5 very quickly. In the very early days of the
6 committee, we used to measure sort of how well we
7 were doing with whether the kind of debt we were
8 looking at, at the bank or at the holding
9 company, differed. And it was really a couple of
10 years before the markets got the message that
11 there really is a different credit risk here,
12 that there are different priorities in play. So
13 I very much would support Wilson's view, and
14 that's a healthy thing. Somebody understands the
15 rules which is good.

16 MR. CONNEELY: Well, this is a
17 fantastic discussion, and thank you for all your
18 input. And I think it confirms a lot of what
19 we're thinking and it gave us a lot of new things
20 to think about. We're running well behind on the
21 agenda here which is not a bad thing. But I'd
22 like to turn it over to Ryan Tetrick to talk

1 about the resolution of non-GSIB large banks.

2 MR. TETRICK: Thanks, John. And part
3 of the lesson of resolution planning needs to be
4 prepare to execute on a compressed timeframe.
5 See how this goes.

6 (Laughter.)

7 MR. TETRICK: So if we can turn to --
8 so we're on slide 14. So I should just start by
9 acknowledging that this is the first time that
10 we're discussing a large bank resolution in the
11 SRAC and explain why we think it's the right time
12 to do so. The policy response to the great
13 financial crisis understandably focused on the
14 largest and most systemic institutions.

15 At the same time, we at the FDIC have
16 taken a number of meaningful steps to improve
17 large bank resolvability and have long been
18 attentive to the significant challenges that are
19 posed by what are sometimes referred to as
20 regional banks or DSIBs. But I'll simply call
21 them large banks for this discussion. While
22 compared to GSIBs, the failure of a large bank

1 might be relatively less threatening to financial
2 stability.

3 It still may be highly costly and
4 result in significant disruption to local
5 communities and potentially to the wider
6 financial system, especially if it occurs in the
7 context of a wider economic downturn. Our goal
8 for this presentation is really simply just to
9 introduce some of the challenges that we see with
10 resolving these institutions and discuss some of
11 the strategic options that might be available to
12 us. During the global financial crisis, the FDIC
13 handled the failure of the largest IDIs with
14 creative and dynamic responses.

15 But the options that were available to
16 us were limited and undesirable, a costly
17 conservatorship in the case of IndyMac and the
18 sale of Washington Mutual to a GSIB which was
19 really only possible because it had a large
20 preexisting stock of long-term debt to absorb
21 losses and because it had already been marketing
22 itself in the route to its failure. And so

1 JPMorgan had conducted significant due diligence
2 by the time the institution failed. So it's fair
3 to say that the challenges and tricky issues here
4 are underexplored publicly and not fully
5 resolved.

6 I promise we won't resolve them in
7 this discussion. We'll just get started here.
8 So really on slide 14, just a quick flyover of
9 the FDI authority under which these institutions
10 would be resolved.

11 The FDIA is the only regime available
12 for resolving insured depository institutions.
13 And importantly the depositor class is senior to
14 unsecured creditors. And the uninsured
15 depositors would share losses pari-passu with the
16 deposit insurance fund which covers insured
17 depositors. Every resolution must pass the
18 least-cost test which means that the FDIC must
19 execute the resolution that is least costly or a
20 resolution that is least costly to the deposit
21 insurance fund.

22 So that really comes into play only

1 when there are losses into the depositor class
2 and therefore costs to the DIF in paying insured
3 depositors. We have bridge authority which would
4 work a lot like the type of bridge authority that
5 we've talked about in Title II except that
6 furniture depository institution, it's a new
7 deposit taking entity chartered by the OCC rather
8 than a company formed by the FDIC. And it's well
9 understood that the deposit insurance fund is
10 available to fund the cost of the resolution in
11 terms of the administrative expenses during the
12 course of the resolution, the payment of
13 insurance.

14 But really importantly for the
15 resolution of large banks which will almost
16 certainly fail due to liquidity. The DIF is a
17 source of temporary liquidity as well. It's
18 large, pre-funded, but also backstopped by
19 significant borrowing authority ultimately by
20 U.S. Treasury.

21 And the scale of the liquidity that we
22 have in the DIF is actually in some ways greater

1 than relative to the institutions that would be
2 resolved or the liquidation that we're entitled
3 to. So there's significant liquidity that we can
4 use to facilitate one of these resolutions. So
5 moving to slide 15.

6 Just quickly which institutions do we
7 have in mind here? So generally in this
8 discussion, we're talking about IDIs with over
9 100 billion dollars in assets that are not
10 subsidiaries of U.S. GSIBs. But from a
11 resolution strategy perspective, there's nothing
12 magic that happens at that 100 billion dollar
13 line.

14 There's nothing magic that happens at
15 the 250 billion dollar line. The issues are
16 really similar. They just become more pronounced
17 as the institutions get larger.

18 Also, I think we find that large banks
19 tend to be generalized as having a very simple
20 structure. A holding company with 95 percent of
21 all assets and activity in the IDI subsidiary
22 conducting traditional banking activity. And

1 part of the objective of this slide is just to
2 break down that mental model just a little bit.

3 That holds for many institutions. But
4 there's a little bit more complexity here than
5 might first be apparent. Some of these
6 institutions, they obviously have more
7 diversified businesses than smaller banks.

8 And some of them even have Title I
9 designated critical operations. In the first
10 couple rows here, you're focusing on the impact
11 of size on strategy. And again, there's not much
12 difference between over 250 and under 250.

13 It's really a matter of degree. And
14 looking at how salable are these institutions and
15 a resolution, very limited possible acquirers for
16 any of the institutions in these categories. And
17 I really want to touch on the model line
18 institutions if you think about it from a
19 resolution strategy perspective.

20 If they're failing, they have some
21 specialized business that they're involved in.
22 And it's almost certain that's part of what's

1 impaired. And that makes preserving franchise
2 value through the course of the resolution
3 significantly more difficult.

4 And then it's just something that we
5 tend to see with the institutions in that
6 category. They have more operations outside the
7 bank chain making operational continuity more of
8 a challenge for us in resolution. And then IDI
9 subsidiaries of FBOs similarly operational
10 continuity challenges.

11 They have relationships with foreign
12 affiliates, with the parent in terms of shared
13 services, shared data, shared personnel, those
14 sorts of things. All right. So slide 16, these
15 are some of the unique challenges that we see
16 from a resolution perspective when considering
17 large banks. And I would be interested to hear
18 from the committee if these are the right
19 considerations or if there's others that we
20 should be focused on.

21 I'll quickly step through them. Here
22 we're distinguishing large bank resolution both

1 from GSIB resolution under Title II but also from
2 the resolution of ordinary community banks. And
3 in a way, they combine a lot of the toughest
4 challenges of each plus the burden of high
5 expectations.

6 I think everybody is going to remember
7 the challenges of failing SIFIs from the global
8 financial crisis. But for large banks, the
9 expectations are probably closer to the failure
10 of an ordinary bank that the FDIC tends to handle
11 routinely and swiftly. So starting the
12 challenges box, the first few here generally
13 speaking relate to strategic options and the
14 latter given to operational challenges just in
15 carrying out the resolution.

16 But obviously it's touched on already.
17 Just from the standpoint of capacity, the capital
18 and operational resources that would be needed,
19 there are very few institutions that could
20 acquire a large bank. And it'll be especially
21 difficult at the time of failure on a compressed
22 timeline.

1 There's no minimum loss absorbency
2 requirement for these institutions. Some of them
3 do have long-term debt that could absorb losses,
4 but there's no requirement. And that means that
5 there could be increased costs and it could limit
6 the strategic options available to the FDIC
7 particularly if the depositor class is impaired.

8 Franchise value be destroyed and it
9 might make it harder for bridge and sale
10 strategies to pass the least cost test. They
11 don't have a debt structure that supports a
12 single point of entry type of resolution. That's
13 sometimes contemplated for these institutions.

14 But without that structure there, that
15 means entry at the IDI which for these
16 institutions is a very complex operating company
17 for using a bridge. That means that over the
18 weekend, it'll involve the transfer of thousands
19 of employees and a wide array of services,
20 assets, and contracts to that bridge institution
21 over the weekend. I've noted the challenges with
22 operational continuity in addition to some

1 services being outside the bank itself.

2 They also just haven't fully addressed
3 the impediments to maintaining operational
4 continuity and resolution that some of the larger
5 firms have and to the same degree. So next
6 handful of challenges here, I know there are a
7 lot of challenges which was just part of the
8 message. Getting to the receivership entity
9 itself, so there's a large number of deposit
10 accounts that we would need to handle at the time
11 of resolution for the largest banks, 10, 20, up
12 to 40 million deposit accounts and more complex
13 account types than for smaller banks.

14 So past the relationships and things
15 like that, that would be hard to work through.
16 And then, of course, large portions of the
17 deposit balances are uninsured, ranging from 40
18 to 50 percent for these institutions on average.
19 And then just other challenges around
20 receivership management, the receivership entity
21 that the FDIC would be responsible for.

22 It'll depend largely on the complexity

1 and scale of the assets that left behind in the
2 receivership. It could be significantly
3 simplified if we're selling the institution or
4 using a bridge and much is moving to that. I
5 should just note that in the event that we have
6 to undertake a liquidation where everything stays
7 in the receivership, the operational challenges
8 are quite daunting in that circumstance.

9 The last two challenges here kind of
10 touch on the path to failure and the point of
11 failure. They obviously -- they have more
12 complex business lines and the fact that we're
13 going to need to make projections about
14 valuations through the course of a bridge period
15 makes our assessment of the potential cost to
16 resolution at the time of failure more difficult.
17 And then combine that with the fact that they're
18 almost certainly going to fail due to a run on
19 liquidity.

20 There'll be an abbreviated runway
21 which will further reduce the time that we have
22 to conduct valuations and to market the

1 institution. So those are the challenges. There
2 are a few advantages.

