FDIC Report Expresses Confidence in GSIB Resolution, May Affect Large Regional Bank M&A Prospects and Strategy

May 14, 2024

Introduction

On April 10, 2024, the Federal Deposit Insurance Corporation (the "FDIC") released a report regarding Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"),[1] titled *Overview of Resolution Under Title II of the Dodd-Frank Act* (the "Report").[2] Enacted in 2010, in response to the 2008 financial crisis, Title II of the Dodd-Frank Act was designed to address the concern that some banks are "too big to fail" by providing the federal government "orderly liquidation authority" in which, as an alternative to bankruptcy, the FDIC is appointed as a receiver to carry out the liquidation and wind-down of a failed "large, complex financial company."[3]

While noting that a resolution under Title II has never been attempted, the Report sets expectations for how such a resolution could be conducted successfully in practice, detailing the structure, procedures and timeline for Title II's usage in the resolution of a U.S.-based global systemically important banking organization ("U.S. GSIB"). In a speech introducing the Report at the Peterson Institute for International Economics, FDIC Chairman Martin J. Gruenberg emphasized the Report's goal of providing predictability and confidence to consumers, stakeholders and the market on the feasibility of a Title II resolution for U.S. GSIBs and other systemically important financial companies, stating that "until we do so successfully, there will be questions as to whether it can be done."[4]

The Report follows approximately a year after the failure of four large banks: Swiss GSIB Credit Suisse and U.S. regional banks Silicon Valley Bank, Signature Bank and First

---

1 12 U.S.C. § 5384.

2 FDIC, *Overview of Resolution Under Title II of the Dodd-Frank Act* (April 10, 2024), *available here*.

3 Report at 1.

4 FDIC, *Remarks by FDIC Chairman Martin J. Gruenberg at the Peterson Institute for International Economics The Orderly Resolution of Global Systemically Important Banks: An Update from the FDIC* (April 10, 2024), *available here*.

Republic Bank (the "Spring 2023 Bank Failures"). However, instead of liquidating these banks, regulators brought each bank out of resolution through a sale to another banking organization. Furthermore, to preserve financial stability, before the sales of Silicon Valley Bank and Signature Bank, federal regulators invoked the systemic risk exception to protect those banks' uninsured depositors.[5]

The Report therefore highlights the bank regulatory agencies' increased focus on the resolvability of regional banks. Gruenberg suggests in his forward that the "plans and processes" described in the Report could also be applied in the case of future large regional bank failures like the ones from Spring 2023.[6] Combined with increased questions around resolvability in the bank merger application process, resolvability-related conditions in recent large bank merger approvals and related statements from agency principals, the Report encourages proactively addressing resolution planning in preparation for and as part of a merger process. At the same time, the agencies' recent proposals around resolution readiness, including the proposal to impose minimum long-term debt ("LTD") requirements for large regional banks,[7] would, if adopted, better enable regional banks to make the case that bank merger activity would not increase risk to the U.S. financial system.

Set forth below is a summary of the key takeaways from the Report, as well as an overview of the recent regulatory activity with respect to resolvability of U.S. GSIBs and large regional banks.

Placing the Report in the Context of Recent Regulatory Activity

By highlighting the progress made by U.S. GSIBs in resolution preparedness, Chairman Gruenberg's speech and the Report take a different tone than other recent FDIC statements regarding the feasibility of large bank resolvability. The Report comes just weeks after the FDIC released its Proposed Statement of Policy on Bank Merger Transactions (the "Proposed Statement") on March 21, 2024.[8] As detailed in our Debevoise In Depth on the topic,[9] the FDIC proposed more stringent criteria for its review of bank merger applications, including heightened scrutiny for transactions resulting in institutions with total assets of over $100 billion, which the FDIC describes

---

[5] FDIC, *Joint Statement by the Department of the Treasury, Federal Reserve, and FDIC* (March 12, 2023), *available* here.

[6] Report at i.

[7] *See* our blog on the topic, *Banking Agencies Release Proposed Rules and Guidance on Long-Term Debt and Resolution Planning*, *available* here.

[8] FDIC, *Request for Comment on Proposed Statement of Policy on Bank Merger Transactions* (Mar. 21, 2024), *available* here.

