Resolution Planning: 2020 Year-in-Review and Looking Forward to 2021

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An article summarizing recent rulemaking, guidance, and other trends regarding financial institution resolution plan requirements.

A little more than a decade after the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) became law, the resolution planning regime, which requires large financial institutions periodically to submit resolution plans to the Federal Reserve Board (FRB) and the Federal Deposit Insurance Corporation (FDIC) (together, the Agencies), is finally settling into a relatively predictable and steady state. There have been recent efforts to codify and harmonize resolution planning guidance to establish predictable standards, and revised rules now provide realistic timing requirements for resolution plan submissions as well as agency feedback, replacing the previous ad hoc experience of frequent delays and uncertainty.

On the other hand, there is still change and uncertainty on the horizon. Many of the first submissions under the new rules and standards—and in the midst of a dual health and economic crisis—will be made in 2021, and new leadership at the regulatory agencies will likely review those submissions. The FDIC meanwhile has not yet finalized changes to its depository institution-level resolution planning rule. In addition, regulators are increasingly focused on other emerging risks, like climate change risk, which may prove relevant to resolution planning.

The agencies retain the ability to impose severe penalties on a firm that fails to submit a credible resolution plan, which means that resolution planning will continue to be an important tool for regulators and important to banking organizations for the foreseeable future. Indeed, in its November 2020 Supervision and Regulation Report, the FRB listed resolution planning as a supervisory priority for large financial institutions.

Below, we summarize some of the key developments in the resolution planning space in 2020, including:

- The extension of certain resolution plan submission deadlines.
- New guidance regarding resolution plan content.
- The recently adopted rules regarding the orderly liquidation of certain broker-dealers under Title II of the Dodd-Frank Act.
- Changes on the horizon.

Extensions of Resolution Plan Submission Deadlines

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In October 2019, the FRB and the FDIC adopted a joint final rule revising the initial regulations implementing the Dodd Frank Act's resolution planning requirements under section 165(d) of the Dodd-Frank Act (165(d) Rule). Under those revisions, the resolution plan filing requirement for domestic firms and foreign firms with less than $100 billion in total consolidated assets was removed, and the resolution plan filing requirement for covered institutions moved from an annual to a two- or three-year submission cycle, depending on the covered institution's category under the FRB's tailoring rules. (For information on the tailoring rules, see Legal Update, FRB Issues Final Rules Tailoring Regulatory Requirements with Risk Profiles).

Under the revised submission cycle, Category I, II and III filers alternate between filing full and targeted resolution plans, either on a biennial cycle for Category I firms (the biennial filers) or a triennial cycle for Categories II and III firms (the triennial full filers). There is also a category called "triennial reduced filers" for any FBO with at least $250 billion in global assets that is not within Category I, II or III. Triennial reduced filers must file an initial full resolution plan (if not done previously) followed by a "reduced" resolution plan every three years. The 165(d) Rule established a schedule for submission due dates for full, targeted and reduced resolution plans under this new framework.

On May 6, 2020, in light of the challenges arising from the COVID-19 pandemic, the Agencies announced two extensions to upcoming resolution plan deadlines. First, for the resolution plans from Barclays, Credit Suisse, Deutsche Bank, and UBS, the Agencies extended the submission date by 90 days, to September 29, 2020. These plans were required to remediate certain "shortcomings" previously identified by the Agencies. Second, for the targeted resolution plans from the large foreign and domestic banks in Categories II and III (the triennial full filers), the Agencies extended the submission date by 90 days, to September 29, 2021. The Agencies noted that targeted resolution plans for the eight US global systemically important banking organizations (US GSIBs) will remain due by July 1, 2021, and that the Agencies will monitor conditions and may adjust this deadline if warranted.

These extensions alter deadlines that would have otherwise been applicable under the 2019 revisions to the 165(d) Rule.

Targeted Resolution Plans for US GSIBs

As noted above, the eight US GSIBs are required to file their first targeted resolution plans under the new 165(d) Rule by July 1, 2021. On July 1, 2020, for the first time, the Agencies provided information to the eight US GSIBs regarding the content of their targeted resolution plans, and posted the template letter that they sent to each of the US GSIBs. In short, the targeted information request requires US GSIBs to focus their targeted plan on the interaction of their coronavirus response to their resolution planning framework.

