[6741-01-P]

FEDERAL DEPOSIT INSURANCE CORPORATION

Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Notice; request for comments.

SUMMARY: Since enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in 2010, the FDIC has been developing its capabilities for implementing the Orderly Liquidation Authority established under Title II of that Act to allow for the orderly resolution of a systemically important financial institution. This notice describes in greater detail the Single Point of Entry strategy, highlights some of the issues identified in connection with the strategy, and requests public comment on various aspects of the strategy.

DATES: Comments must be received by the FDIC by [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN *FEDERAL REGISTER*].

ADDRESSES: You may submit comments by any of the following methods:

• *Agency Web Site:* *http://www.fdic.gov/regulations/laws/federal*. Follow instructions for Submitting comments on the Agency Web Site.

• *Email:* *Comments@FDIC.gov*. Include ‘‘Single Point of Entry Strategy’’ in the subject line of the message.

• *Mail:* Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street N.W., Washington, DC 20429

• *Hand Delivery/Courier:* Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m. (EST).

• *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.

Public Inspection: All comments received will be posted without change to *http://www.fdic.gov/regulations/laws/federal* including any personal information provided. Comments may be inspected and photocopied in the FDIC Public Information Center, 3501 North Fairfax Drive, Room E–1002, Arlington, VA 22226, between 9 a.m. and 5 p.m. (EST) on business days. Paper copies of public comments may be ordered from the Public Information Center by telephone at (877) 275–3342 or (703) 562–2200.

FOR FURTHER INFORMATION CONTACT:

Federal Deposit Insurance Corporation, 550 17th Street N.W., Washington, DC 20429: Office of Complex Financial Institutions: Herbert Held, Associate Director, Systemic Resolutions & Policy Implementation Group, Resolution Strategy & Implementation Branch (202) 898-7329; Rose Kushmeider, Acting Assistant Director, Systemic Resolutions & Policy Implementation Group, Policy Section (202) 898-3861; Legal Division: R. Penfield Starke, Assistant General Counsel, Receivership Section, Legal Division (703) 562-2422; Elizabeth Falloon, Supervisory Counsel, Receivership Policy Unit, Legal Division (703) 562-6148.

SUPPLEMENTARY INFORMATION:

Background

Since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) the FDIC has been developing its capability for resolving systemically

important financial institutions (SIFIs). The Orderly Liquidation Authority (OLA) set out in Title II of the Dodd-Frank Act provides the FDIC with the ability to resolve such firms when bankruptcy would have serious adverse effects on financial stability in the United States. After consultation with public and private sector stakeholders, the FDIC has been developing what has become known as the Single Point of Entry (SPOE) strategy to implement its Authority. The purpose of this document is to provide greater detail on the SPOE strategy and to highlight issues that have been identified during the development of this strategy. We are seeking comment on this strategy and these issues to assist the FDIC in implementing its OLA responsibilities.

The financial crisis that began in late 2007 demonstrated the lack of sufficient resolution planning on the part of market participants. In the absence of adequate and credible resolution plans on the part of global systemically important financial institutions (G-SIFIs), the financial crisis highlighted deficiencies in existing U.S. financial institution resolution regime as well the complexity of the international structures of G-SIFIs. At that time, the FDIC's receivership authorities were limited to federally insured banks and thrift institutions. The lack of authority to place a holding company or affiliates of an insured depository institution (IDI) or any other non-bank financial company into an FDIC receivership to avoid systemic consequences limited policymakers' options, leaving them with the poor choice of bail-outs or disorderly bankruptcy. In the aftermath of the crisis, Congress enacted the Dodd-Frank Act in July 2010.

Title I and Title II of the Dodd-Frank Act provide significant new authorities to the FDIC and other regulators to address the failure of a SIFI. Title I requires all companies covered under it to prepare resolution plans, or "living wills," to demonstrate how they would be resolved in a

rapid and orderly manner under the Bankruptcy Code (or other applicable insolvency regime) in the event of material financial distress or failure. Although the statute makes clear that bankruptcy is the preferred resolution framework in the event of the failure of a SIFI, Congress recognized that a SIFI might not be resolvable under bankruptcy without posing a systemic risk to the U.S. economy.

