FDIC PODCAST

Living Wills

BRIAN SULLIVAN: Hey, welcome back to the FDIC podcast, where we talk about the world of banking, bank supervision, and why it all matters to the safety and soundness of our financial system. I'm Brian Sullivan with the Federal Deposit Insurance Corporation and obviously, issues of safety and soundness are very much front of mind these days. And so today we talk of failure. You know, nobody likes to talk about death, but estate planners often recommend that folks consider making a living will, a legal document that clearly spells out what medical treatments a person wants or doesn't want in the extreme event that they become unable to communicate those intentions.

Well, today we're going to talk about living wills when it comes to banks— a plan that clearly spells out how a financial institution will be resolved in the event of financial distress, bankruptcy or even failure. And joining us today to talk about these living wills and the resolution planning process is Ryan Tetrick, deputy director of the FDIC's Resolution Readiness Branch. Hey, Ryan, welcome.

RYAN TETRICK: Brian, it's great to be here.

BRIAN SULLIVAN: What are these living wills as they relate to banks and why are they so important to the health of the financial system?

RYAN TETRICK: A living will is a popular term for what financial regulators call a resolution plan. These are plans prepared by financial institutions that provide a playbook for what will happen in the event of their failure, how their assets will be sold or transferred, how their liabilities will be paid off, and importantly, how critical operations will be stabilized and services will be continued, maintained, or transferred through the process.

They occupy a similar space as other types of crisis planning that banks do. So they have recovery plans that show how they would recover from a material financial distress and manage liquidity in the event that something goes poorly and then recover and return to health. There's stress testing that the institutions conduct that simulates their performance in various hypothetical economic scenarios. And then financial institutions, and lots of institutions, have business continuity plans that show how their operations could continue in the event of a natural disaster or a cyberattack attack.

So living wills are similar to those types of things, but they're really different in one key way, which is all of those are tools and practices to show how an institution can *survive*. And living wills go further. They take the bank into a sort of uncomfortable place that nobody really wants to think about. What happens when you're gone? What happens if you fail? And the goal is to ensure that a large financial institution has a plan that they can carry out to manage their orderly failure in a way that does not require taxpayer-funded bailouts or cause widespread disruption to the financial system.

BRIAN SULLIVAN: Okay. Ryan, let's start with just a little history of why living wills are a thing these days, why the planning process was a consequence of all the lessons that we learned following the Great Recession of 2008.

RYAN TETRICK: So you think back to the Great Recession. There are a number of large and very complex financial institutions that got into trouble, and there were really only very bad options for dealing with that. Either a disorderly failure that was going to have cascading effects throughout the financial system and lead to widespread…

BRIAN SULLIVAN: …the whole too big to fail thing…

RYAN TETRICK: …the whole too big to fail thing. And then there was the other option, which was the too big to fail part that they—to avoid those cascading consequences—there was a need for government support that ultimately put the taxpayer at risk for bearing the costs of the situation.

To take just one example, notorious example…when Lehman Brothers failed, there is no plan for how to how to wind it down. There had been no analysis of what would happen if its complex financial positions, its derivatives and repurchase agreements, unwound and how that would impact the financial system. There was data in other countries that was necessary to access in the U.S. that couldn't be accessed once it had failed. There was no plan for retaining key employees that were needed to wind down operations in an orderly way. And there was a complex web of legal entity and financial relationships that has taken more than a decade to work through.

Today, all of those problems, all of those challenges, have been disentangled in advance and the institutions have been required to work through them so that when they fail, they can be taken apart in a more orderly way.

BRIAN SULLIVAN: Ryan are only certain banks required to have these plans or to create these living wills?

RYAN TETRICK: So, it's only a requirement for the very largest and most complex financial institutions. And there's different categories of plan filers. It's only those institutions with over $50 billion in total assets that are required to file a plan of *any* type. And then as institutions get larger and more complex, the requirements get more frequent and stronger.

So there are several factors that we look at but for the most part, it's those institutions over $250 billion in total assets that are required to file the type of resolution plans required by the Dodd-Frank Act that show how they be resolved under the bankruptcy code. And then it's only the eight very largest institutions, the so-called global, systemically important banks in the U.S. (GSIBs) that have the most significant requirements and the most frequent plan filings?

BRIAN SULLIVAN: So just to be clear, there are different planning requirements for different types of banking organizations, whether they're individual banks or bank holding companies.