As prescribed in the 165(d) Rule, the targeted resolution plan must include:

- The "core elements" of a full resolution plan, including capital, liquidity, and recapitalization strategies.
- Responses to the Agencies' targeted information request in the template letter.
- A description of material changes experienced by the US GSIB since the firm's last submission (or an affirmation that there are no material changes), and changes the firm has made to its resolution plan in response.
- A description of changes to the firm's previously submitted resolution plan resulting from changes in law or regulation, or guidance or feedback from the Agencies.

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The Agencies also state they will review whether the US GSIB's shortcoming has been adequately addressed in connection with reviewing the 2021 targeted plan.

The Agencies note that the targeted information request for the 2021 targeted plans focuses on the firm's actions in response to events surrounding the coronavirus. Specifically, the Agencies explain that they intend to use the firm's response to the stress caused by the coronavirus to inform the Agencies' assessment of the firm's resolution-related capabilities and infrastructure. As part of their targeted plans, the US GSIBs specifically must address how their firm utilized existing resolution tools, such as their resolution trigger framework, resolution capital and liquidity capabilities, and how the coronavirus response affected their resolution planning infrastructure, such as support for continuing critical operations.

In the press release accompanying the template letter, the Agencies also note that they recently completed a review of so-called critical operations (operations at certain firms whose failure or discontinuance would threaten US financial stability) and informed the firms of their findings. The Agencies plan to complete another review by July 2022, which will include a broader evaluation of the framework used to identify critical operations.

ANPR Regarding Depository Institution Plans

In 2019, the FDIC issued an advance notice of proposed rulemaking (the ANPR) seeking comment on potential changes to the FDIC's rule regarding resolution plans (the IDI Rule) that are required to be filed by certain insured depository institutions (IDIs). The IDI Rule currently requires IDIs with more than $50 billion in assets to submit resolution plans to the FDIC. The FDIC indicated that the next round of IDI resolution plans will not be required until this rulemaking process is completed. As of the date of this publication, the FDIC has not yet issued a proposed rule.

On May 22, 2020, the FDIC announced that while amendments to the rule remain pending, the FDIC plans to carry out targeted engagement and capabilities testing—which is an approach to IDI resolution planning contemplated in the ANPR—with select firms on an as-needed basis. Therefore, it is possible that some firms could be subject to such testing despite not having a formal filing due. The FDIC explained that progress on a proposed rule had slowed due to recent market volatility and economic strains stemming from the pandemic, but that the FDIC was continuing its work on a proposal. At this point, we would expect the FDIC to finalize the rule during the Biden administration and, therefore, the contours of the final rule likely will be affected by changes in the composition of the FDIC board of directors.

Proposed Guidance for FBO Resolution Plans

On March 6, 2020, the Agencies proposed resolution plan guidance (Proposed Guidance) for certain foreign banking organizations (FBOs) that are triennial full filers and whose US intermediate holding companies (IHCs) have a score of 250 or more under the second methodology of the GSIB surcharge framework. (For information on the GSIB surcharge framework, see Legal Update, FRB Releases Final Rule on Risk-based Capital Surcharges for GSIBs). As of March 6, 2020, this group of FBOs included Barclays, Credit Suisse and Deutsche Bank (the Specified FBOs). Comments on the Proposed Guidance were originally due on May 5, 2020, but the comment period was later extended to June 4, 2020, in light of the challenges arising from the COVID-19 emergency.

Developments Informing the Proposed Guidance

The Proposed Guidance is based upon and largely consistent with prior guidance applicable to the Specified FBOs and UBS AG for their 2018 resolution plan submissions (see Guidance for 2018 § 165(d) Annual Resolution Plan Submissions By Foreign-based Covered Companies that Submitted Resolution Plans in July 2015) (the 2018 FBO Guidance). The Agencies note that three principal developments inform the Proposed Guidance and how it updates aspects of the 2018 Guidance:

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- The Agencies' review of the FBOs' most recent resolution plan submissions and the issuance of individual letters communicating the Agencies' views on and shortcomings contained in the 2018 resolution plans filed by the firms subject to the 2018 FBO Guidance.