Title II, therefore, provides a back-up authority to place a SIFI into an FDIC receivership process if no viable private-sector alternative is available to prevent the default of the financial company and if a resolution through the bankruptcy process would have serious adverse effects on U.S. financial stability. Title II gives the FDIC new OLA that provides the tools necessary to ensure the rapid and orderly resolution of a covered financial company.

While the Dodd-Frank Act does not specify how a resolution should be structured, Title II clearly establishes certain policy goals. The FDIC must resolve the covered financial company in a manner that holds owners and management responsible for its failure accountable—in order to minimize moral hazard and promote market discipline—while maintaining the stability of the U.S. financial system. Creditors and shareholders must bear the losses of the financial company in accordance with statutory priorities and without imposing a cost on U.S. taxpayers.

In developing a resolution strategy the FDIC considered how it could overcome a number of impediments that must be addressed in any resolution. Key impediments are:

- Multiple Competing Insolvencies: multiple jurisdictions, with the possibility of different insolvency frameworks, raise the risk of discontinuity of critical operations and uncertain outcomes;
- Global Cooperation: the risk that lack of cooperation could lead to ring-fencing of assets or other outcomes that could exacerbate financial instability in the United States and/or loss of franchise value, as well as uncertainty in the markets;
- Operations and Interconnectedness: the risk that services provided by an affiliate or third party might be interrupted, or access to payment and clearing capabilities might be lost;
- Counterparty Actions: the risk that counterparty actions might create operational challenges for the company, leading to systemic market disruption or financial instability in the United States; and
- Funding and Liquidity: the risk of insufficient liquidity to maintain critical operations, which may arise from increased margin requirements, termination or inability to roll over short-term borrowings, loss of access to alternative sources of credit.

Additionally, the FDIC and the Federal Reserve issued Guidance in 2013 asking SIFIs filing their second Resolution Plans to discuss strategies for overcoming these obstacles in those Plans. Addressing these impediments would facilitate resolution under the bankruptcy process and, if necessary, under a Title II process.

The Single Point of Entry Strategy

To implement its authority under Title II, the FDIC is developing the SPOE strategy. In choosing to focus on the SPOE strategy, the FDIC determined that the strategy would hold shareholders, debt holders and culpable management accountable for the failure of the firm. Importantly, it would also provide stability to financial markets by allowing vital linkages among the critical operating subsidiaries of the firm to remain intact and preserving the continuity of services between the firm and financial markets that are necessary for the uninterrupted operation of the payments and clearing systems, among other functions.

Overview

U.S. SIFIs generally are organized under a holding company structure with a top-tier parent and operating subsidiaries that comprise hundreds, or even thousands, of interconnected entities that span legal and regulatory jurisdictions across international borders and share funding and support services. Functions and core business lines often are not aligned with individual legal entity structures. Critical operations can cross legal entities and jurisdictions and funding is often dispersed among affiliates as need arises. These integrated structures make it very difficult to conduct an orderly resolution of one part of the company without triggering a costly collapse of the entire company and potentially transmitting adverse effects throughout the financial system. Additionally, it is the top-tier company that raises the equity capital of the institution and subsequently down-streams equity and some debt funding to its subsidiaries.

In resolving a failed or failing SIFI the FDIC seeks to promote market discipline by imposing losses on the shareholders and creditors of the top-tier holding company and removing culpable senior management without imposing cost on taxpayers. This would create a more

stable financial system over the longer term. Additionally, the FDIC seeks to preserve financial stability by maintaining the critical services, operations and funding mechanisms conducted throughout the company's operating subsidiaries. The Dodd-Frank Act provides certain statutory authorities to the FDIC to effect an orderly resolution. Included among these are the power to establish a bridge financial company and to establish the terms and conditions governing its management and operations, including appointment of the board of directors. Additionally, the FDIC may transfer assets and liabilities to the bridge financial company without obtaining consents or approvals.