3 Importantly as was touched on the
4 first panel, we maintain a dedicated and onsite
5 presence at these institutions. It's hugely
6 valuable in understanding these companies day to
7 day. And then also in the runway to resolution
8 when one of these banks fails, we'll have ready
9 access to the source of technical information
10 that we need to be prepared to resolve one of
11 them.

12 We maintain two resolution-specific
13 record keeping requirements that relate to large
14 bank resolution. One requires these banks to be
15 able to calculate deposit insurance within 24
16 hours notice from the FDIC and provide that to us
17 within 24 hours. Another requires certain of
18 these institutions to provide us with position
19 level QFC data so that we can assess their
20 derivatives portfolio, make decisions in a timely
21 way over a resolution weekend.

22 And then, of course, we have an IDI-

1 specific resolution planning requirement which
2 increasingly involves not just the plant
3 submission but engagement around the planning
4 process with the institutions on an ongoing
5 basis. So that's a lot. I'll stop there and
6 interested for any reaction before we move on.

7 MEMBER MAYOPOULOS: I'm curious as to
8 -- it seems to me that at this scale of failure,
9 the likely cause is probably a macro event that's
10 likely to affect multiple institutions at once.
11 And I'm curious as to how you feel about your
12 ability to collectively coordinate all of that
13 and how you think about the scenario planning
14 about what you do with one institution may impact
15 what happens at another institution and kind of
16 the knock-on effect of that.

17 MR. TETRICK: Yeah, so that could be
18 the case, right? There could be something
19 particular that a particular bank is doing in its
20 idiosyncratic failure. But it could be a larger
21 downturn and there's multiple institutions under
22 stress at the same time.

1 Part of the -- and we'll get into this
2 in the next part of this discussion. Part of the
3 challenge here is that there isn't a built-in
4 strategy the way that there is for GSIB
5 resolution. And the GSIB model really relies on
6 the resources of the institution, single point of
7 entry.

8 And we're relying on sort of
9 maintaining operations that limits the resource
10 need on the FDIC. Now bridge strategies for a
11 large bank can look a lot like that. The
12 challenge is there's not a built-in exit.

13 So we try to focus on strategies that
14 reduce the resource need of the FDIC. We can't
15 control the timeline. But there is decision
16 making with the other authorities about which
17 weekend institutions fail on. So we would hope
18 to not be resolving multiple institutions at the
19 same time. But there's significant challenges
20 and multiple failing at once.

21 And then just to the latter part of
22 your question about the impacts on other

1 institutions, this is one of the reasons why
2 we're really focused on the impact, particularly
3 on uninsured depositors. Because if there's a
4 resolution that's impacting uninsured depositors
5 and they're similarly situated banks, I think
6 we'd be concerned about what the knock-on effects
7 would be to those uninsured depositors. At other
8 banks, we're seeing haircuts occur at the bank
9 that's being put into resolution.

10 MEMBER ERVIN: You probably don't need
11 any extra challenges, but I want to throw two
12 more in. One is for acquirers. As you get
13 bigger, a lot of regulatory tasks escalate.

14 So it's not just the cost of the
15 institution. It's the cost across your whole
16 institution where everything would be held at the
17 higher capital and CCAR standards, et cetera.
18 That's similarly true for foreign banks.

19 Foreign banks find it more expensive
20 to operate cross border than they used to. So I
21 think your pool of cross border buyers also is
22 difficult. So I think in terms of what happens

1 to buyers in this group I think is important.
2 The second one is a legal tale. I remember a few
3 years ago I think it was Jamie Dimon said if I
4 tried to do this again, my board would ask me to
5 have a psychological examination that I picked up
6 a lot of lawsuits with acquisitions.

7 Those are very difficult to due
8 diligence on in the kind of time frame you're
9 looking at and the costs are huge. So I don't
10 know if there's any ways you can mitigate some of
11 those risk for an acquirer, if there any tools
12 you have in terms of making it a cleaner
13 institution to purchase. But that strikes me as
14 another thing that in this kind of compressed
15 time frame for these scales of institution could
16 be quite difficult.

17 MR. TETRICK: To quickly respond,
18 because there may be limited acquirers just in
19 terms of capacity, our planning, we know we can't
20 depend on an acquirer being available. So sort
21 of looking at solutions that allow us to market
22 an institution over time out of a bridge rather

1 than compressed over a weekend. But we are
2 looking at things we can do to at least expand
3 the range of scenarios when an acquirer could
4 pick up one of these institutions quickly. Legal
5 risk is a good thing to look into. But there are
6 regulatory barriers particularly for the largest
7 institutions that would need to be overcome.

8 MEMBER CLAYTON: But also Ryan, I
9 think as far as the legal risk, as we said, WaMu
10 came on us very quickly. And everything was
11 transferred over. We had the option to retain
12 certain liabilities in the receivership and pay
13 them pursuant to the priority scheme. So it's
14 possible that we could offer Jamie Dime and a
15 different option next time.

16 (Laughter.)

17 MEMBER O'CONNOR: I won't comment on
18 that one. Just a couple things spring to mind.
19 One, these large institutions -- and by the way,
20 I should start with I completely appreciate you
21 want to have a more prescriptive approach to
22 getting information and creating a playbook.

1 But the starting point I would say is,
2 one, you have liquidity and capital stress
3 testing which obviously improves the shock
4 absorbency. When I think about the Title I,
5 Title II resolution plans for GSIBs, they were
6 driven by, one, making sure that critical
7 operations would continue. There would
8 opportunity for recapitalization and to make
9 those institutions internalize the costs of
10 externalities they create because they created
11 such systemic risk.

12 I didn't hear those components here.
13 And I'm not saying you don't go on this path.
14 But maybe you talk about it a little bit
15 differently because these -- size was the other
16 thing that jumped out, size not necessarily
17 equaling risk.

18 So something big and simple, right?
19 As long as you have the right information, you're
20 going to be able to resolve in a very traditional
21 sense to the way you would draw smaller scale
22 banking institutions. So I would posit size, be

1 careful on.

2 You can be a lot smaller and create a
3 lot more complexity and be a lot more
4 destabilizing. And then the question also I
5 would push on, I love the recognition of model
6 line being a problem because I think it sort of
7 can be. But I would also say when you look at
8 some of these small banks and the 40 to 50
9 percent uninsured depositors, we also have to
10 make sure and I think you were leading down this
11 path that if it's not systemic, those components
12 can fail.

13 That's a terrible thing to say. But
14 the reality is I think also collectively want to
15 be careful of bailouts and moral hazards that
16 would be potentially embedded. So I think we're
17 on the right path of thinking about it.

18 Part of the wording we might want to
19 use a little bit differently because you're not
20 necessarily dealing with systemic institutions
21 and forcing them to bear the externalities which
22 is why you drove Title I, Title II for the GSIBs.

1 And you also have this good cushion of liquidity
2 and capital stresses. And I would just offer up
3 that as you think through how you present it.

4 MEMBER TAHYAR: I think this is very
5 thoughtful, and I think it's good that the FDIC
6 and the Fed are thinking about this right now.
7 One thing to be -- we need to be crystal clear on
8 is that the imposition of a long-term debt
9 requirement on banks that don't have a lot of
10 long-term debt right now in a rising interest
11 rate environment means that you would be imposing
12 enhanced increased today costs to solve a
13 contingent problem. And that has to be very,
14 very carefully balanced.

15 And so as you're doing your analysis
16 on the APNR, I would hope that's a place where
17 you would be doing a very, very deep dive.
18 Another deep dive, thinking about the uninsured
19 deposits which some of them might be hot money
20 and some of them might be sticky in the sense
21 that if it's brokered deposits, it's hot. But if
22 it's Joe's Auto Body Shop making payroll, it's

1 sticky. And so I would hope as you're doing the
2 good and careful thinking around this APNR that
3 there could be some data driven analysis around
4 that because there's a lot of challenges to think
5 through here.

6 MS. KTMNIG: I have to add -- not to
7 add challenges. I think one thing to be seen, we
8 can see it on our side. But I think also
9 Washington Mutual was already mentioned.

10 The first guaranteed to successful
11 resolution is that it comes early enough at a
12 point whether it's still franchise left which
13 gets us back to the discussion we had in the
14 first round. The second part gets us back
15 probably to supervisory presence and realistic
16 assessment. The second one is clearly something
17 we are contemplating is you might not be able to
18 find a qualified buyer for the whole thing.

19 But you might be able as part of your
20 resolution planning to say there are buckets to
21 be prepared. Now it's very simple to say they
22 need to be prepared. If it takes two years,

1 that's far too long.

2 So really in resolution planning
3 already to think about whether there are chances
4 to produce buckets which increase your
5 optionality if need be without really
6 jeopardizing the firm. And I won't comment on
7 the question, what to do with a bank which has a
8 balance sheet. Here is equity, there are
9 deposits, and nothing is in between which is the
10 challenge in this topic.

11 MEMBER ERVIN: But I think, for
12 example, in Europe, you generally force MREL on
13 banks that are smaller than GSIBs, a lot smaller,
14 and same thing in the UK. So from an
15 international competitiveness issue, we're in a
16 pretty different place from other jurisdictions
17 that have wrestled with this. I agree with Meg
18 that this needs to be done in a calibrated way.
19 We have a different market.

20 On the other hand, if we're going to
21 internalize an externality, it is going to be a
22 cost of dealing with a contingency. And it's a

1 question of does that cost go to the DIF and get
2 spread around everybody else, including the
3 people who are behaving virtuously? Or is it
4 internalized to the institution? That would be
5 difficult to resolve. I would think as a matter
6 of economics, you generally want to lean towards
7 the latter.

8 MEMBER TAHYAR: And it's interesting.
9 One of the tools we don't have here is contingent
10 capital which is what MREL has, right? And
11 there's been a tax blocker on that. And that may
12 well be something that as you're going through
13 the process of thinking through this is to
14 rethink whether that tax blocker is appropriate.