- Revisions to the content related to payment, clearing, and settlement activities (PCS) and derivatives and trading activities (DER) in the updated guidance for the resolution plan submissions by the eight US GSIBs in February 2019 (see 84 Fed. Reg. 1438 (Feb. 4, 2019)) (the 2019 Domestic Guidance).

- The 2019 revisions to the resolution planning rule, which, as mentioned above, modified:
  - the scope of application of the resolution planning requirements;
  - the frequency of resolution plan submissions;
  - informational content requirements; and
  - procedures for the identification of critical operations.

Summary of Key Aspects of Proposed Guidance

The Proposed Guidance is largely consistent with the 2018 FBO Guidance and with the 2019 Domestic Guidance, as relevant. The Agencies note in particular that the capital and liquidity sections are largely unchanged from the 2018 FBO Guidance. The Proposed Guidance introduces certain material changes to the PCS and DER areas to reflect the Agencies' review of the 2018 FBO resolution plan submissions and revisions in the 2019 Domestic Guidance. There are also certain technical changes in the Proposed Guidance to reflect the 2019 revisions to the 165(d) Rule. Finally, the Proposed Guidance would consolidate all relevant guidance applicable to the FBOs into a single document, as the Agencies did for the 2019 Domestic Guidance.

Changes to PCS

As noted above, the Proposed Guidance would incorporate certain material changes to the PCS portions of the guidance, including distinguishing between expectations related to users and providers of PCS services to reflect the different financial and operational considerations associated with each activity. In particular, the Proposed Guidance would make the following changes:

- **Frameworks**. The Proposed Guidance provides that firms should develop frameworks that articulate their strategies for continued access to PCS services to focus the firms' consideration of this issue. The Proposed Guidance also builds upon the existing guidance by specifying that the framework through which a firm maintains continued access to PCS services should consider key clients of the firm's US operations (which may include affiliates of the firm), key financial market utilities (FMUs), and key agent banks. The Agencies note that because agent bank relationships may replicate PCS services provided by FMUs or facilitate access to FMUs, the Proposed Guidance would expressly include the development of playbooks for key agent banks.

- **Playbooks**. Under the Proposed Guidance, the Agencies would expect a firm to provide a playbook for each key FMU and key agent bank, whether there is a direct relationship or an indirect relationship (including indirect arrangements through any US or non-US affiliate or branch) between the firm and each key FMU and key agent bank. The Proposed

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Guidance differentiates the type of information to be included in a firm's key FMU and key agent bank playbooks based on whether a firm is a user or a provider (or both) of PCS services with respect to that FMU or agent bank.

Changes to DER

The Proposed Guidance also would incorporate certain material changes to the DER areas, as the Agencies have observed that the Specified FBOs are increasingly booking US derivatives and trading activities that originate from US entities into non-US affiliates, thus creating cross-border interconnections and interdependencies. The Proposed Guidance would, among other things:

- Clarify the Agencies' expectations with respect to a firm's capabilities to monitor and manage its US derivatives and trading activities in the period leading up to and during execution of the US resolution strategy without risk of a serious adverse effect on US financial stability.
- Consistent with the 2019 Domestic Guidance, eliminate the expectations of the 2018 FBO Guidance that a firm's US resolution plan include separate passive and active wind-down scenario analyses, the agency-specified data templates, and rating agency playbooks.
- Modify certain expectations for the Specified FBOs to reflect better the structures and business activities of the firms that would be Specified FBOs under the proposed guidance, including the size and complexity of their US derivatives and trading activities and the associated risks to the orderly resolution of their US entities.