To implement the SPOE strategy the FDIC would be appointed receiver only of the top-tier U.S. holding company, and subsidiaries would remain open and continue operations. The FDIC would organize a bridge financial company, into which it would transfer assets from the receivership estate, primarily the covered financial company's investments in and loans to subsidiaries. Losses would be apportioned according to the order of statutory priority among the claims of the former equity holders and unsecured creditors, whose equity, subordinated debt and senior unsecured debt would remain in the receivership. Through a securities-for-claims exchange the claims of creditors in the receivership would be satisfied by issuance of securities representing debt and equity of the new holding company or holding companies (NewCo or NewCos). In this manner, debt in the failed company would be converted into equity that would serve to ensure that the new operations would be well-capitalized.

The newly formed bridge financial company would continue to provide the holding company functions of the covered financial company. The company's subsidiaries would remain

open and operating, allowing them to continue critical operations for the financial system and avoid the disruption that would otherwise accompany their closings, thus minimizing disruptions to the financial system and the risk of spillover effects to counterparties. Because these subsidiaries would remain open and operating as going concerns, and any obligations supporting subsidiaries' contracts would be transferred to the bridge financial company, counterparties to most of the financial company's derivative contracts would have no legal right to terminate and net out their contracts. Such action would prevent a disorderly termination of these contracts and a resulting fire sale of assets.

Under the Dodd-Frank Act, officers and directors responsible for the failure cannot be retained and would be replaced. The FDIC would appoint a board of directors and would nominate a new chief executive officer and other key managers from the private sector to replace officers who have been removed. This new management team would run the bridge financial company under the FDIC's oversight during the first step of the process.

During the resolution process, measures would be taken to address the problems that led to the company's failure. These could include changes in the company's businesses, shrinking those businesses, breaking them into smaller entities, and/or liquidating certain subsidiaries or business lines or closing certain operations. The restructuring of the firm might result in one or more smaller companies that would be able to be resolved under bankruptcy without causing significant adverse effect to the U.S. economy.

The FDIC intends to maximize the use of private funding in a systemic resolution and

expects the well-capitalized bridge financial company and its subsidiaries to obtain funding from customary sources of liquidity in the private markets. The FDIC, however, realizes that market conditions could be such that private sources of funding might not be immediately available. If private-sector funding cannot be immediately obtained, the Dodd-Frank Act provides for an Orderly Liquidation Fund (OLF) to serve as a back-up source of liquidity support that would only be available on a fully secured basis. If needed at all, the FDIC could facilitate private-sector funding to the bridge financial company and its subsidiaries by providing guarantees backed by its authority to obtain funding through the OLF. Alternatively, funding could be secured directly from the OLF by issuing obligations backed by the assets of the bridge financial company. These obligations would only be issued in limited amounts for a brief transitional period in the initial phase of the resolution process and would be repaid promptly once access to private funding resumed.

If any OLF obligations are issued to obtain funding, they would be repaid during the orderly liquidation process. Ultimately OLF borrowings are to be repaid either from recoveries on the assets of the failed firm or, in the unlikely event of a loss on the collateralized borrowings, from assessments against the eligible financial companies.[1] The law expressly prohibits taxpayer losses from the use of this Title II authority.

The Appointment of the FDIC as the Title II Receiver

[1] The Dodd-Frank Act defines "eligible financial companies" as any bank holding company with total consolidated assets of $50 billion or more and any nonbank financial company supervised by the Board of Governors of the Federal Reserve as a result of its designation by the Financial Stability Oversight Council.

If a SIFI encounters severe financial distress, bankruptcy is the first option. Under Title I the objective is to have the SIFI produce a credible plan that would demonstrate how resolution under the Bankruptcy Code would not pose a systemic risk to the U.S. economy. A Title II resolution would only occur if a resolution under the Bankruptcy Code could not be implemented without serious adverse effects on financial stability in the United States.