15 MEMBER HERRING: I think that's a very
16 important point because that extra layer of
17 liability really gives you a lot more option and
18 time in dealing with it. I'm reminded of
19 something that the OFC did -- the Office of
20 Financial Research did, I probably put an extra C
21 in it -- sometime ago where they looked at the
22 GSIB scores of all of the major U.S. banks. And

1 I can say from the point of view of a
2 professional who grades, it was very nice to see
3 a huge break point between the GSIBs and
4 everybody else.

5 I haven't seen that updated now that
6 we've had several mergers. And I'm wondering if
7 you using those -- I'm not sure -- they're not
8 perfect metrics but they are well recognized. If
9 they look closer together than they once did.

10 But in the original cut, there was
11 just a really comforting break between the GSIBs
12 and everybody else. Could've been reverse
13 engineered. I wouldn't say it wasn't.

14 But nonetheless, it did indicate they
15 were quite different. If they become more alike,
16 then I think it's a much easier sell to say we
17 know there's a problem. We know how to deal with
18 it, and these things should be extended.

19 MR. TETRICK: So as I respond to that,
20 maybe we can turn to the next slide. If you
21 look, there's still pretty significant grade
22 distribution on those scores. They may have

1 tightened some.

2 But I guess part of the way that we
3 think about systemic risk is it's not necessarily
4 binary. It depends on the scenario. And when
5 one of these institutions is failing, if it's in
6 the context of a wider stress, a regional bank
7 could be disruptive.

8 So we've touched on a lot of this
9 here. But just quickly and how do we think about
10 what's the right strategy. There's not a single
11 answer. These are the broad three approaches
12 that we think about.

13 But we really focus on the middle
14 option here, the use of a bridge bank. We've
15 talked about why a sale to a third party acquirer
16 would be a significant challenge. A liquidation
17 would be extremely costly.

18 For a bridge bank, one thing that
19 we're looking very, very closely at is that
20 there's a big difference between a bridge in
21 which we can pass all deposits in a bridge in
22 which we can only pass insured deposits. And if

1 there are losses incurred by the depositor class,
2 then that makes it harder to pass the cost tests
3 and pass all deposits. It also means that the
4 franchise is probably significantly destroyed at
5 that point.

6 And then importantly a bridge
7 strategy, that's not an exit. That's only half a
8 strategy. You need an exit to have a full
9 strategy.

10 And so what we focus on making the
11 bridge itself feasible and we think about some of
12 the ways that we could exit from a bridge. And
13 certainly being able to more readily break up
14 parts of these institutions by lines of business,
15 regional franchises, sales of portfolios and
16 looking at that in advance, that's very helpful
17 and it could help with a multiple quire type
18 exit. We think about whole bank type exits.

19 Maybe over time if there's time to
20 market out of a bridge, you can have a single
21 acquirer. You could have an IPO type exit. And
22 if there's significant long-term debt, you could

1 contemplate a bailout type exit for these
2 institutions too where you're turning the
3 institution over to its creditors.

4 The problem is that the FDIC is not
5 going to want to be in a bridge for an extended
6 period of time. And these institutions are very
7 large. And so executing any of those options
8 could take a long time, and there's not a built-
9 in exit strategy like there is for GSIBs.

10 And maybe I'll just turn to the last
11 slide here. Just acknowledge there's in addition
12 to building up our own operational capabilities
13 to operate a large bridge, these are some of the
14 things that we're doing to enhance large bank
15 resolvability. Obviously, we have the IDI
16 resolution planning process.

17 We're strengthening that starting with
18 a number of submissions that are coming in this
19 year. We've committed with the Federal Reserve
20 to provide guidance to Category 2 and 3
21 institutions, so some of the largest banks that
22 file Title I resolution plans. And then we've

1 noted the ANPR on long-term debt.

2 And we look forward to seeing the
3 comments. And those come in towards the end of
4 the year. I think that's it on this topic.

5 ACTING CHAIRMAN GRUENBERG: Thank you,
6 Ryan.

7 MEMBER ERVIN: Could I just make one
8 comment? It goes back to something that Dick
9 brought up which is, is there a dividing line in
10 terms of the systemic risk scores? One of the
11 things I do worry about is sort of the continuity
12 to the U.S. banking system.

13 We've had our GSIBs since they got
14 designated. They stuck there. None of them have
15 de-GSIB'ed. And in terms of the other banks,
16 they tend to try to stay within their buckets.
17 And I worry that we've created some of these
18 discontinuities, that there's no sort of ramp up
19 that you cross a line also and you go into full
20 Title I, planning full TLAC, et cetera.

21 It would seem to me that there is no
22 bright line that really just magically separates

1 that bank that's a millimeter over the line from
2 one that's not quite so much over the line and
3 that if I was thinking about a system that would
4 work smoother, that'd be more future proof
5 because banks want to grow and scale becomes
6 important. That having some ramp into some of
7 those capabilities would give you options whether
8 to bail in on its own resources or help with a
9 merger. That some sort of phasing in would feel
10 like saying that both solves an industrial
11 structure problem as well as a resolution
12 problem.

13 MEMBER PETERSON: And I want to add to
14 that that I don't think that's just based on
15 size. It's activity based. It's broker dealers.
16 It's international activity. It's asset
17 management, et cetera.

18 MR. TETRICK: I think that's right.
19 To Sandie's point earlier, I mean, if you just
20 look at the GSIB scores and the sizes, there are
21 many regional banks that are larger than some of
22 the GSIBs. And that's because a lot of what's

1 scoring there is the complexity of the
2 activities, the cross border activity.

3 And breaking into that type of
4 activity isn't something that the regional banks
5 can readily ramp up into. So I think that might
6 be part of why you don't see as much movement
7 there. But it's definitely not just size. Size
8 is important to us in terms of just who can
9 acquire if you just look at it from a strategy
10 perspective.

11 MEMBER PETERSON: Size is only one-
12 fifth of the G6.

13 ACTING CHAIRMAN GRUENBERG: I'd like
14 to give you all a brief break if we could. Let's
15 take five to seven minutes. And maybe if we can
16 come back by around 11:20 or so, we could start
17 our last session.

18 (Whereupon, the above-entitled matter
19 went off the record at 11:14 a.m. and resumed at
20 11:26 a.m.)

21 MR. CONNEELY: Okay, great. Almost
22 everybody came back, so that's a positive. Ready

1 to get -- okay, great. So we're on our last
2 session of the day. We're going to be talking
3 about CCP resolution challenges.

4 And there are a lot of challenges in
5 that regard as the chairman noted up front.
6 First we'll hear from Associate Director Jenny
7 Traille on Title II resolution for CCPs. And
8 then we have our guest speaker, Sir Jon Cunliffe,
9 Deputy Governor for Financial Stability and CPMI
10 chair. And he will over some remarks as well.
11 So with that, I will turn it over to Jenny.

12 MS. TRAILLE: Thank you, John. So as
13 mentioned a few times today, we wanted to revisit
14 the topic of CCP resolution under Title II that
15 we started to discuss in the last SRAC meeting in
16 2020. And in particular, I'd like to focus on
17 some of the key challenges we face domestically
18 as we think about resolving one of these
19 institutions and highlights on the ongoing work
20 that the FDIC is involved in internationally to
21 address what are some common challenges across
22 authorities and jurisdictions.

1 So in this session, we would like your
2 thoughts of the prioritization of efforts to
3 tackle these challenges that I'll describe along
4 with any other insights that you may have and
5 that you can share in addressing this complex but
6 critical area of systemic risk. So many of you
7 may recall that when we last met in 2020, we
8 discussed the FDIC's objectives with respect to
9 resolution, specifically to maintain the
10 provision of the critical clearing functions in
11 order to protect adverse effects on U.S.
12 financial stability. We also gave a very high
13 level overview of some of those challenges, and
14 we would like to spend our time today going into
15 some more detail.

16 So the first challenge that we face is
17 a lack of resources that are available
18 exclusively to support resolution. CCPs
19 themselves have robust loss management waterfalls
20 as part of their rule books, particularly with
21 respect to managing member defaults. But we need
22 to plan for it and be prepared for a situation in

1 which these resources are significantly depleted
2 or even exhausted by the time the FDIC is
3 appointed as receiver.

4 We wouldn't want a scenario where if
5 recovery failed, resolution would also fail. So
6 another aspect to this issue of resources is the
7 potential for these end of waterfall tools to
8 have some tradeoff such as potentially pre-
9 cyclical impacts to markets and participants that
10 are already under stress in that type of tale
11 event. So while the FDIC would have the
12 authority to use the tools and resources within
13 the CCP's rule book in Title II to the extent
14 that they are still available, their application
15 or the availability that we would think about in
16 that context would be weighed against the
17 financial stability consequences.

18 And unlike SPOE for GSIBs which we've
19 talked about many times already today where we
20 have financial resources available to absorb
21 losses and recapitalize a firm with the purpose
22 of allowing it to continue to perform those

1 critical functions for the market while the
2 resolution process is ongoing, we don't have
3 dedicated losses absorbing resources reserve for
4 resolution in the CCP context. Such tools have
5 been proposed and publicly debated by legislative
6 bodies, by regulators, academics, and
7 practitioners. And certain jurisdictions have
8 considered or even adopted some of these tools
9 such as resolution cash calls that are reserved
10 for resolution.

11 The second challenge we wanted to
12 highlight which we've mentioned earlier in Jim's
13 remarks in the first session is the lack of
14 requirement for CCPs to file resolution plans
15 with the FDIC. So this is again an important
16 contrast to the bank space where GSIBs are
17 required to file resolution plans under Title I.
18 And in addition to providing for the resolution
19 of GSIBs under bankruptcy without systemic
20 implications, the Title I planning and review
21 process as we've talked about greatly informs the
22 FDIC's resolution planning under Title II.

1 So the Title I process includes firm
2 engagement and capabilities testing which then
3 leads to refined guidance over time and builds
4 our understanding of the individual firm's
5 operational options and challenges and
6 resolution. And this has facilitated ongoing
7 improvements in the FDIC's resolution readiness
8 over time. And along with the benefit to the
9 FDIC, we touched on this a bit in the last SRAC
10 as well.