RYAN TETRICK: That's right. So there are Title I plans and there are IDI plans. So there's two different types of plans that institutions file. The first, the Title I plans…these are the plans required by the Dodd-Frank Act that show how an institution could resolve itself at the level of its holding company under the bankruptcy code. That's what most people think about when they think about living wills, and those are the plans that we review jointly with the Federal Reserve. And those are the ones I mentioned. It's generally institutions over $250 billion…there are some other factors, but generally only over $250 billion that file those plans.

Then, the FDIC has a separate requirement just for what's called the insured depository institution (IDI), the bank, the place where you put your deposits. And we require a separate resolution plan just for the bank that we review separately.

BRIAN SULLIVAN: The FDIC recently proposed new regulations to improve the effectiveness of these resolution planning requirements. What are they?

RYAN TETRICK: So, Brian, I'll start with the revised IDI Plan, Part 360.10. That's the one that applies to the banks themselves, the place where you actually place here deposits. That rule was first adopted in 2011, and we're proposing some revisions that would incorporate past guidance and would also incorporate lessons learned from the recent banking failures.

In addition, we're proposing that for institutions in the 50-to-$100 billion range, they would provide us with only "informational filings" that involve a limited subset of the of the information, and that for the largest institutions, those over $100 billion, they would provide us with more comprehensive resolution plans.

And then at the same time, we're proposing some changes that would apply to the Title I planning process, and those would provide for specific expectations for institutions that are headquartered in the U.S. and some specific expectations for institutions that are subsidiaries of foreign companies.

BRIAN SULLIVAN: Were these proposed rules prompted by our experience earlier in the year?

RYAN TETRICK: They weren't. We were working on these changes prior to the recent bank failures and we had a lot of the content in place when these banks failed as we were moving forward with the rulemaking process. But they were certainly informed by those failures. So once the banks failed, we went back and looked at the rules that we were drafting and we enhanced some things, adjusted some things, but actually a lot of the things that we learned from the banking failures we anticipated needing before those banks failed.

BRIAN SULLIVAN: Okay Ryan, elephant in the room. We've had three bank failures at the point we're recording this…Silicon Valley Bank, Signature Bank, and First Republic. Did they have resolution plans and were they a help?

RYAN TETRICK: Yeah, of course. So, none of those institutions filed Title I plans, the bankruptcy plans, however, some of them did file IDI plans. Signature Bank had actually never filed an IDI plan.

Its first plan ever was due in June and First Republic filed an update to its IDI plan in December. And we were in the process of reviewing those plans when the banks failed. Now, that said, even though we were still reviewing them, they were very, very useful when we were resolving Silicon Valley Bank and First Republic. First, they gave us a lot of information about what was valuable about the institutions, and that helped us formulate how we marketed the institutions to bidders.

They also provided a lot of really useful information about the operations of the bank that bidders were interested in and that helped us navigate the potential challenges in resolving them, whether it was around technology or personnel or shared services between the bank and its affiliates. And then Silicon Valley Bank as well, had a lot of cross-border operations and their resolution plan was very helpful in understanding the cross-border footprint of the firm and how we would interact with foreign supervisors. And that helped us when we were working with foreign authorities.

BRIAN SULLIVAN: So for the living wills you did have, they served their purpose?

RYAN TETRICK: We picked them up. We used them. We interacted with both the bank and other regulators as we were resolving those banks and then unfortunately, we just didn't have one for Signature Bank.

BRIAN SULLIVAN: Now, I gather that prior to the economic crisis of 2008 and the years beyond that, banks and bank holding companies were *not* required to file resolution…or even *have* resolution plans? All this to say, does it mean that before they were required to do so, banks didn't engage in any meaningful resolution planning?

RYAN TETRICK: So in the run-up to the 2008 financial crisis, inside the FDIC, we were beginning to think about the need for resolution plans. But the institutions themselves did not conduct any, you know, prescriptive resolution planning. And understandably…institutions' ongoing concerns are focused on offering products…lending, taking deposits, providing payment services and regulators and the banks also should be focused on safety and soundness. Are they healthy? Will they survive? But it's sort of unnatural to think about what happens when you fail…

BRIAN SULLIVAN: …again, the reluctance to think about such things.

RYAN TETRICK: Sure, right. But, you know, we recognize you can learn a lot about an institution by looking at risk profile, by looking at it at its business profitability, but not how to take it apart, not how to dismantle. And that requires a very particular way of thinking and that's why this requirement was put in place.