Before a SIFI can be resolved under Title II, two-thirds of the Federal Reserve Board and the Board of Directors of the FDIC must make recommendations to the Secretary of the Treasury (Secretary) that include a determination that the company is in default or in danger of default, what effect a default would have on U.S. financial stability, and what serious adverse effect proceeding under the Bankruptcy Code would have.[2] With the recommendations and plan submitted by the Federal Reserve and the FDIC, the Secretary in consultation with the President would determine, among other things, whether the SIFI was in default or danger of default and that the failure and its resolution under bankruptcy would have a serious adverse effect on U.S. financial stability. If all conditions are met, a twenty-four hour judicial review process is initiated, if applicable.[3] At the end of this period, absent adverse judicial action, the FDIC is appointed receiver, the bridge financial company would be chartered and a new board of directors and chief executive officer appointed.

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[2]The SEC and the Federal Insurance Office are substituted for the FDIC if the company or its largest subsidiary is a broker/dealer or insurance company, respectively; the FDIC is also consulted in the determination process in these cases.

[3] Subsequent to a determination, the Secretary would notify the board of directors of the covered financial company. If the board of directors does not consent to the appointment of the FDIC as receiver, the Secretary shall petition the court for an order authorizing the Secretary to appoint the FDIC as receiver.

Organization and Operation of the Bridge Financial Company

Upon its appointment as receiver of the top-tier U.S. holding company of the covered financial company, the FDIC would adopt articles of association and bylaws and issue a charter for the bridge financial company. From a pre-screened pool of eligible candidates, the FDIC would establish the initial board of directors, including appointment of a chairman of the board. At its initial meeting the board of directors would appoint a chief executive officer of the bridge financial company based upon the nomination of candidates that have been vetted and screened by the FDIC. Other experienced senior management, including a chief financial officer and chief risk officer, also would be promptly named.

In connection with the formation of the bridge financial company, the FDIC would require the company to enter into an initial operating agreement that would require certain actions, including, without limitation: 1) review of risk management policies and practices of the covered financial company to determine the cause(s) of failure and to develop and implement a plan to mitigate risks identified in that review; 2) preparation and delivery to the FDIC of a business plan for the bridge financial company, including asset disposition strategies that would maximize recoveries and avoid fire sales of assets; 3) completion of a review of pre-failure management practices of all key businesses and operations; 4) preparation of a capital, liquidity and funding plan consistent with the terms of any mandatory repayment plan and the capital and liquidity requirements established by the appropriate federal banking agency or other primary financial regulatory agency; 5) retention of accounting and valuation consultants and

professionals acceptable to the FDIC, and completion of audited financial statements and valuation work necessary to execute the securities-for-claims exchange; and 6) preparation of a plan for the restructuring of the bridge financial company, including divestiture of certain assets, businesses or subsidiaries that would lead to the emerging company or companies being resolvable under the Bankruptcy Code without the risk of serious adverse effects on financial stability in the United States. The initial operating agreement would establish time frames for the completion and implementation of the plans described above.

Day-to-day management of the company would continue to be supervised by the officers and directors of the bridge financial company. The FDIC expects that the bridge financial company would retain most of the employees in order to maintain the appropriate skills and expertise to operate the businesses and most employees of subsidiaries and affiliates would be unaffected. As required by the statute, the FDIC would identify and remove management of the covered financial company who were responsible for its failed condition. Additionally, the statute requires that compensation be recouped from any current or former senior executive or director substantially responsible for the failure of the company.

The FDIC would retain control over certain high-level key matters of the bridge financial company's governance, including approval rights for any issuance of stock; amendments or modifications of the articles or bylaws; capital transactions in excess of established thresholds; asset transfers or sales in excess of established thresholds; merger, consolidation or reorganization of the bridge financial company; any changes in directors of the bridge financial company (with the FDIC retaining the right to remove, at its discretion, any or all directors); any

distribution of dividends; any equity-based compensation plans; the designation of the valuation experts; and the termination and replacement of the bridge financial company's independent accounting firm. Additional controls may be imposed by the FDIC as appropriate.