11 The process has also been beneficial
12 to the firms, in particular the capabilities that
13 they have developed as part of the resolution
14 planning efforts have proven useful both in
15 business as usual and in stress. The third
16 challenge area that we want to go over today is
17 that the FDIC does not benefit from a direct
18 resolution engagement with these institutions.
19 And rather we rely on the supervisory authorities
20 of our regulatory counterparts, the CFTC, the
21 SEC, the Federal Reserve.

22 And that informs our understanding of

1 resolvability. So this dynamic combined with a
2 lack of Title I authority means that the FDIC
3 doesn't have the ability to directly remove
4 barriers to resolution or proactively enhance the
5 resolvability of the CCPs such as requiring
6 changes to rules, structures, capabilities, or
7 operations. So these challenges add to the
8 complexity of CCP resolution which I think is
9 acknowledged as already a difficult problem.

10 And so we work with our U.S.
11 counterparts and within our existing authorities
12 to make progress. Over the last several years,
13 we've invested a significant amount of resources
14 together across a number of fronts. We have
15 worked to understand how we might improve
16 resolvability within our existing authorities to
17 increase our shared understanding of the
18 processes involved in a Title II resolution,
19 including how we would make a determination for
20 entry into resolution for a CCP and how to
21 address the FDIC's information needs.

22 We've also worked to better understand

1 the supervisory monitoring and actions during BAU
2 and to develop ex ante frameworks and legal
3 documents to support resolution planning. And
4 yet more work remains. So I do want to spend a
5 few minutes talking about some of the work that
6 we're doing on an international front where we're
7 very active to further progress.

8 So if I could ask for the next slide.
9 So the FDIC is very involved in international
10 standard setting bodies such as the Financial
11 Stability Board or FSB. We also directly engage
12 with foreign, supervisory, and resolution
13 authorities through bilateral and multilateral
14 work streams.

15 This work helps us develop a mutual
16 understanding of our respective resolution
17 frameworks, address challenges across
18 jurisdictions, and learn from one another's best
19 practices. When we last met, we described our
20 involvement in FSB's work on FMI resolution,
21 financial market infrastructure resolution, which
22 focuses on CCPs. The FDIC has played a key

1 leadership role in that work since 2015, and we
2 continue to be deeply engaged.

3 Currently, Acting Chairman Gruenberg
4 chairs the FSB's resolution steering group. And
5 Art Murton, the chairman's deputy for financial
6 stability, co-chairs the working group on FMI
7 cross border crisis management. And this work
8 has continued over these years in a number of
9 forms.

10 Over the course of late 2020 and 2021,
11 the FSB led a series of joint workshops with the
12 Committee on Payments and Market Infrastructure,
13 CPMI, and International Organization of
14 Securities Commissions, IOSCO, and Basel
15 Committee, BCBS. And these workshops focused on
16 the systemic risk posed by CCPs as well as the
17 possible systemwide impacts that could occur from
18 CCP recovery and resolution. Then in November of
19 2020, the FSB published guidance that laid out a
20 framework for authorities to assess the adequacy
21 of their financial resources to support an
22 orderly resolution.

1 And this guidance is meant to help
2 jurisdictions analyze and identify potential gaps
3 in resources, and then consider means for
4 addressing those gaps. That guidance then led to
5 the chairs of the FSB, CPMI, and IOSCO committing
6 to conduct further work on financial resources
7 for both recovery and resolution. And in March
8 of this year, there was a report that was
9 published that was part of an effort to determine
10 whether and what future policy work might be
11 needed on the use, composition, and amount of
12 resources.

13 When that was published, the FSB
14 agreed to review the sufficiency of the existing
15 tool kit for resolutions specifically. And
16 considering the need for resources reserved
17 specifically for resolution, including their
18 associated costs and benefits, the tradeoffs that
19 would come with those potential policy choices.
20 And this work is currently a major focus that's
21 led by our acting chairman as the chair of that
22 working group with RSG (phonetic).

1 And then I also want to highlight that
2 we work directly with foreign counterparts across
3 several venues. The first that I'll mention
4 connects nicely to our guest speaker that will
5 come up next. And that's engagement on CCP
6 resolution among principles from the Bank of
7 England, the Fed, the SEC, the CFTC, and the
8 FDIC.

9 This group of five agencies has met
10 several times since 2018, including in the summer
11 of last year and February of this year. These
12 meetings serve as a venue for high level
13 engagement on these unique challenges. And they
14 serve to guide the plans for staff level work
15 that are ongoing among the five agencies across
16 several work streams.

17 We also host crisis management groups
18 for CCPs. We talked about them a little bit
19 earlier today on the bank space. We do this
20 jointly with the CFTC and the SEC. And these CMG
21 meetings or groups meet annually.

22 And we've had two of them since 2017.

1 We added a third in 20210. And we also
2 participate in these meetings for foreign CCPs
3 which are hosted by the resolution authorities in
4 those jurisdictions. These meetings are valuable
5 meetings to understand our shared challenges,
6 share approaches and progress, and try to
7 identify improved resolution options. So with
8 that backdrop, I want to turn to our chairman to
9 introduce our guest speak who has graciously
10 agreed to speak today and address questions.

11 ACTING CHAIRMAN GRUENBERG: Thank you,
12 Jenny. That was very helpful. We wanted Jenny
13 to sort of lay out that background and context
14 before we turn to our guest speaker, Sir Jon
15 Cunliffe.

16 I suspect some of you may know Jon.
17 He serves as the Deputy Governor of the Bank of
18 England for financial stability. He's also
19 chairing as Jenny mentioned the Committee on
20 Payments and Market Infrastructure for the BIS.
21 He's really been an international leader on
22 payment system issues and has particularly

1 focused international attention for several years
2 now around the risks related to both the
3 supervision and the resolution of central
4 counter-parties.

5 I think of all the issues relating to
6 the resolution of systemic financial institutions
7 since the 2008 crisis, this is the one that
8 really stands out as clearly a profound system of
9 consequence in which we've arguably made at least
10 progress. There are a lot of reasons for that.
11 Perhaps Jon will talk about that.

12 But I couldn't think of anybody better
13 to at least give us a broader perspective on what
14 I do think is a fundamental systemic resolution
15 risk for the FDIC and for this committee to
16 engage in. I would note that prior to taking
17 over his payment system responsibilities, Jon had
18 also been responsible for the resolution work at
19 the Bank of England. So Jon and Elke and I
20 collaborated very closely on the cross border
21 working relationship on the traditional GSIB
22 resolution issues.

1 And in some sense, we're now
2 continuing that on the CCP work in Jon's current
3 capacity. And I would note Jenny mentioned the
4 US/UK working group on CCP resolution. I always
5 envied Jon at those meetings because on the U.S.
6 side we had the Fed, the FDIC, the SEC, and the
7 CFTC and on the other side was Jon --

8 (Laughter.)

9 ACTING CHAIRMAN GRUENBERG: --
10 basically embodying all these authorities and
11 thinking to myself, boy, his life may not be easy
12 but it's at least a little simpler than ours. So
13 with that, I think Jon is on the line. And we
14 can ask him to offer his remarks. Jon, thank you
15 so much for joining us today.

16 MR. CUNLIFFE: No problem. Thanks,
17 Martin. First just to check whether I'm audible
18 and visible.

19 ACTING CHAIRMAN GRUENBERG: Yes, both
20 are true.

21 MR. CUNLIFFE: Okay, thanks. And
22 secondly, apologies. It's a privilege to get a

1 chance to address this group. And I would've
2 liked to have been there in person, but I have a
3 meeting tomorrow morning in Basel which we'll
4 among other things talk about the work planned
5 for CCPs and non-default losses and the like.

6 And it made it just impossible to be
7 with you and to get back in time. And as it's
8 nighttime in Switzerland, I'm afraid I may look a
9 little -- the lighting may look a little strange.
10 So I apologize for that as well.

11 Just a quick word about what I do. So
12 I'm Deputy Governor for Financial Stability. But
13 I also have responsibilities for CCPs, settlement
14 systems, and payment systems for the supervision
15 and regulation.

16 So I'm both kind of micro-prudential
17 and macro-prudential in this area. And up to a
18 few years ago, I also had responsibility for
19 resolution. One of the reasons I gave that up to
20 another deputy governor actually was because we
21 thought it was bad practice to have the same
22 person responsible for supervisor and for

1 resolution. I think it's good practice for those
2 things generally to be split.

3 So for today's perspective, I guess
4 I'm speaking from the perspective of the FSOC
5 from a financial stability perspective and the
6 CFTC and the SEC and CCP regulator perspective.
7 And I'm not speaking from the perspective of the
8 FDIC. But I can still remember resolution --

9 (Laughter.)

10 MR. CUNLIFFE: -- work. As Marty
11 said, I also chair the BIS Committee on Payment
12 Systems and Market Infrastructure. And more
13 importantly, the joint committee with have with
14 IOSCO which functions as the standard setter --
15 the international standard setter for CCPs and
16 issues the PFMI which are our version of the
17 Basel standards for CCPs and settlement systems.
18 So I thought I'd start today with all my hats on
19 and then speak from different perspectives.

20 But I'll identify when I'm talking
21 from a UK perspective. And I apologize again in
22 advance. I don't know how much of these issues

1 you covered in previous discussions, so some of
2 what I say may seem blatantly obvious in which
3 case talk amongst yourselves or something.

4 (Laughter.)

5 MR. CUNLIFFE: If I lose people, I'm
6 happy to pick things up in questions. I'll set
7 out briefly why we need effective regimes to deal
8 with CCP failure, why CCPs are different than
9 banks, and the risks they take and how they
10 manage them, and what the UK regime will do. And
11 we have proposals for a new regime which are now
12 in front of Parliament which I hope we'll get
13 Parliamentary approval and we can start to
14 implement early next year.