BRIAN SULLIVAN: Now, both the Federal Reserve and the FDIC make at least portions of these living wills public for all to see. Is that correct?

RYAN TETRICK: That's right. So there's a public portion of each of the plans. It's generally, you know, 20 to 80 pages. They're posted on our websites, both the Federal Reserve's and the FDIC's, and anybody can go look at those public portions of the plans. We also make the very prescriptive guidance that we give to the institutions public and portions of the feedback that we get back to the institutions.

And I think that transparency is important for two reasons. One is that the public deserves to see that there is a plan to promote confidence in the banking system for when these institutions should fail. And then it's also important for predictability. In the event that one actually fails, it will give stakeholders some understanding of what will happen…the customers, the creditors, the counterparties and the other authorities. If they don't know what's going to happen, they're more likely to panic. We all panic when…

BRIAN SULLIVAN: …when there's no plan at all.

RYAN TETRICK: In any type of situation, in finance, or in any type of situation. And just knowing how this process will unfold, what some of the key steps will be, and who will be involved, should create some predictability in the event that there is a crisis.

BRIAN SULLIVAN: So, what's the biggest myth about these living wills? Now, I've heard that some complain it's a burdensome process. It produces, you know, stacks of papers that somebody puts on the shelf and nobody reads.

RYAN TETRICK: So this is an important point. And, you know, I was going to suggest, Brian, that you close your eyes and you picture a living will, and you'd probably picture a big stack of papers sitting on somebody's desk somewhere. And look, there is a document that's a part of this process. The core part of it is actually relatively short, I'd say. There's a narrative that's required that's usually 100 pages and for the largest, maybe, maybe longer than that. But it really misses the key purpose of what these plans are for. So the plan submission does give us information that we otherwise wouldn't have and some steps to take. But the most powerful parts of this process are not the paper itself. In order to have a credible resolution plan, the institutions have had to change their organizations and how they operate so that they can be resolved in an orderly way. They've had to simplify their organizational structures; they've had to eliminate hundreds of legal entities; and they've had to align their operations, personnel, technology, business lines to their legal entities so that they could be resolved in an orderly manner. So it's actually resulted in tangible changes to the way that banks are organized and operate today in order to have a credible resolution plan.

And then, even more powerful than that, the institutions also have to demonstrate that they can do what they say they would do in their resolution plan. So we call this having 'resolution capabilities.' So, some of the things that they have to be able to demonstrate are that they have a governance process that can get them into resolution. They have to demonstrate that they have a capability to project financial resource needs in resolution, that they can fund themselves through the resolution process. They have to show that they have a plan for retaining key staff that they could deploy. And then they have to show that they've been conducting tests of all of this, that there have been simulations and exercises that show that they can actually carry it all out.

BRIAN SULLIVAN: So it's not an idle exercise here. This has a practical benefit of testing what would happen, God forbid, if they were to fail..they've actually tested and exercised these plans.

RYAN TETRICK: Absolutely. And so you asked earlier, you know, there was resolution planning conducted before the crisis. No. And the environment today is also that at all of these institutions that have a resolution planning requirement, they have dedicated recovery and resolution planning teams. Those teams engage stakeholders and experts throughout the organization. We…at the Federal Reserve and the FDIC both…have teams of resolution plan reviewers, and this is a constant process. We're all reviewing plans and engaging around them and engaging around these capable.

BRIAN SULLIVAN: You read these plans all the time, right?

RYAN TETRICK: It's sort of a weird vocation. We wake up every morning…rain or shine…we think, what if today's a crisis for this bank and what would we do? And so that's. It's a permanent vocation now.

BRIAN SULLIVAN: Well, that that's good to know. I was about to ask you, what do you think the long-term benefits have been since these living wills have been required? It sounds like there's been a cultural change.

RYAN TETRICK: That's right. And not only do they have to think about it and submit a plan that that we review and provide them feedback on, but they have to demonstrate that they're thinking about it in all of their key business decisions. So when they start a new line of business or acquire a new business or sell part of their business, they have to show that they've thought about the resolution implications of that and that they are actually required to show us how this would impact or change any elements of their resolution plan. So it's integrated into all of their day-to-day decision making.

BRIAN SULLIVAN: Well, Ryan Tetrick, thank you so much for stopping by and telling us about how these living wills impact our banks out there. It's been instructive.

RYAN TETRICK: Brian, it's been a great conversation. Thank you so much for having me.