Funding the Bridge Financial Company

It is anticipated that funding the bridge financial company would initially be the top priority for its new management. In raising new funds the bridge would have some substantial advantages over its predecessor. The bridge financial company would have a strong balance sheet with assets significantly greater than liabilities since unsecured debt obligations would be left as claims in the receivership while all assets will be transferred. As a result, the FDIC expects the bridge financial company and its subsidiaries to be in a position to borrow from customary sources in the private markets in order to meet liquidity needs. Such funding would be preferred even if the associated fees and interest expenses would be greater than the costs associated with advances obtained through the OLF.

If the customary sources of funding are not immediately available, the FDIC might provide guarantees or temporary secured advances from the OLF to the bridge financial company soon after its formation. Once the customary sources of funding are reestablished and private market funding can be accessed, OLF monies would be repaid. The FDIC expects that OLF monies would only be used for a brief transitional period, in limited amounts with the specific objective of discontinuing their use as soon as possible.

All advances would be fully secured through the pledge of the assets of the bridge financial company and its subsidiaries. If the assets of the bridge financial company, its subsidiaries, and the receivership are insufficient to repay fully the OLF through the proceeds generated by a sale or refinancing of bridge financial company assets, the receiver would impose risk-based assessments on eligible financial companies to ensure that any obligations issued by the FDIC to the Secretary are repaid without loss to the taxpayer.

The Dodd-Frank Act capped the amount of OLF funds that can be used in a resolution by the maximum obligation limitation. Upon placement into a Title II resolution this amount would equal 10 percent of the total consolidated assets of the covered financial company based on the most recent financial statements available. If any OLF funds are used beyond the initial thirty (30) day period or in excess of the initial maximum obligation limit, the FDIC must prepare a repayment plan.[4] This mandatory repayment plan would provide a schedule for the repayment of all such obligations, with interest, at the rate set by the Secretary. Such rate would be at a premium over the average interest rates on an index of corporate obligations of comparable maturities. After a preliminary valuation of the assets and preparation of the mandatory repayment plan, the maximum obligation limit would change to 90 percent of the fair value of the total consolidated assets available for repayment.

Claims Determination and the Capitalization Process

[4] The FDIC would prepare a mandatory repayment plan after its appointment as receiver of the covered financial company, but in no event later than thirty (30) days after such date. The FDIC would work with the Secretary to finalize the plan and would submit a copy of the plan to Congress. The mandatory repayment plan would describe the anticipated amount of the obligations issued by the FDIC to the Secretary in order to borrow monies from the OLF subject to the maximum obligation limitation as well as the anticipated cost of any guarantees issued by the FDIC.

The FDIC is required by the Dodd-Frank Act to conduct an administrative claims process to determine claims against the covered financial company left in receivership, including the amount and priority of allowed claims. Once a valuation of the bridge financial company's assets and the administrative claims process are completed, creditors' claims would be paid through a securities-for-claims exchange.

Claims Determination

The Dodd-Frank Act established a priority of claims that would apply to all claims left in the receivership. Following the statutory priority of claims, the administrative expenses of the receiver shall be paid first, any amounts owed to the United States next, then certain limited employee salary and benefit claims, other general or senior unsecured creditor claims, subordinated debt holder claims, wage and benefit claims of senior officers and directors, and finally, shareholder claims. Allowable claims against the receivership would be made pro rata to claimants in each class to the extent that assets in the receivership estate are available following payments to all prior senior classes of claims. Liabilities transferred to the bridge financial company as an on-going institution would be paid in the ordinary course of business.

Certain claims of the holding company would be transferred to the bridge financial company to facilitate its operation and to mitigate systemic risk. For instance, obligations of vendors providing essential services would be assumed by the bridge financial company in order to keep day-to-day operations running smoothly. Such an action would be analogous to the

"first-day" orders in bankruptcy where the bankruptcy court approves payment of pre-petition amounts due to certain vendors whose goods or services are critical to the debtor's operations during the bankruptcy process. The transfer would also likely include secured claims of the holding company because the transfer of fully secured liabilities with the related collateral would not diminish the net value of the assets in the receivership and would avoid any systemic risk effects from the immediate liquidation of the collateral. The FDIC expects shareholders' equity, subordinated debt and a substantial portion of the unsecured liabilities of the holding company—with the exception of essential vendors' claims—to remain as claims against the receivership.