15 And in doing so, I'll touch on some of
16 the suggestions that have been made for CCP
17 resolution. So first, what does it matter?
18 Well, as we know, CCP's role as central nodes in
19 the financial system have made them if they're
20 large enough naturally systemic and they protect
21 key markets from counter-party credit risk.

22 And we saw what a failure in that area

1 can do during the great financial crisis. And by
2 mandating use of CCPs for some key financial
3 derivatives after the GFC, we've made some of
4 them even more systemic globally. For example,
5 60 percent of credit derivatives are now -- swaps
6 are now cleared centrally as opposed to 10
7 percent before the great financial crisis.

8 Eighty-five percent of interest rate
9 contracts are cleared by CCPs. It was about 40
10 percent before the financial crisis. And of
11 course, that's just the proportions.

12 The actual quantum has grown as these
13 markets have expanded pretty significantly. And
14 just as important as financial markets, we've
15 seen the role of CCPs in commodity markets and in
16 terms of the recent stress and the role they play
17 in enabling hedging and forward contracts. So
18 CCPs represent a concentration of risk.

19 I always say this. That is not some
20 unintended consequence after the great financial
21 crisis. I mean, the assessment at the time is
22 the benefits from centralization in terms of

1 consistent and prudent margining, transparency,
2 netting, and the mutualization of losses made
3 central counterparts clearing preferable to a
4 complex and what would be a peak wave (phonetic)
5 of bilateral contracts with much larger gross
6 margin flows.

7 That was the decision we took back in
8 2009. I think it still holds, but we can't
9 ignore the concentration of risk and the failure
10 of a CCP and the effects that would have. And it
11 would transmit stress quite widely throughout the
12 financial system.

13 And it would remove the protection
14 against counter-party credit risk which I think
15 is essential for markets to operate. So we do
16 need to find effective ways to manage a CCP
17 failure. And because the concentration effects
18 exist, it means actually there are returns to
19 concentration in being a CCP which means many of
20 these businesses are global and they meet
21 international standards in the same way as we
22 need international standards -- strong

1 international standards for the resolution of
2 globally systemic banks.

3 However, and it's an important point,
4 CCPs are not banks. And the design of any
5 resolution framework I think needs to reflect
6 some of the essential differences. The first and
7 most obvious, the risks they run are very
8 different.

9 They don't do maturity or liquidity
10 transformation. They don't have complex balance
11 sheets with asset and liability structures or
12 mismatches that need to be resolved. The two
13 risks they face essentially are counter-party
14 credit risk, and we'll talk about that, and
15 operational risk of some sort of operational
16 failure.

17 On counter-party credit risk, I mean,
18 this stems from the default of one or more of
19 their members. As their function is to be the
20 central counterpart, in other words, to stand
21 between the two parties to a trade, they really
22 have to ensure at all times that they have

1 exactly offsetting contracts with the buyer and
2 the seller. In other words, they have to
3 maintain matchbook at all times.

4 And if one of the counter-parties
5 defaults, they need to be able to absorb the
6 losses that will probably be necessary to restore
7 that matchbook by finding contracts to offset the
8 contracts that have been lost. Now unlike banks,
9 they don't hold capital really to absorb loss
10 absorbing capital. Rather under their rule
11 books, they can effectively pass losses with
12 limit back to their clearing members.

13 First they do that and I think the
14 previous speech I mentioned the waterfall of
15 allocation of losses. First they do that by
16 using the pre-positioned resources of the
17 defaulting member. And then they fail to
18 neutralize the losses by using the pre-funded
19 default fund to which all members contribute.

20 And then when the pre-funded resources
21 run out, they have the ability to make cash calls
22 on the remaining members. And then after that,

1 they can start to haircut the margin they owe to
2 some of their members. And finally, they can
3 tear up some or if necessary all of the contracts
4 they have with their members.

5 So actually, unlike banks, when it
6 comes to default losses, CCPs can't go bankrupt.
7 At the end of the waterfall of recovery actions,
8 they just tear up all the contracts and
9 effectively the clearing service disappears. And
10 I should say that if you follow the rule book,
11 the equity of the others is untouched in that
12 process.

13 But of course, from a financial
14 stability point of view, those clearing services
15 are important. And tearing up of contracts
16 removes the hedges that counter-parties will be
17 depending upon in stress. So the CCP service
18 needs to be kept operating and the transmission
19 of stress needs to be kept to a minimum.

20 So a quick word about non-default
21 losses. The other main risk is operational
22 losses not caused by default, fraud. It could be

1 cyber. It could be investment losses.

2 Here CCPs generally have no powers to
3 pass those losses on to their members. Non-
4 default losses have to be absorbed by CCP
5 capital. And CCP capital is generally pretty
6 small relative to the size of their operations.

7 For one of our big CCPs, their capital
8 is 500 million euro. Their default fund is ten
9 times that. The open interest passing through
10 the CCP is many, many times greater.

11 So non-default losses could therefore
12 wipe out the capital of the CCP and lead it to
13 insolvency. And the result again would be the
14 loss of the clearing service. So how should
15 resolution address those risks?

16 Well, the first point to make is that
17 even though for default losses, the CCP rule book
18 means it can effectively wind itself up without
19 bankruptcy. The latter stages of that waterfall
20 process could be systemically very damaging in
21 the allocation of losses across the wider
22 financial system, particularly when one comes to

1 the tearing up of contracts. And clearly as I
2 said earlier, poor financial markets could
3 disappear if we lose effective clearing services.

4 And in following through those
5 recovery actions, CCP managements have choices
6 they can make in how they carry out those
7 actions. And there are some actions they can't
8 do under their rule books. And to some extent,
9 they're tied to the secrets of actions that the
10 rule book sets out.

11 And the last point to make that as
12 they carry out those actions, it's very likely
13 that there'll be disagreements between CCP
14 management owners on the one hand and clearing
15 members on the other. And we've seen cases of
16 that with defaulting members in some instances in
17 CCPs in the past. So my first point is it is
18 imperative that the resolution authority can step
19 in and take control before CCP recovery actions
20 are exhausted.

21 I think the earlier speaker made the
22 point that you want to ensure that when you get

1 to resolution the resources or the options that
2 are available have effectively been exhausted.
3 So for us, one key issue is the resolution
4 authority needs to be able to step in on failure
5 or the likelihood of failure before recovery
6 actions have been taken too far. And the
7 resolution authority needs to be able to use the
8 CCP recovery tools flexibly.

9 But where those are sufficient, it
10 needs to have extra tools that it can use outside
11 the rule book. And of course, it needs to
12 understand to do this and to step in that way, it
13 needs to understand the business of the CCP. And
14 there needs to be a resolution plan that has
15 agreed in advance.

16 And resolution authorities I think can
17 then take actions, most of which will be in the
18 CCP rule book. But they can take them with the
19 view to the avocation of losses across the system
20 in taking into account financial stability
21 considerations. And then, of course, resolution
22 authorities will operate within a public law

1 framework.

2 And I think one of the points has been
3 made to us by the private sector is that would
4 reduce once a resolution authority steps in.
5 That reduces these tensions between CCP
6 management and owners on the one hand and members
7 on the other. And of course, in all of this,
8 it's important as with other forms of resolution
9 that there is a robust no creditor worse off
10 provision.

11 And the counterfactual in this case is
12 I think should be what would happen if the rule
13 book had been followed all the way to the end of
14 the waterfall? So the current UK regime -- we
15 have a regime, we have one in place since 2013 --
16 has many of those features. But it doesn't have
17 them all.

18 And the legislation that's now going
19 through Parliament I think will give us all of
20 those powers to operate ex ante, to require
21 resolution plans, to remove obstacles to
22 resolution, to step in when we need to step in.

1 And then it will give us in some areas some extra
2 powers that don't exist in some of the CCP rule
3 books. And it will ensure that no credit worse
4 off provision in the way that I described it.

5 This raises the question, though, for
6 default losses is do we need extra pre-funded
7 resources either in recovery or resolution to
8 supplement what already exists. And I think,
9 Marty, this is really where your resolution group
10 is now focusing. So seen from our perspective,
11 there are two reasons why you might want to
12 increase the pre-funded resources in the CCP
13 waterfall.

14 The first and this is a key issue for
15 us is the question of incentives because our CCP
16 equity is not going to be written down. In the
17 case of default losses, do CCPs really have the
18 right incentives to risk manage properly,
19 particularly when they're in competition as many
20 are internationally with other CCPs? And a point
21 that's raised by the private sector is whether
22 the allocation of losses between members on the

1 one hand and CCP owners on the other is unfair
2 because it's very little CCP skin in the game
3 when the losses are mutualized.

4 So it's for that reason that some
5 jurisdictions like the UK already require CCP
6 owners to have skin in the game. It's not
7 equity, but it's pre-funded resources that can be
8 called upon as mutualization takes place --
9 mutualization of losses takes place in the
10 waterfall. And the issue is how large that skin
11 in the game should be.

12 Kind of what stages of the waterfall
13 should be exposed to loss? The UK regime that's
14 now being legislated will give us the power to
15 call for a second skin in the game tranche which
16 we could insert at a later point in the
17 waterfall. But the key point here, I think --
18 and the size of that is something we have yet to
19 determine.

20 But the key point here to be clear,
21 the objective is to ensure that the incentives
22 are sufficient and rightly placed to avoid

1 resolution by incentivizing CCP management. It's
2 not really a question of ensuring the pre-funded
3 resources are available in resolution. So that's
4 the second reason you might want to increase pre-
5 funded resources to ensure that you have enough
6 in resolution and that you don't want to rely on
7 cash calls, haircutting the variation margin, or
8 in the later stages tear up once the resolution
9 authority comes in.

10 So one option which has been much
11 discussed, pages written about this, would be for
12 CCP to raise extra resources by issuing bailout
13 bonds in the way the banks do. And then those
14 bonds could be written down in resolution and the
15 funds used to absorb losses. So a number of
16 reasons have been given as to why that might be
17 preferable to depending on the cash calls and
18 cutting of margin and other tools.

