Why You Should Care About Title II?

BRIAN SULLIVAN: Welcome back to the FDIC podcast, where we talk about the world of banking and why the banking system is so important to the financial stability of our nation and the broader global economy. I'm Brian Sullivan with the Federal Deposit Insurance Corporation. And today we're going to take a big picture look at banking by imagining what could possibly go wrong should a large, complex financial company fail…the kind of company that has large global banking operations that many people believe is simply too big to fail.

So in this episode, we look at what would happen if *that* were to happen. Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act provides a framework for how the FDIC would resolve the failure of one of these banks, so-called GSIBs…global, systemically important banking organizations. In fact, the FDIC issued a paper on all this back in April, and we'll talk about that.

BRIAN SULLIVAN: Joining us to answer to tackle Title II…are Ryan Tetrick, deputy director of the FDIC's Resolution Readiness Branch. And Susan Baker, an FDIC senior advisor for systemic risk. And welcome to you both…

RYAN TETRICK: Hi, Brian. It's good to be back with you.

SUSAN BAKER: Nice to be here.

BRIAN SULLIVAN: Ryan, when you and I last spoke on this podcast, we talked about Title I and these things called 'living wills' or resolution plans that certain individual banks have to file to demonstrate how they might be resolved in some kind of orderly way should they fail. What is Title II all about and how do resolution plans fit into all that?

RYAN TETRICK: Sure. So resolution plans, including those required by Title I of the Dodd-Frank Act, are about planning by the banks, planning that they do, whereas Title II is about action that would be taken *by the government* should one of those banks fail. So as we discussed in the podcast last year, resolution plans are a requirement only for the very largest banks and financial companies, which requires them to provide the FDIC and the Federal Reserve with information and plans on a regular basis that show that they could manage their own failure or which would enable us to handle their failure should we need to. And as we discussed, there's different types of resolution plans with Title I plans being the requirement that applies to only the very largest and most systemically important banks. In contrast, Title II, the Title II orderly liquidation authority…sometimes we say Title II and sometimes we say OLA…is a set of special authorities and tools that we have that the FDIC, in coordination with other financial regulatory authorities, has to take control of a failing, systemically important financial institution at the time of a crisis and manage that failure in an orderly manner.

So wherever we can, we draw on the information and plans and capabilities developed as part of the bank's own resolution planning process, but Title II brings some powerful new additional tools to the table, like a liquidity facility that's ultimately provided by U.S. Treasury called the Orderly Liquidation Fund that we could use to help manage the resolution process and certain powers to stay financial contracts and manage the claims through an administrative process in the event of a resolution.

Importantly, Title II is only available in cases where there is a risk to overall U.S. financial stability and there are built in protections that prevent any losses to taxpayers from the use of the authority.

BRIAN SULLIVAN: Yeah, I gather none of what you just said prevailed in the global financial crisis.

RYAN TETRICK: Right. So these tools didn't exist during the 2008 global financial crisis. And Title II was put in place as part of a response to that to give the government tools to handle the failure of a company like a Lehman Brothers or AIG, which got into a lot of trouble. These gave us new powers that didn't exist. We didn't have the tools to seize those types of companies when they failed in 2008. Now we do.

BRIAN SULLIVAN: Yeah. So what kind of financial companies are we talking about here? Several large banks failed last year, regional banks. And then, of course, we had a very large foreign bank, Credit Suisse that failed. Was Title II used in any of that?

RYAN TETRICK: So no. Title II wasn't used for those institutions. It's a great question. So first, let's start with Credit Suisse. Credit Suisse wasn't a U.S. company. It had U.S. operations but those didn't fail independently. It was, of course, a large bank headquartered in Switzerland. And in that case, the Swiss government *could* have undertaken the type of resolution that we're going to talk about here in a minute for systemic banks in the U.S. but they chose to pursue another option which was available to them, which was a government-assisted merger with another Swiss bank…

BRIAN SULLIVAN: …With some Swiss taxpayer involvement, though, too, no?

RYAN TETRICK: There is there is some Swiss taxpayer exposure for a period and there were other differences from a resolution process.

So the types of companies that it could apply to are the eight U.S. GSIBs…there's eight institutions that are identified as U.S. GSIBs and those are companies like JP Morgan, Goldman Sachs, Citigroup…there's a handful of others. And then it could also apply to any other type of financial company that's determined at the time that it fails that would that would pose systemic risk to the US financial system.