In general the FDIC is to treat creditors of the receivership within the same class and priority of claim in a similar manner. The Dodd-Frank Act, however, allows the FDIC a limited ability to treat similarly situated creditors differently. Any transfer of liabilities from the receivership to the bridge financial company that has a disparate impact upon similarly situated creditors would only be made if such a transfer would maximize the return to those creditors left in the receivership and if such action is necessary to initiate and continue operations essential to the bridge financial company.

Although the consent of creditors of the receivership is not required in connection with any disparate treatment, all creditors must receive at least the amount that they would have received if the FDIC had not been appointed as receiver and the company had been liquidated under Chapter 7 of the Bankruptcy Code or other applicable insolvency regime. Further, any transfer of liabilities that involves disparate treatment would require the determination by the Board of Directors of the FDIC that it is necessary and lawful, and the identity of creditors that

have received additional payments and the amount of any additional payments made to them must be reported to Congress. The FDIC expects that disparate treatment of creditors would occur only in very limited circumstances and has, by regulation, expressly limited its discretion to treat similarly situated creditors differently.[5]

Similar to the bankruptcy process, for creditors left in the receivership, the FDIC must establish the claims bar date for the filing of claims; this date must not be earlier than ninety (90) days after the publication of the notice of appointment of the FDIC as receiver. With the exception of certain secured creditors whose process might be expedited, the receiver would have up to one hundred eighty (180) days to determine the status of a claim unless that determination period is extended by mutual agreement.[6] A claimant can seek a de novo judicial determination of its claim in the event of an adverse determination by the FDIC. Such an action must be brought within sixty (60) days of the notice of disallowance.[7] To the extent possible and consistent with the claims process mandated by the Dodd-Frank Act, the FDIC intends to adapt certain claims forms and practices applicable to a Chapter 11 proceeding under the Bankruptcy Code. For example, the proof of claim form would be derived from the standard proof of claim form used in a bankruptcy proceeding. The FDIC also expects to provide information regarding any covered financial company receivership on an FDIC website, and would also establish a call center to handle public inquiries.

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[5] The FDIC has stated that it would not exercise its discretion to treat similarly situated creditors differently in a manner that would result in preferential treatment to holders of long-term senior debt (defined as unsecured debt with a term of longer than one year), subordinated debt, or equity holders. See 12 CFR 380.27.

[6] The FDIC would endeavor to determine the majority of claims (as measured by total dollar amount) within a shorter time frame.

[7] An expedited process is available to certain secured creditors in which the FDIC's determination must be made within ninety (90) days and any action for a judicial determination must be filed within thirty (30) days.

Capitalization

In reorganization under the bankruptcy laws, creditors' claims are sometimes satisfied through the issuance of securities in the new company. Likewise, the SPOE strategy provides for the payment of creditors' claims in the receivership through the issuance of securities in a securities-for-claims exchange. This exchange involves the issuance and distribution of new debt, equity and, possibly, contingent securities—such as warrants or options—in NewCo (or NewCos) that will succeed the bridge financial company to the receiver. The receiver would then exchange the new debt and equity for the creditors' claims. This would provide value to creditors without resorting to a liquidation of assets. The warrants or options would protect creditors in lower priority classes, who have not received value, against the possibility of an undervaluation, thereby ensuring that the value of the failed company is distributed in accordance with the order of priority.

Prior to the exchange of securities for claims, the FDIC would approve the value of the bridge financial company. The valuation would be performed by independent experts, including investment bankers and accountants, selected by the board of directors of the bridge financial company. Selection of the bridge financial company's independent experts would require the approval of the FDIC, and the FDIC would engage its own experts to review the work of these firms and to provide a fairness opinion.

The valuation work would include, among other things, review and testing of models that had been used by the covered financial company before failure as well as establishing values for

all assets and business lines. The valuation would provide a basis for establishing the capital and leverage ratios of the bridge financial company, as well as the amount of losses incurred by both the bridge financial company and the covered financial company in receivership. The valuation would also help to satisfy applicable SEC requirements for the registration or qualified exemption from registration of any securities issued in an exchange, in addition to other applicable reporting and disclosure obligations.