19 One is whether cash calls will be too
20 procyclical in the event of CCP stress. And it
21 would be better to have the resources pre-
22 positioned. And the other is whether cash calls

1 will actually be effective because clearing
2 members might want under stress resist further
3 cash calls.

4 And this is a kind of complex debate.
5 And I think it's going to be where Chairman
6 Gruenberg's international group go next. But I
7 thought I'd offer a few thoughts on this. And
8 it's informed, in part, by the first stage of the
9 international work which looked at the
10 sufficiency of pre-funded and non-prefunded
11 resources in a number of systemic CCP's ability
12 to absorb losses and recovery and resolution.
13 And I think that work was published earlier in
14 the year.

15 And the work suggested that these
16 systemic CCPs could absorb failure of up to four
17 of their largest clearing members. And the
18 international standard is two large clearing.
19 But they can absorb failure up to the four
20 largest clearing members, although some would
21 exhaust pre-funded resources and need to go into
22 cash calls at that point.

1 But the cash calls that will be
2 necessary would be within the capacity of the
3 remaining clearing members which tend to be the
4 larger financial institutions. And on the
5 question of whether firms would be able to resist
6 cash calls, I'd only observe that if you resist a
7 cash call you're effectively in default. And
8 that triggers other default cross causes.

9 So I think it's unlikely that clearing
10 members would try to resist contributing to cash
11 calls. But there's a big caveat in all of this
12 which is in a (phonetic) in which, say, three to
13 four of the biggest clearing members fail, we may
14 find that actually those liquidity resources
15 aren't available for the other clearing members.
16 And this could make the stress more stressful.

17 And the only points I'd make, though,
18 is if we're in a stress in which three to four of
19 the big clearing members fail, remember that's
20 not just in one CCP. That's across the board and
21 across the financial system. And if the
22 resolutions that we're talking about potentially

1 the failure of, say, two to four GSIBs.

2 And then the resolution arrangement
3 for those GSIBs has also failed, the resolution
4 would enable them to continue to meet their
5 obligations to a CCP without default. I think
6 we're going to be in a pretty heavy systemic
7 crisis and bailout bonds and the resources that
8 they might offer, even if it's a full reload of
9 the default fund may help. But they're likely to
10 be able to resolve the systemic issues that we
11 face.

12 And those considerations I think need
13 to be balanced quite carefully. In the end, it's
14 a question of how far into the tale of the risk
15 distribution you want to go with protection. And
16 does the extra bang that you get by, say, bailout
17 bonds, is it proportional and do the costs
18 outweigh the benefits?

19 And I'd say that there are costs which
20 we need to recognize. Just a simple thought
21 experiment back of the envelope. If a CCP issued
22 bonds equal to the default bonds, so it would

1 have a full reload in resolution.

2 The annual coupon of that could be
3 equal to or greater than CCP capital. And those
4 costs, of course, are likely to get passed back
5 to users raising the cost and reducing the
6 incentives to clear. So one needs to think about
7 benefitting that sort of systemic stress you will
8 get from this against the costs and the
9 disincentives to clear in business as usual.

10 Of course, jurisdictions are different
11 and there could be jurisdictional reasons why one
12 might want to go at least some distance down that
13 route. And in a world where the resolution
14 authority either doesn't have the line of sight
15 or can't effectively or quickly step in before
16 the resources that are available in recovery are
17 exhausted or whether the resolution authority is
18 not able to plan for CCP resolution and for the
19 comes in and has to deal with a very complex
20 situation without there being a plan or
21 sufficient advance knowledge or where CCP rule
22 books are either -- they don't provide sufficient

1 options or actually there are obstacles to
2 resolution there which can't be cleared away. In
3 those circumstances, one might argue, well, a
4 reservoir of pre-funded resources that can be
5 accessed only in resolution might be necessary to
6 enable CCP clearing service to continue to
7 operate.

8 The next stage of the FSP work will
9 look at these issues and maybe tease them apart
10 and give us better line of sight. And finally,
11 and I'll stop here shortly, just I should say a
12 word about non-default losses because in a way
13 these are equally if not more worrying because
14 the position is very different. And the CCP
15 recovery actions are very limited.

16 And the capital to absorb these losses
17 is pretty limited as well. So the resolution
18 authority in that case will not be able to depend
19 on the waterfall. It will need to have access to
20 some other resources.

21 So in the UK, the new powers that we
22 hope will be approved by Parliament will give us

1 the power to make a cash call. We're thinking of
2 something proposed to be put out there. It's
3 three times the default fund to cope or to absorb
4 the losses of -- non-default losses and to
5 recapitalize the CCP.

6 And of course, if those circumstances,
7 there is no credit or worse option, well,
8 protection that protects the equity. And so the
9 equity of the CCP will be wiped out. We need to
10 think about what then happened to ownership and
11 whether the CCP was passed back to the members.

12 But we feel it very important in the
13 UK there is a resolution authority. We have
14 access to resources, the deal with non-default
15 losses. Now bailout bonds could be a reason to
16 do that as well.

17 But as I say, the cost of holding them
18 is high. And of course, if it's an idiosyncratic
19 failure of the CCP because of fraud or cyber,
20 then we won't be in a systemic crisis. And those
21 cash calls wouldn't have that procyclical effect.
22 But again, that's how you deal with non-default

1 losses as a resolution authority needs to be
2 worked out.

3 And I think it's very important a
4 resolution authority has access to some resources
5 to meet that and to be able to keep the clearing
6 service in operation. And the last point I'd
7 make and this is something that will come up in
8 our meetings tomorrow, of course the CPMI-IOSCO
9 standards are for the operation of CCPs. They
10 don't include resolution. We deal with life and
11 the resolution authorities deal with that
12 (phonetic).

13 (Laughter.)

14 MR. CUNLIFFE: But I think we need to
15 think about in recovery should CCPs have better
16 options to deal with non-default losses. And
17 that's work that I hope we'll be starting in the
18 future. I'll stop there, Marty. Thank you.

19 ACTING CHAIRMAN GRUENBERG: Jon, thank
20 you very much for that. I must say exceptionally
21 lucid presentation on a pretty complicated
22 subject. And Jon's agreed to take a few

1 questions from the committee if there any members
2 that would like to follow up with him. Yes, Dick
3 Herring from the University of Pennsylvania for
4 Jon's benefit.

5 MEMBER HERRING: Thank you. That was
6 a terrific overview. You didn't mention one of
7 the differences from a bank resolution that
8 strikes me as very important in this case. In a
9 bank resolution, we can hope at least to have a
10 resolution weekend. It strikes me that with a
11 CCP, you have almost no time to intervene and try
12 to take control of the situation, keep it from
13 deteriorating quickly. How do you deal with that
14 much shorter time for action?

15 ACTING CHAIRMAN GRUENBERG: Jon, I
16 think you may be on mute.

17 MR. CUNLIFFE: I'd been on mute. I'm
18 sorry. Look, that's a real challenge. And in
19 the circumstances which this is happening and say
20 two clearing members have defaulted, prices will
21 be moving very fast in markets. And so you'll be
22 in a situation of general stress.

1 We've -- I mean, to my mind, it makes
2 the case for the resolution authority to be
3 closely involved with the business of the CCP for
4 there to be close cooperation between the CCP
5 supervisors and the CCP resolution authority.
6 It's easy for me to say that because in the Bank
7 of England we look at these things in an
8 integrated way. But also the resolution plan has
9 got to have stabilization.

10 That said, some of the defaults we've
11 seen in the past, CCPs have been able to go
12 through that default waterfall quite quickly.
13 I'm thinking of Lehman Brothers. So the Lehman
14 Brothers default. There were large positions
15 held certainly at the London Clearinghouse.

16 And those positions were closed. They
17 were auctioned off, the losses absorbed in the
18 middle of a global stress if you remember. The
19 losses absorbed and people paid out very quickly
20 whereas the nonessential clear contracts took
21 years to work out in a bankruptcy.

22 But it is a challenge. I think what

1 we'll do in the UK also is we will do some dry
2 runs and some kind of resolution testing. I
3 think that once the resolution authority steps
4 in, we haven't had to do a big resolution in the
5 UK I'm pleased to say.

6 But once the resolution authority
7 steps in and says, look, we are now in charge.
8 We're taking over control of the rule book and
9 the actions, I think that might also have a
10 stabilizing effect. But ex ante planning,
11 wargaming, knowing where your tools are and the
12 risks I think will be essential. But it will be
13 quite a stress period.

14 MEMBER HERRING: Thank you.

15 ACTING CHAIRMAN GRUENBERG: Wilson
16 Ervin?

17 MEMBER ERVIN: Thanks, John. I agree.
18 This is a terrific presentation on a tough
19 subject. We recently gone through a period in a
20 few markets where interest rates were quite
21 shocked and went outside some of the initial
22 margins that people had been thinking about.

1 I am wondering if we're thinking about
2 different types of events where we might want to
3 protect, could minimum initial margins, some sort
4 of constraints on that be another solution if
5 we're thinking about different types of
6 waterfalls that could internalize more of these
7 to the stressed members and take some of the
8 pressure out of this. A second question I had is
9 if you're not wiping out equity in some of these
10 cases, how do you align the incentives of the CCP
11 towards systemically positive events? If it's
12 really not coming out of their pockets, how do
13 you improve that alignment going forward?

14 MR. CUNLIFFE: So on the first, I
15 think, I'm doing work with IOSCO co-chairing a
16 group with Ros Behnam of the CFTC on what we saw
17 in the dash for cash in 2020 and actually what
18 we've seen in the commodity markets. I should
19 say, by the way, if that was a polite reference
20 to the little local difficulty we had in long
21 gilts in the UK a couple weeks ago, those are all
22 bilaterally margined. So we didn't actually --

1 there was no CCP impact.