[9] *See* our Debevoise In Depth on the FDIC's Proposed Statement of Policy, *available* here.

as "more likely to present financial stability concerns" and which "may pose significantly different resolvability and stability risks" than smaller banks.[10] The Report also comes months after the proposal of heightened capital requirements for large banks through the implementation of Basel III Endgame, which Chairman Gruenberg stated was necessary to "enhance the resilience and stability of the banking system." [11] In a notable contrast to these sentiments, the Report provides the FDIC's detailed plans for resolving U.S. GSIBs, with the intention of making "readily apparent" that the FDIC is ready to resolve "even large, complex, and interconnected financial companies." [12]

The Report, however, appears to continue the bank regulatory agencies' recent push to use resolution planning and preparedness as a means to establish greater equivalence between large regional banks (i.e., generally those with above $100 billion of assets) and their GSIB counterparts. In response to the Spring 2023 Bank Failures, the FDIC, the Federal Reserve Board (the "FRB") and the Office of the Comptroller of the Currency (together with the FDIC and FRB, the "Agencies") proposed new rules and guidance governing LTD and so-called "clean holding company" requirements at large banks (in the "LTD NPR"), resolution plans of insured depository institutions, and section 165(d) holding company resolution plans (the "165(d) Guidance Proposals").

Indeed, while the Report focuses on the use of Title II to potentially resolve U.S. GSIBs, the most systematically important U.S. banking organizations in the global banking system, it is not meant to be read with only those entities in mind. Chairman Gruenberg states in his foreword to the Report, "[a]lthough this paper focuses on the example of a U.S. GSIB resolution, many of the plans and processes described are relevant to how the FDIC would respond if called upon to be receiver for other types of systemically important financial companies." [13] The Report later emphasizes that Title II can be used to resolve any bank holding company, not just a GSIB.[14] While this Debevoise In Depth principally focuses on GSIBs, its perspective on the FDIC's approach may be relevant to large regional banks as well.

Overview of Title II Resolution Process

The Report details the three major operational steps the FDIC plans to take to facilitate a potential Title II resolution of a U.S. GSIB and the "preparations and expectations" the

[10] Proposed Statement at 47.
[11] FDIC, *Statement by Martin J. Gruenberg, Chairman, FDIC, On Basel III Notice of Proposed Rulemaking* (July 27, 2023), *available here*.
[12] Report at 45.
[13] Report at i.
[14] Report at i.

FDIC has in relation to each. The first step is launching and beginning to implement the resolution. Launching the resolution involves a multiagency determination that the Title II process would mitigate the adverse effects of the GSIB's failure on U.S. financial stability. [15]

Once a resolution is formally launched, the FDIC begins implementing the U.S. GSIB's Single Point of Entry ("SPOE") strategy. Under the SPOE strategy, only the parent holding company of the U.S. GSIB is placed into resolution while ownership interests in the underlying subsidiaries are transferred from the failed parent company to a new Bridge Financial Company under the control of the FDIC. Because the claims of the failed holding company's shareholders and unsecured creditors are not transferred to the Bridge Financial Company and are left to become claimants against the receivership, they absorb the bulk of the GSIB's losses. The key objective of the SPOE resolution strategy is to allow material subsidiaries to continue operating during the resolution process and thereby promote U.S. financial stability without imposing a material burden on U.S. taxpayers.

Thereafter, the FDIC would stabilize the operations of the Bridge Financial Company, recapitalizing material domestic and foreign subsidiaries, provide liquidity support and maintain continuity of operations. [16] If emergency liquidity is needed, Title II provides the Orderly Liquidation Fund at the U.S. Treasury, which serves as a temporary backstop source of liquidity that must be repaid with the assets of the GSIB. [17]

The final step is exiting from the resolution process. The process of exiting remains flexible depending on the needs of the business and can include: "selling subsidiaries or specific business lines; winding down or liquidating specific portfolios, business lines or subsidiaries in an orderly manner; or breaking up certain operating subsidiaries for sale or spin-off." [18] The FDIC estimates that the typical resolution process would take at least nine months. [19]

---

[15] Report at 20, 22. Notably, this is a similar process to the one followed in the Spring 2023 Bank Failures to invoke the systemic risk exception utilized in the resolutions of Silicon Valley Bank and Signature Bank.

[16] Report at 33.

[17] Id.

[18] Report at 39. Among other potential approaches, the Report notes that the FDIC would be willing to exit Bridge Financial Companies, using a securities-for-claims exchange approach wherein a successor company or companies issue new debt and equity securities to the receivership, which then distributes them to satisfy creditor claims against the receivership. *See* Report at 40.

[19] Id.