Due to the nature of the types of assets at the bridge financial company and the likelihood of market uncertainty regarding asset values, the valuation process necessarily would yield a range of values for the bridge financial company. The FDIC would work with its consultants and advisors to establish an appropriate valuation within that range. Contingent value rights, such as warrants or options allowing the purchase of equity in NewCo (or NewCos) or other instruments, might be issued to enable claimants in impaired classes to recover value in the event that the approved valuation point underestimates the market value of the company. Such contingent securities would have limited durations and an option price that would provide a fair recovery in the event that the actual value of the company is other than the approved value. When the claims of creditors have been satisfied through this exchange, and upon compliance with all regulatory requirements, including the ability to meet or exceed regulatory capital requirements, the charter of the bridge financial company would terminate and the company would be converted to one or more state-chartered financial companies.[8]

[8] The FDIC retains the discretion in appropriate circumstances to make cash payments to creditors with de minimis claims or for whom payment in the form of securities would present an unreasonable hardship.

The bridge financial company would issue audited financial statements as promptly as possible. The audited financial statements of the bridge financial company would be prepared by a qualified independent public accounting firm in accordance with generally accepted accounting principles and applicable SEC requirements. The FDIC has consulted with the SEC regarding the accounting framework that should be applied in a Title II securities-for-claims exchange, and has determined that the "fresh start model" is the most appropriate accounting treatment to establish the new basis for financial reporting for the emerging company. The fresh start model requires the determination of a fair value measurement of the assets of the company, which represents the price at which each asset would be transferred between market participants at an established date. This is the accounting framework generally applied to companies emerging from bankruptcy under Chapter 11 of the Bankruptcy Code to determine their reorganization value and establish a new basis for financial reporting. The valuation and auditing processes would establish the value of financial instruments, including subordinated or convertible debt and common equity in NewCo (or NewCos) issued to creditors in satisfaction of their claims.

Figure 1 demonstrates the claims and capitalization process. In this hypothetical example, ABC Universal Holdings Inc. is placed into a Title II receivership following a loss on assets and subsequent liquidity run. Upon transfer of ABC's remaining assets and certain liabilities into a bridge financial company a valuation is performed and the estimated losses in ABC are calculated to be $140 billion - $155 billion. The company's assets are then written down and losses apportioned to the claims of the shareholders and debt holders of ABC Universal Holdings Inc., which have been left in the receivership, according to the order of priority. In this example, shareholders and subordinated debt holders lose their entire respective