2 The impact was taken by the banks that
3 were providing the repo basically and margining
4 bilaterally. But more generally, I think we do
5 need to look at the responsiveness of CCP margin
6 to shocks. And I mean, this goes down to the
7 unlovely name, do you need mechanisms for anti-
8 procyclicality.

9 So in other words, should we be
10 calling margin more prudently in good times or
11 normal times so that the jump to stress margin is
12 not so great in their terms. And we will be
13 looking at that work. We published a report in
14 that group.

15 We just looked for the dash for cash,
16 and I'm hoping we can look at that
17 internationally, at least some interest to look
18 at the responsiveness of CCP margin models
19 because ideally as we've been, so more than
20 ideally, you don't want to be in a resolution
21 situation to begin with. And the protection
22 against default losses is the initial margin that

1 the defaulter has to pay in advance and then the
2 sizing of the reporting. And I hope out of that
3 will come some views on how to measure
4 procyclicality of margin and stress which is what
5 will cause the default.

6 The margin would go up. You will see
7 the clearing member will not be able to pay. And
8 do we need to -- I think you called it minimum
9 margin. But do we need to be calling a bit more
10 margin in normal times a bit overprudently in
11 order to avoid a big jump under stress?

12 Some jurisdictions already in the UK
13 and Europe have, I'll use the word, anti-
14 procyclicality measures. We learned some lessons
15 in the dash for cash about how effective they
16 are. But I think that is an issue. It's one
17 answer. The other answer to avoid you getting to
18 resolution is exactly as you said, making sure
19 the incentives are aligned.

20 The problem with equity, this is
21 something I think the FSB wrestled with when it
22 put out its first set of guidance some years ago

1 is if you have a no creditor worse off protection
2 and if the rule book basically says the CCP can
3 call of them to make unlimited calls on its
4 members and then wind itself up and still
5 preserve the equity. You can't square that with
6 writing down the equity and resolution with a no
7 creditor worse off guarantee. I think that's
8 something that needs to be looked at again
9 actually. And we need to think about whether the
10 no creditor worse off guarantee should offer that
11 level of protection to shareholders in terms of
12 incentives.

13 But skin in the game, so resources
14 which are not equity don't go to the ownership
15 but which belong to the CCP owners and which are
16 exposed either initially when mutualization
17 happens or initially and then as you dig deeper
18 into the waterfall, that's one way of if you like
19 creating the incentives that writing down the
20 equity would give you without having to wrestle
21 with this no creditor worse off protection which
22 is important in resolution because we are

1 disturbing people's legal property rights and
2 they do need to be protected. But I think
3 incentives will be part of it. And certainly in
4 my jurisdiction we're going to be looking at skin
5 in the game and whether that is in the right
6 place.

7 ACTING CHAIRMAN GRUENBERG: Yes,
8 Sandie?

9 MEMBER O'CONNOR: Jon, thanks so much.
10 A few just sort of follow-ons. You talked a
11 little bit about the non-default losses and
12 having the resolution authority have the ability
13 to cash call. Again, just how are you thinking
14 through because you clearly know that's the risks
15 that are occurring are solely brought on board by
16 the CCP management itself.

17 And I should say we're talking about
18 deneutralize, not neutralize CCPs. But they make
19 the choices on where to place their investments,
20 where to place that collateral, and how much they
21 spend on their cyber resilience. So having the
22 backstop of doing a cash call of the clearing

1 members which have no engagement in that risk
2 management but provide a pocket.

3 Well, I understand that can stabilize.
4 That's just such a disconnect. How can that be a
5 good long-term approach? And maybe you're saying
6 that's why we want to look for better tools to
7 really aligning incentives to appropriate risk
8 management. That would be the first question I
9 have. And I have another one if I could,
10 Chairman.

11 MR. CUNLIFFE: Let me do that one.
12 Should I do that one because I'll --

13 MEMBER O'CONNOR: Please.

14 MR. CUNLIFFE: -- forget.

15 (Laughter.)

16 MEMBER O'CONNOR: Me too. It's all
17 good.

18 MR. CUNLIFFE: Yeah, so look, I mean,
19 before losses start, there is a really big
20 problem, we already have actually in the UK that
21 you can mutualize the investment losses where
22 they put their money, where they put their

1 margin, where they lose that. So we already have
2 that in the UK regime, but we'll extend it. I
3 think you're in the world of second best here.

4 Bear in mind that however you fund
5 that, whether it's pre-funded resources or
6 whether it's a cash call, have a clearing
7 obligation, clearing mandate on many of these
8 services. Those costs are going to be passed
9 back to users. So it's not a question that there
10 is some way that users can avoid the costs.

11 If you say we -- and of course, with
12 non-default losses, it's very difficult to size
13 them, particularly something like a cyber attack.
14 But if we said, like -- the idea I think has been
15 talked about in the UK that it's a multiple of
16 the default fund. The carry cost of that is
17 pretty large, and it's passed back to the
18 members.

19 Now of course, these resources,
20 they're not doing anything because they're just
21 sitting there kind of waiting to be used which is
22 a difference I think with banks (phonetic). So

1 in that world of second best, I think you wanted
2 two things. Non-default losses would wipe out
3 CCP equity.

4 There's no, no creditor worse off
5 protection there because in the current rule
6 books that's what would happen. So the incentive
7 has to come from the wipe out of the equity which
8 you think would have some incentive effect. And
9 then I think members will be -- members need the
10 clearing service, and we need the clearing
11 service to continue.

12 And the choice then is because these
13 are multilateral. You go back to the members or
14 whether the public sector steps in. And I think
15 public sector support, but CCPs are something we
16 all want to avoid for the obvious reasons.

17 And so one last thing which is as we
18 back resolution in the situation where CCP's
19 capital is wiped out by the members. And then
20 the losses are absorbed by the cash call, and the
21 CCP is re-capitalized by the cash call. Then in
22 those situations, the members would then owe the

1 clearing services.

2 I mean, they might not want to, but
3 that's pretty much the same as in bank
4 resolution. But I don't think there's an easy
5 answer to this. One better answer to this I
6 think might be for CCPs to have better recovery
7 options and also to think about how would their
8 members, they manage these risks.

9 As a general view, think the more you
10 put members -- expose members to these risks, the
11 more they will demand, I think, more involvement
12 in risk management and to understand what is to
13 be expected on CCPs. And maybe that comes to
14 something around the governance of CCPs and the
15 governance of risk management machinery. Just
16 one last point on that which -- I'll get told off
17 for saying it, but I'll say it anyway.

18 When you talk to the CCPs, they tell
19 us that the pressure they get from their members
20 is to charge less margin, to reduce the cost of
21 failing all the time. When you talk to the
22 clearing members at very senior levels, they say

1 they're worried about the risk in CCPs and the
2 fact that they are exposed to these risks, both
3 the neutralized default and the non-default. And
4 they don't have kind of enough influence on the
5 CCPs.

6 I think some of the answers to this
7 lie in the clearing members. And actually
8 whether the risk controlled impulse in the
9 clearing member outweighs the can I do this trade
10 as cheaply as possible impulse in the clearing
11 member. So there are some issues there, I think,
12 for clearing members as well.

13 MEMBER O'CONNOR: Yeah.

14 MR. CUNLIFFE: So you had a second
15 question.

16 MEMBER O'CONNOR: Yeah, let's -- so
17 well, I think just a couple things. I think on
18 the governance, I think you nailed it there. And
19 I think if you see many of the writings and the
20 acting chairman mentioned them by both buy side
21 and sell side, I think there's just a very clear
22 drive by global industry -- and I'm no longer in

1 it anymore -- to actually build up front
2 resources because you want them to be
3 predictable, manageable, and understood. Yet it
4 seems really hard to get there. And I'm just
5 curious as to your viewpoint because it seems
6 like our regulators are aligned. Our academics
7 are aligned.

8 The industry wants something yet we
9 are not there yet. And I think up front is the
10 way to go and inclusive of bail-inable debt
11 except I would just offer rather than shock
12 absorbency, that's really your recapitalization
13 mechanism, right? Because then it moves from a
14 demutualized to a mutualized model which is
15 probably a more appropriate model.

16 But that's just not where we are at
17 the moment. So I guess my question is why are we
18 collectively having a hard time if everyone says
19 they want more pre-funded, they want TLAC, they
20 want better collateral, they want more
21 appropriate through the cycle margins. So I'd
22 love your view because I certainly can't figure

1 it out.

2 MR. CUNLIFFE: So first of all, I
3 think to the extent the CCPs complete a margin
4 that they shouldn't. So I don't know if they do
5 or not.

6 MEMBER O'CONNOR: They do.

7 MR. CUNLIFFE: But to the extent they
8 do, that's because they're under commercial
9 pressure from their clearinghouse. And when you
10 talk to them, particularly for clearing services,
11 there's a contest between different CCPs. We
12 certainly get an awful lot of reports that they
13 are basically under pressure because they're
14 clearing members will go to the cheapest auction
15 and of course pre-funded resources cost money.

16 But there are other things that cost
17 money in terms of margin as well. So I'm not
18 sure it's quite as one sided as one things. And
19 of course, the cost of bailout bonds as I say, so
20 I think the report from London Clearinghouse is
21 around 10 billion.

22 I don't know what it will be on the

1 bailout bond. But that cost particularly where
2 there's a clearing mandate and they're legally
3 obliged to use the CCP. And they just want to
4 get into the economic regulation of CCPs. Maybe
5 we'll have to go there one day.

6 Those costs are going to come back to
7 members as well. So I don't see this as such a
8 one side set of issues to be honest. I think
9 there's a really big issue about transparency.
10 And this comes down to margin models.

11 One of the recommendations of the
12 CPMI-IOSCO group as I mentioned was that there
13 should be much more transparency around margin
14 models and their procyclicality, how they will
15 react in stress so that clearing members can see
16 that and plan for it. But also metrics so that
17 clearing members can have a view on whether they
18 want to use CCPs with more procyclical models or
19 less procyclical models. Some of it will depend
20 on the nature of the clearing services.