The Report's Confidence in the Resolvability of U.S. GSIBs

While acknowledging the challenges inherent in potentially executing a Title II resolution, the Report ultimately expresses confidence in the Agencies' ability, both legally and practically, to resolve U.S. GSIBs without harming global financial stability. In his speech and his forward to the Report, Chairman Gruenberg expressed approval of the steps regulators and GSIBs have taken to enhance resolvability since the implementation of Title II, specifically pointing to the existence of Title I, or 165(d), resolution planning requirements, the 2013 development of the concept of the SPOE resolution strategy, and the 2017 rules requiring GSIBs to maintain minimum total loss absorbing capacity ("TLAC") and LTD, to comply with the so-called "clean holding company" requirements and to provide for contractual stays on counterparty actions for Qualified Financial Contracts ("QFCs"). He notes that "substantial progress has been made within the banking industry and among regulatory authorities to make GSIB resolution actionable in the United States" and that "progress…has been made toward enabling such a resolution and ending 'too big to fail." [20]

Chairman Gruenberg expresses a belief that orderly liquidation of GSIBs is not only possible, but also should be utilized more frequently by regulators in handling GSIB failures. Gruenberg particularly expresses regret in how Swiss authorities handled the failure of Credit Suisse last year, deciding not to place the bank into resolution and instead facilitating an acquisition by UBS Group AG. He made it clear that the Report is meant to reaffirm that the FDIC would act differently in a similar U.S. situation, noting "we are prepared to apply the resolution framework that the FDIC and other regulatory authorities in the U.S. and globally have worked so hard to develop." [21]

This confidence contradicts past statements where the FDIC, and Chairman Gruenberg in particular, expressed hesitancy regarding large bank growth and M&A because of concerns that large banks are not resolvable. [22] In fact, it has been posited that perhaps the FDIC's more stringent merger requirements in its Proposed Statement are meant to "ensure that merged banks cannot fail because the FDIC can't handle a failed bank," especially one that is larger and more complex. [23] The FDIC itself highlights that the "growth and consolidation" of large banks over the past few decades has led to an increase in "the number of large and systemically important banking organizations,"

---

[20] Report at i-ii.

[21] Remarks by Gruenberg.

[22] *See, e.g.*, FDIC, *Statement by Martin J. Gruenberg, Member, FDIC Board of Directors Bank Merger Act Application: SunTrust Bank, Atlanta, Georgia, to be acquired by Branch Banking and Trust Company, Winston-Salem, North Carolina* (Nov. 19, 2019), *available* here.

[23] Karen Petrou, *Horizontal Bank Mergers: Critical Industry Infrastructure in Harm's Way*, *Federal Financial Analytics* (April 2, 2024), *available* here.

which has "contributed to the need for a review of the regulatory framework that applies to bank merger transactions."[24] The FDIC also justifies its concerns regarding the growth of large banks and the resulting need for more rigorous merger requirements by explaining how the failure of a large bank could present "greater challenges to the FDIC's resolution and receivership functions" and perhaps even limit the resolution options available to the FDIC.[25] Moreover, Acting Comptroller of the Currency Michael Hsu recently singled out resolvability as a particularly important criterion in considering bank merger applications.[26]

Yet in Chairman Gruenberg's forward to the Report, he notes that the Report is meant to reaffirm that "should the need arise, the FDIC is prepared to apply the resolution regime" to a failed U.S. GSIB.[27] The Report undercuts both the Proposed Statement's harsher merger requirements and the FDIC's related concerns about large bank growth.

Regulators' Continued Focus on Large Regional Bank Resolution Planning and Preparedness

The Report does, however, provide a consistent indicator of the Agencies' desire to shape resolution preparedness for large regional banks in a similar manner to GSIB resolution preparedness. In 2019, Chairman Gruenberg spoke of the "challenges posed by the failure of a large regional bank," specifically noting that the default strategy for such a bank of a weekend sale was made incredibly challenging by its size and lack of potential purchasers.[28] In April 2022, Acting Comptroller Hsu discussed potential regulatory responses to what he perceived to be a "resolvability gap" with respect to large regional banks.[29] Later that year, but before the Spring 2023 Bank Failures, the FRB and FDIC jointly issued an advance notice of proposed rulemaking ("LTD ANPR") related to LTD and other resolution-related requirements aimed at banking organizations with $250 billion or more in assets.[30]

---

[24] Proposed Statement at 5.

[25] Proposed Statement at 6.

[26] Office of the Comptroller, *Acting Comptroller Discusses Bank Mergers*, YouTube at 32:30-36:00 (February 12, 2024), *available* here.

[27] Report at ii.