The proposed DER guidance is organized into five sections:

- **Booking Practices**. The Proposed Guidance clarifies the capabilities a firm is expected to have related to its booking practices, including:
  - descriptions of its booking model framework; and
  - demonstrations of its ability to identify, assess, and report on each US entity that originates or otherwise conducts (in whole or in material part) any significant aspect of the firm's US derivatives or trading activities.
- **US Activities Monitoring**. The Proposed Guidance clarifies the Agencies' expectations that a firm address the risk of untimely transfer or other prolonged disruptions in clients' ability to execute transactions by being able to provide timely transparency into the management of its US derivatives and trading activities, including those originated from US entities and booked directly into non-US affiliates. The Proposed Guidance also indicates that a firm should be able to assess the potential impact on the firm's clients and counterparties engaged in US derivatives and trading activities and related risk transfer arrangements among and between the US entities and non-US affiliates.
- **Prime Brokerage Customer Account Transfers**. The Proposed Guidance confirms that a firm should have the capacity to facilitate the orderly transfer of US prime brokerage account balances to peer prime brokers and describes the Agencies' related expectations in greater detail. In particular, the Proposed Guidance clarifies that a firm's US resolution plan should describe and demonstrate its ability to segment and analyze the quality and composition of such account balances.

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- **Portfolio Segmentation**. The Proposed Guidance confirms that a firm should have capabilities to produce analyses that reflect granular portfolio segmentation, taking into account trade-level characteristics and at an entity level, for any derivatives portfolio of a US entity.

- **Derivatives Stabilization and De-risking Strategy**. The Proposed Guidance confirms that a firm's plan should provide a detailed analysis of its strategy to stabilize and de-risk any derivatives portfolio of any US IHC subsidiary that continues to operate after the US IHC enters into a US bankruptcy proceeding (US derivatives strategy) and provides additional detail regarding the Agencies' expectations. In particular, the Proposed Guidance clarifies that a firm should incorporate into its US derivatives strategy assumptions consistent with a lack of access to the bilateral OTC derivatives market at the start of its resolution period and also confirms and clarifies expectations related to other elements that should be addressed in the firm's analysis of its US derivatives strategy.

Orderly Liquidation of Covered Broker-Dealers

Title II of the Dodd-Frank Act created the orderly liquidation authority as an alternative to bankruptcy to enable the US Treasury (upon the recommendation of certain agencies and in consultation with the President) to invoke a receivership process to provide for the liquidation of a financial company the failure of which via bankruptcy could adversely affect financial stability in the United States. The orderly liquidation authority can be used to resolve a "financial company," which is a broadly defined term that could include a large broker-dealer. If invoked, Title II generally provides for the appointment of the FDIC as receiver for a troubled financial company and gives the FDIC broad power to resolve the company in an orderly manner using similar powers that the FDIC uses to resolve IDIs under the Federal Deposit Insurance Act. In particular, among other things, it authorizes the creation of a bridge financial company to which the troubled financial company's assets and certain liabilities may be transferred.

The FDIC has indicated that it may employ the so-called "single point of entry" (SPOE) strategy under Title II, pursuant to which only the top-tier parent company would enter resolution under Title II, and the subsidiaries, including a broker-dealer subsidiary, would remain outside of resolution. (See Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013)). Nevertheless, Title II does include special provisions that would permit the resolution of a broker-dealer subsidiary or a standalone broker-dealer under Title II if necessary.

In particular, section 205 of Title II includes special provisions for resolving a financial company that is a broker-dealer registered with the Securities and Exchange Commission (SEC) and a member of the Securities Investor Protection Corporation (SIPC). If the FDIC is appointed as a receiver for a broker-dealer entity, section 205 provides that the FDIC must appoint SIPC to act as trustee for the liquidation of the broker-dealer. Section 205 also seeks to coordinate the functions of SIPC as trustee with those of the FDIC as receiver, and requires the FDIC and SEC, in consultation with SIPC, jointly to issue rules to implement section 205.

On July 24, 2020, the FDIC and the SEC, in consultation with SIPC, adopted a final rule clarifying and implementing provisions regarding the orderly liquidation of broker-dealers (meaning either a broker-dealer subsidiary or standalone broker-dealer) in the event the FDIC is appointed receiver for the "covered broker-dealer" under Title II.