Then, for the large banks that failed in the U.S. last year. So SVB, Signature Bank and First Republic,…these were all what we call regional banks, and they weren't really positioned for a Title II resolution. Title II is necessary when there's a lot of really significant non-bank activity. All of those had the majority of their operations, the vast majority of their operations contained within

the bank itself, the insured depository institution, the entity that takes deposits. And they weren't organized in a way to make the type of resolution that we'll talk about in a minute…a Single Point of Entry resolution…workable. And we really had all the tools that we needed to resolve those banks under our long standing FDI Act authority, which is specific to resolving just insured depository institutions. Title II is about resolving a more complex financial company, and we think about using it at the holding company level for bank holding companies.

BRIAN SULLIVAN: Susan, The FDIC, as we described earlier, has released a report outlining how the FDIC gets prepared for the orderly resolution of a large or complex financial company…one of these GSIBs under Title II of Dodd-Frank. Why should people care about that?

SUSAN BAKER: Well, in 2008, we only had bad options for handling the resolution of systemically important financial institutions. We had a disorderly failure that would, you know, create havoc in the financial system…

BRIAN SULLIVAN …Took a decade to sort through.

SUSAN BAKER: Exactly. Or we had public bailouts, for example, with AIG. You know, resolution provides a third option that is preferable to both those options because we can avoid systemic fallout and at the same time hold management and investors accountable for their investments and their losses. And fundamentally, you know, this is about protecting taxpayers and preserving financial stability. And Title II is the tool that we use to do that.

BRIAN SULLIVAN: So that's why people should care! So, what are some of the key takeaways from that report? I guess it expressed how the FDIC would behave in such a scenario.

SUSAN BAKER: Exactly. The goal of the paper is really to increase transparency about the FDIC's preparedness to undertake a Title II, you know, setting the expectations is really crucial to financial stability. You explain what you're going to do so people know what will happen.

BRIAN SULLIVAN: …People like to know we have a plan.

SUSAN BAKER: We have a plan and when you are seen to be doing what you said you were going to do, it helps to lower the temperature and calm things down. You know, market participants need to know the plans, who will bear losses, and basically how financial stability will be safeguarded. So what this report presents to the banking community, investors and public at large, it's really the most comprehensive description of how the FDIC is prepared to use its authority in the event of a GSIB failure. We want shareholders to know what will happen in a Title II resolution…

BRIAN SULLIVAN: …that they'll be taking the losses.

SUSAN BAKER: Exactly. You know, it's important that people know that the losses are borne by the shareholders and the creditors, not the taxpayers and not the depositors. You know, and more importantly, this paper is about explaining the strategy we have that keeps the bank's material operations open and operating so that it protects the depositors, it preserves value, it promotes financial stability and prevents taxpayer bailouts.

BRIAN SULLIVAN: Now, Ryan, you had said that, you know, you approach it from the bank holding company level, but the goal here, is it not through all of this is, to keep the material subsidiaries open and operating through all of this. Susan or Ryan, you do this through the so-called Single Point of Entry. So describe what that is and how is it that the parent fails but the offspring live on?

SUSAN BAKER: So in the paper, we describe our plans for using Single Point of Entry resolution strategy, as we call it. So, SPOE. As you said, only the parent goes into resolution…so that's the holding company…and the ownership of its material subsidiaries get transferred over to a bridge financial company and they are given enough capital and the liquidity to remain open and operating.

The FDIC has a program that maintains a roster of CEOs who are prepared and trained to step in and take that kind of position. But basically Single Point of Entry, what gets left behind, the shareholders and creditors of the failed GSIB holding company, *they* bear the losses but the operations of the firm like the bank, the insured depository institution, remain open and operating and depositors will retain access to all their funds. Luckily for us, the U.S. GSIBs have adopted a Single Point of Entry resolution strategy in all of their Title I plans in which where they plan for themselves to be resolved under bankruptcy. So they've organized their company to make that work and pre-positioned resources to make sure that their material subsidiaries and their key service companies will be able to continue operating and support the rest of the group. So that all remains open and operating. And so they've planned for this, the firms have, and they've organized for this. And the FDIC really benefits from that work if a Title II is applied.

All that said, resolution planning is an iterative process and it takes work to maintain and improve these plans. The GSIBs still have work to do to improve their plans and some of these have issues we've recently communicated to them in their Title I feedback letters. So while they continue that work, there's no doubt the firms and the FDIC have already done a lot that will enable us to conduct a Single Point of Entry resolution under Title II.

BRIAN SULLIVAN: Ryan, let's imagine if all of this happens, if this process is applied, what will the effects be? Will there be…I have to imagine there would be consequences for the financial system or for the bank that fails.