[28] Martin J. Gruenberg, *An Underappreciated Risk: The Resolution of Large Regional Banks in the United States*, remarks at The Brookings Institution, Center on Regulation and Markets (Oct. 16, 2019), *available* here.

[29] Michael J. Hsu, *Financial Stability and Large Bank Resolvability*, remarks before the Wharton Financial Regulation Conference 2022 (Apr. 1, 2022), *available* here.

[30] Resolution-Related Resource Requirements for Large Banking Organizations, 87 Fed. Reg. 64170 (Oct. 24, 2022), *available* here.

The Spring 2023 Bank Failures following the release of the LTD ANPR highlighted, from the Agencies' perspective, the complexity of resolving non-GSIB banking organizations with $100 billion or more in total assets. In response, the Agencies proposed to lower the total assets threshold for the application of the LTD requirement from $250 billion, as suggested in the LTD ANPR, to $100 billion in the LTD NPR. The Agencies similarly proposed to impose stricter capital requirements on banking organizations with $100 billion or more in assets. Furthermore, in the 165(d) Guidance Proposals, the Agencies included extensive guidance for domestic non-GSIBs implementing SPOE strategies, despite no covered organizations having adopted an SPOE strategy.

While Title II may have been designed for GSIBs, Chairman Gruenberg's statements and the Agencies' recent proposed rules indicate that the FDIC would like to ensure that even non-GSIBs take steps to make themselves resolvable using a similar approach. Chairman Gruenberg emphasizes this with his references to the Spring 2023 Banking Failures in both his speech and introduction to the Report.

As such, large regional banks may wish to consider affirmatively addressing in any M&A application the implications of the potential transaction on their resolution planning and preparedness, so as to avoid unnecessary delays. Potential acquirers could demonstrate in their merger applications a commitment to resolution planning and scrutiny as to resolution preparedness. Resolution planning in particular has been a focus of the Agencies in recent large regional bank mergers. In October 2022, simultaneously with the release of the LTD ANPR, the FRB and OCC approved U.S. Bank's acquisition of MUFG Union Bank.[31] As part of their approval, they imposed an interim resolution plan requirement, conditioning approval of the merger on U.S. Bank filing an interim update to its resolution plan within six months of the consummation of the merger.[32] Furthermore, in a recent request for additional information regarding the proposed merger between Capital One and Discover, the FRB asked Capital One to provide further details on how the potential transaction would impact its resolution plan.[33]

---

[31] Federal Reserve System, *Order Approving the Acquisition of a Bank, FRB Order No. 2022-22* (October 14, 2022), *available* here; Office of the Comptroller of the Currency, *Bank Merger Approval Letter, OCC Control No. 2021-LB-Combination-323603* (October 14, 2022), *available* here.

[32] U.S. Bank was ultimately excused from this resolution plan requirement, but only after completing and filing the interim update with the Agencies. *See* Federal Reserve System, *Letter to Spencer A. Sloan, Esq.* (Oct. 16, 2023), 6, *available* here.

[33] Federal Reserve Bank of Richmond, *Letter to Rosemary Spaziani, Esq.* (April 12, 2024), *available* here.

The aforementioned commitment and scrutiny to resolution planning and preparedness, the FDIC's apparent confidence in the regulations, and guidance the Agencies have produced to support resolution preparedness of U.S. GSIBs provide an argument by acquirers in favor of receiving approval for large bank growth and M&A. Moreover, if, despite industry comment, the Agencies' recent proposed LTD, resolution planning and capital rules are finalized, as a small benefit, the finalization also should provide a basis for large regional banks to affirmatively assert that the Agencies' resolvability concerns have been further diminished, which supports the Agencies moving merger applications along more successfully and expediently.

* * *

Please do not hesitate to contact us with any questions.

Gregory J. Lyons
Partner, New York
+1 212 909 6566
gjlyons@debevoise.com

Jeff Robins
Partner, New York
+ +1 212 909 6526
jlrobins@debevoise.com

Elie J. Worenklein
Counsel, New York
+1 212 909 6239
eworenklein@debevoise.com

Tejas N. Dave
Associate, New York
+1 212 909 6155
tndave@debevoise.com

Ezra Newman
Associate, New York
+1 212 909 6278
enewman@debevoise.com

Gabriela Urias
Law Clerk, New York
+1 212 909 6755
gurias@debevoise.com

This publication is for general information purposes only. It is not intended to provide, nor is it to be used as, a substitute for legal advice. In some jurisdictions it may be considered attorney advertising.