21 Clearly a great difference between
22 clearing agricultural futures on the one hand and

1 interest rates on the other. But I think
2 transparency is a big issue here. But I think
3 also we need to think -- individual regulators
4 needs to think about whether I called it pre-
5 funded or whether I call it just the way those
6 margin models attune between pre-stress and
7 stress.

8 I think there's a conversation to
9 happen as well. But I mean, I guess my point is
10 at the end some of the pressures on CCPs come
11 from the members. I think it would help if
12 members looked to the seniority and the
13 background of the people they appoint to those
14 committees.

15 MEMBER O'CONNOR: Yeah, I think you're
16 right about that. And I would suggest to that
17 where members -- clearing members raise certain
18 issues that are related to risk, whether it's
19 margin or collateral or things of that nature.
20 There's a way that those that oversee the CCPs
21 have insight into that because I think there's a
22 gap between what the clearing members may weigh

1 as a viewpoint and whether or not that gets taken
2 on board.

3 Reference, Don and I wrote a little
4 bit about this in the Task Force on Financial
5 Stability in December 2017 when Bitcoin went on
6 to CME, for example, and got part of the
7 waterfall in the default fund. That's
8 interesting, not standardized, et cetera. So I
9 just think we need to create some transparency
10 there so that the regulators can be actually
11 helpful in understanding the risks that are
12 coming on board.

13 MR. CUNLIFFE: I think that's right.
14 But I think the regulators also need the power to
15 be able to take those decisions. And different
16 jurisdictions have regulators who have different
17 powers for the approval or not of new clearing
18 products.

19 But some of this goes, I think, to
20 regulator and supervisable powers (phonetic).
21 And it's not just new products. And there's also
22 actually part of the legislation I was talking

1 about. We'll give the Bank of England rulemaking
2 power in this area which we haven't had in the
3 past because it was all done in euros. We have
4 to have more options, I think, in the future.

5 ACTING CHAIRMAN GRUENBERG: Good. Are
6 there any other questions for Jon?

7 (No audible response.)

8 ACTING CHAIRMAN GRUENBERG: Jon, thank
9 you. This has been a superb overview of an
10 important issue. And we want to elevate
11 attention to it, so this will be an ongoing issue
12 and matter of attention for the FDIC. And we'll
13 bring it back to this committee as well. So
14 thanks a lot.

15 MR. CUNLIFFE: Okay, thanks. Thank
16 you for the invitation, Marty. Also, thank you
17 for taking on the international work. These are
18 basically global infrastructures and we need to
19 manage this.

20 ACTING CHAIRMAN GRUENBERG: Thank you.
21 We'll see you. All right. Well -- yeah, John.

22 MEMBER REED: It was interesting, the

1 contrast between the Bank of England. I got the
2 sense from our earlier discussion that most of
3 the progress we've making here is procedural.
4 We've got a lot of people talking together and
5 building understanding that we didn't have
6 before. But substantively, where do we stand
7 here in the United States if one of these units
8 were to get into serious trouble. Do we have the
9 capability to deal in a timely way?

10 ACTING CHAIRMAN GRUENBERG: I'll be
11 glad to respond, but I'll give Jenny first crack.

12 MS. TRAILLE: Sure. So I mean, we've
13 highlighted a number of the challenges today,
14 including the runways likely to be short. So I
15 think that we look at the existing planning that
16 we have, our existing authorities and tools. We
17 talked a lot about the procedure, the way we work
18 with the supervisors and the other authorities
19 because that's how we build our understanding and
20 our information.

21 And so we do look at individual firms
22 and we do build on that planning. But we

1 acknowledge that there are challenges and there's
2 more work to be done there, data. I mean,
3 there's a lot of things that we've highlighted.

4 I think ultimately the strategy for
5 CCP resolution isn't that much different than
6 what we would attempt to achieve in further
7 institutions in that you're trying to preserve
8 those critical operations for the market. And so
9 if there was a -- we would look to move those
10 critical operations into a bridge institution.
11 And so the work then goes into how do you
12 operationalize that. But the strategy isn't so
13 much different. It's just all sort of the
14 unknowns and the information that we need.

15 ACTING CHAIRMAN GRUENBERG: If I can
16 comment, and it really goes to the broader issue
17 that was raised earlier about the gap on the
18 resolution side relating to non-bank financial
19 companies of which CCPs are in some sense the
20 ultimate example of a systemic nonbank financial
21 company. And the fact is this is my perspective
22 on it that the Dodd-Frank Act really put in place

1 a coherent framework of authorities for the
2 agencies to deal with the resolution of a global
3 systemic banking organization. We really have
4 the Title II authorities with the orderly
5 liquidation fund backstop complemented by the
6 Title I resolution plans which gives us both a
7 line of sight into the companies and authorities
8 to get the firms to make organizational and
9 operational changes to enhance their
10 resolvability.

11 And we got domestically and
12 internationally an agreement on a requirement for
13 TLAC additional loss absorbing resources to
14 facilitate the resolution of the firm. So that
15 we really have a -- and we've made enormous
16 progress if I may say in terms of cross border
17 cooperation with the key jurisdictions
18 represented by Elke's presence here and Jon's
19 participation in this meeting. So that we've
20 really built what I would consider to be a fairly
21 credible framework which hasn't been tested yet
22 in practice.

1 We have not yet executed it. So I
2 have that caveat that until we do it, I'd be a
3 little cautious about what representations we
4 make. But I think we have a set of authorities,
5 capabilities, resources that did not exist across
6 international relationships that simply didn't
7 exist prior to 2008 that puts us, I believe, in a
8 very different place.

9 And then I happen to believe we could
10 execute if it were required of us. I think in
11 the nonbank financial company sector and the CCPs
12 are the prime illustration of this. We don't
13 have that coherent framework.

14 And I should mention the supervision
15 authority that we talked about earlier where we
16 as the banking agency have a supervisory role and
17 line of sight into these firms. On the nonbank
18 side and CCPs are a good illustration, we have by
19 default Title II would be the public authority
20 for a systemic firm failure, whether it's a bank
21 or nonbank. And we can bring those authorities
22 to bear.

1 But the supervision responsibilities
2 are in the market regulators. And we do not have
3 a resolution planning requirement. And we've
4 just been -- we're talking about internationally
5 additional resources, loss observing resources,
6 and resolution but don't have something in place.

7 So we don't have the framework on the
8 nonbank side including the CCPs that we've built
9 on the banking side. We have the benefit of now
10 having a framework and an example to learn from
11 and apply. But frankly, we have a lot of work to
12 do in the United States with our counterpart
13 agencies to try to as best we can the Fed, the
14 SEC, the CFTC to try to collaborate in the
15 absence of additional statutory authority as well
16 as on the international side to try to build
17 stronger cross border relationships.

18 But the question is a fair one. We
19 don't have the framework, the infrastructure in
20 place on the nonbank side. And that's why this
21 is on the agenda for today's meeting because I
22 think looking at the post-crisis world, this is

1 probably where our attention and priority needs
2 to be.

3 MEMBER CLAYTON: Yeah, all I can say
4 is I agree with you. Back in my old seat, both
5 of these conversations that we've had today are
6 related. Who are the members of the CCPs?

7 They're the entities that we're
8 looking at. And I knew that if it's a broker-
9 dealer, you would be calling me, telling me make
10 sure they make good on their obligations to the
11 CCP because they have to be related, right? They
12 can't look at CCP resolution in isolation from
13 resolution of financial institutions because
14 they're going to happen at the same time.

15 MEMBER O'CONNOR: And the great news
16 is in most of the financial institution -- I
17 think in all of the financial institution
18 resolution recovery plans, their exposures to the
19 CCP are in there, right? And their largest
20 counter-party exposures are in there. Where I
21 think the model becomes less stable from the
22 centralized approach is these uncapped cash

1 calls, these potential contract tear ups which is
2 basically taking the CCP out of the space of
3 being a CCP and opening up exposures that people
4 can't manage.

5 And just to follow that thought
6 through, if you're a clearing member, you're not
7 allowed to operate out of a CCP. If you're an
8 end user, you can go. But who are you going to
9 trade with because there's no market debt?

10 So these are -- again, if they're
11 predictable, manageable, it can be done. Those
12 pieces need to be closed down. And the last bit
13 I think we should carry on thinking about is, who
14 has some of these extraordinary tools?

15 Who can enact them, like, variation
16 margin haircutting? And for those who may not be
17 as familiar with it and I'm sorry to say I am as
18 familiar with it as I am. That would be the
19 equivalent of in a bank resolution plan saying we
20 are just going to haircut your deposit in order
21 to survive.

22 That wouldn't exist anywhere else. So

1 if we're going to think like that, who does that
2 and for how much? Because that might be
3 perfectly good in recovery for a recovery and
4 resolution authority to do.

5 But I would question that in the hands
6 of the management of the CCP that has taken it
7 into this place. And again, the demutualized
8 model, not the mutualized model. So I think
9 that's where the work needs to be done.

10 And the reason hair is not on fire is
11 because we do have a lot more strength in our
12 CCPs. There is margin. We saw the results of
13 the recent report that came out at 4 times
14 coverage and 1.4 times scale up, right?

15 Those are good things. But time, we
16 need to sort it out it seems to me. So really
17 please keep doing this really important work so
18 we can finish taking it to the hoop.

19 ACTING CHAIRMAN GRUENBERG: Thank you.
20 Anything else for today?

21 (No audible response.)

22 ACTING CHAIRMAN GRUENBERG: Well,

1 thank you all. This has been a very helpful
2 discussion, and we appreciate you all taking
3 part. And we'll do it again next year. Thank
4 you, all. And we'll have lunch upstairs.

5 (Whereupon, the above-entitled matter
6 went off the record at 12:33 p.m.)

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Advisory Committee

Before: FDIC

Date: 11-09-22

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