RYAN TETRICK: Right. So the goal of a Title II Single Point of Entry resolution is to apply those consequences to the appropriate parties, the investors in the holding company, and to contain the fallout to the rest of the financial system so that it's only those exposed to that holding company who are at risk and the rest of the financial system can continue without undue disruption.

I should touch on something that's really big and new and different since the financial crisis, which is called 'total loss absorbing capacity' or TLAC. And what this is, is it's a very large stock of additional equity and debt that these holding companies are required to maintain…all of the GSIBs…sufficient to replace their entire capital requirement when they fail. It's set aside just for resolution purposes and this group of investors and creditors is put on notice in advance…they're in place today…that they're on the hook for bearing the costs of a resolution. So that's really important. We pre-positioned a pool of resources that can be used in resolution and the investors

in these stocks, in this debt, are sophisticated…they understand the risks and all of those risks are clearly disclosed in advance.

BRIAN SULLIVAN: Well, it sounds like a big rainy day fund if anything.

RYAN TETRICK: It's really, really important. It's come at some expense to the industry. But they understand that this is necessary to operate at the scale and size that they do. And then, you know, some other consequences of the resolution…the institution itself that failed…something caused it to fail. So we're going to need to address that through the course of the resolution. We're going to need to replace the management that oversaw the failed business model and the risk management lapses and redress those. And some parts of the business might need to be restructured or wound down through the course of the process so that what comes out will be smaller and simpler and less systemically important than the entity that failed but that's all part of, you know, maintaining value and building credibility in whatever that entity is that goes forward.

And then I should note that, look, these are GSIBs, these are very large, complex institutions. And if one is failing, it's going to be a period of financial distress generally. Our goal is to keep that contained, managed so that the vast majority of participants in the financial system don't need to worry. It's really just those creditors of the holding company that are the focus of the costs of the resolution.

BRIAN SULLIVAN: And when do we have to use this authority to resolve a GSIB? What do you think will be the biggest challenge if that balloon goes up?

SUSAN BAKER: Well, Brian, my favorite topic….communications.

RYAN TETRICK: Yeah, of course. Yeah, you'll appreciate this. I do think it's communications. Do want to touch on that Susan?

SUSAN BAKER; Sure. I mean, given the scope and size of these operations, I think communicating clearly and quickly to the range of stakeholders in many, many countries. I mean, it will be a real challenge to reach all the people who need to be reassured by our plans. They have millions of customers, thousands of employees, hundreds of countries and that's why part of why we released this paper was to get in front of that and have this conversation today and to do some communication in advance so that when we do have a crisis, people will be like, “Now what happens to me?” And they can go find this paper and it will explain like, you're okay, these firms remain open and operating, we've got you. We've thought about this. So hopefully that will be reassuring.

BRIAN SULLIVAN: Right. Well, I'd like to invite you both to offer some final thoughts, because the failure of one of these GSIBs is concerning enough. And when it happened back in the great financial crisis and there were none of these plans available, there were no good consequences. With this plan, with writing it down in this report, with talking about it in podcasts like this, and all the ways you communicate to the industry and all the stakeholders out there, do you think that it gives that calm that the marketplace will need in a moment like that?

SUSAN BAKER: I sure hope so. I mean, I would encourage people to read the paper, you know, knowing what to expect during a crisis is important. You know, look at your emergency instructions in the seat pocket in front of you! Here they are. You know, I want depositors and customers and counterparties to really appreciate all that the FDIC has done to be ready for this and to make sure that even the largest U.S. banking organizations can fail in an orderly way. I mean, our paper gives you the roadmap and anyone can turn to it when a crisis does arrive. And I think that should help to promote a coordinated, orderly resolution with fewer surprises about who will be affected and who will not.

BRIAN SULLIVAN: Ryan does all of this Title II planning allow you to sleep better at night?

RYAN TETRICK: I sleep wonderfully when I'm not working, maybe because I'm working so much on making this work.

Look, I think Title II is a tool to enable failure in an orderly manner. We didn't have that tool in the last crisis. We either had to provide bailouts or there were disruptive failures. And I think what everyone should understand is we have the paper, which is important. We have also done a tremendous amount of work and there's been a lot of costs that the industry has borne and that we have to enable this authority to work.

BRIAN SULLIVAN: Well, if it's any consolation, I'll sleep better at night. So thank you both Susan Baker and Ryan Tetrick for joining us on the FDIC podcast.

SUSAN BAKER: It's a pleasure to be here.

RYAN TETRICK: Thanks so much, Brian.