The final rule includes the following key requirements and clarifications:

- **Protective decree**. Upon the appointment of SIPC as trustee for a covered broker-dealer, Title II requires that SIPC file promptly a notice and application for a protective decree with a federal district court. The main purpose of this requirement is to give notice to interested parties that an orderly liquidation proceeding has been initiated. The final rule clarifies that a notice and application for a protective decree is to be filed with the federal district court in which a liquidation of the covered broker-dealer under the Securities Investor Protection Act of 1970 (SIPA) is pending, or if no

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such liquidation is pending, the federal district court for the district within which the covered broker-dealer's principal place of business is located.

- **Bridge broker-dealer**. Section 210 of Title II provides the FDIC, as receiver, with authority to form a bridge broker-dealer to which customer accounts and other assets and liabilities may be transferred. Among other things, the final rule states that if the FDIC establishes one or more bridge broker-dealers with respect to a covered broker-dealer, then the FDIC shall transfer all customer accounts and all associated customer name securities and customer property to such bridge broker-dealer(s) unless the FDIC, after consultation with the SEC and SIPC, determines that: (1) the transfer of such accounts, securities, and property to one or more qualified broker-dealers will occur "promptly" such that the use of the bridge broker-dealer(s) would not facilitate such transfer to one or more qualified broker-dealers; or (2) the transfer of such customer accounts to the bridge broker-dealer(s) would materially interfere with the ability of the FDIC to avoid or mitigate serious adverse effects on financial stability or economic conditions in the United States. The final rule also clarifies that the transfer to a bridge broker-dealer of any account or property does not create any implication that the holder of such an account qualifies as a "customer" or that the property qualifies as "customer property" or "customer name securities" within the meaning of SIPA or within the meaning of the final rule. The preamble to the final rule indicates that the FDIC, as receiver, in consultation with SIPC, as trustee, will allocate customer property and property made available through advances from SIPC in a manner consistent with SIPA and with SIPC's normal practices. Relatedly, transfers to the bridge broker-dealer of customer property, along with property made available through advances from SIPC, that is allocated to the customer's account would satisfy and discharge the customer's net equity claim against a covered broker-dealer.

- **Claims of customers and other creditors**. The final rule addresses the claims process for the covered broker-dealer's customers and other creditors as well as the respective roles of the trustee and the receiver with respect to those claims. The final rule generally provides SIPC with the authority as trustee for the covered broker-dealer to make determinations, allocations, and advances in a manner consistent with its customary practices in a liquidation under SIPA, although the rule does not explicitly contemplate SIPC appointing a third party to serve in the role of trustee, as it often does in practice. The FDIC, as receiver, must consult with SIPC, as trustee, regarding procedures for filing a claim, including the form of claim and the filing instructions, to facilitate a process that is consistent with SIPC's general practices.

- **Qualified financial contracts**. The final rule's section on qualified financial contracts (QFCs), consistent with the statute, states that QFCs are governed in accordance with Title II. Title II imposes a temporary (one business day) stay on the ability of QFC counterparties to exercise default rights based upon the appointment of the FDIC as receiver for the covered company.

The final rule, among other things, also clarifies how the relevant provisions of SIPA would be incorporated into a Title II proceeding, specifies the roles of the FDIC as receiver and SIPC as trustee with respect to a covered broker-dealer, and provides for SIPC's administrative expenses. The final rule became effective on October 30, 2020.

Looking Ahead

As we have discussed throughout this article, certain aspects of resolution planning have matured and appear to be reaching a near steady-state for banking organizations in the United States. Nevertheless, uncertainty and change is on the horizon, particularly in light of anticipated revisions to FDIC rules and the submission of the first set of new resolution plans under the revised 165(d) rule, both occurring in the context of a change in administration. At the same time, resolution planning regimes are still very much in the beginning stages for other market participants, such as central counterparties and so-called "global stablecoin" arrangements. (See Financial Stability Board, Guidance on Financial Resources to Support CCP Resolution and

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on the Treatment of CCP Equity in Resolution (Nov. 16, 2020); The Systemic Risk Counsel, Statement: Reigniting Reforms to Ensure A Resilient and Stable Financial System: A Second Phase? (Oct. 9, 2020); and Financial Stability Board, Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements: Final Report and High-Level Recommendations at 34 (Oct. 13, 2020).) Therefore, we expect resolution planning to remain an important item on the regulatory agenda for the foreseeable future.

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