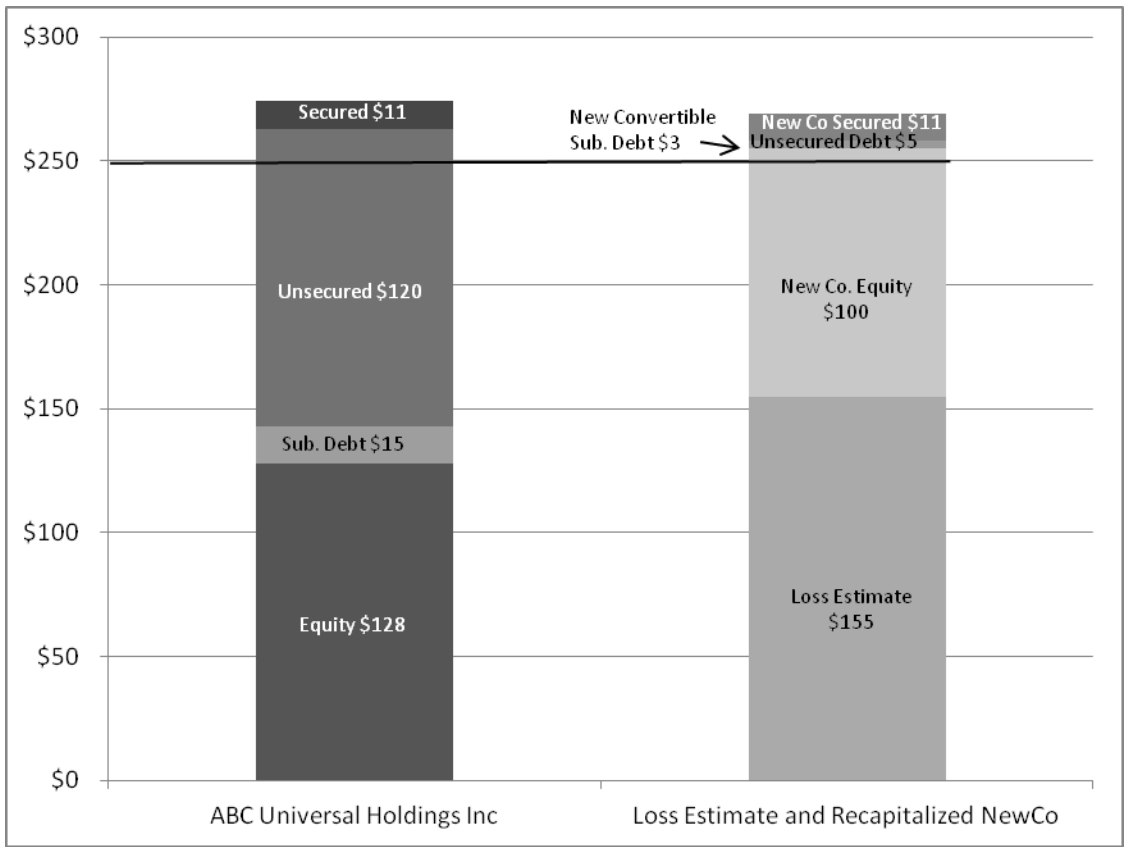
claims of $128 billion and $15 billion. Additionally, unsecured debt holders lose $12 billion of their $120 billion in claims against the receivership.

In order to exit the bridge financial company, NewCo must meet or exceed all regulatory capital requirements. To do this, the unsecured creditors are given $100 billion in equity, $3 billion in subordinated debt, and $5 billion in senior unsecured debt of NewCo. Additionally, call options, warrants, or other contingent claims are issued to compensate the unsecured debt holders for their remaining claims ($12 billion). The former subordinated debt holders and equity holders of ABC Universal Holdings Inc. are also issued call options, warrants or other contingent value rights for their claims, which would not have any value until the unsecured claimants had been paid in full.

Figure 1

Claims Waterfall

($B)



Ownership of securities in NewCo (or NewCos) would be subject to any applicable concentration limits and other restrictions or requirements under U.S. banking and securities laws and other applicable restrictions, including for instance, cross-border change-of-control issues. In addition, the FDIC may determine to pay claims in cash or deposit securities into a trust for prompt liquidation for those portions of certain creditors' claims that would result in the creditors owning more than 4.9 percent of the issued and outstanding common voting securities of NewCo (or NewCos).

Restructuring and the Emergence of NewCo (or NewCos)

The FDIC's goal is to limit the time during which the failed covered financial company is under public control and expects the bridge financial company to be ready to execute its securities-for-claims exchange within six to nine months. Execution of this exchange would result in termination of the bridge financial company's charter and establishment of NewCo (or NewCos).

The termination of the bridge financial company would only occur once it is clear that a plan for restructuring, which can be enforced, has been approved by the FDIC, and that NewCo (or NewCos) would meet or exceed regulatory capital requirements. This would ensure that NewCo (or NewCos) would not pose systemic risk to the financial system and would lead to NewCo (or NewCos) being resolvable under the Bankruptcy Code. This might be accomplished either through reorganizing, restructuring or divesting subsidiaries of the company.

This process would result in the operations and legal entity structure of the company being more closely aligned and the company might become smaller and less complex. In addition, the restructuring might result in the company being divided into several companies or parts of entities being sold to third parties. This process would be facilitated to the extent the former company's Title I process was effective in mitigating obstacles and addressing impediments to resolvability under the Bankruptcy Code.

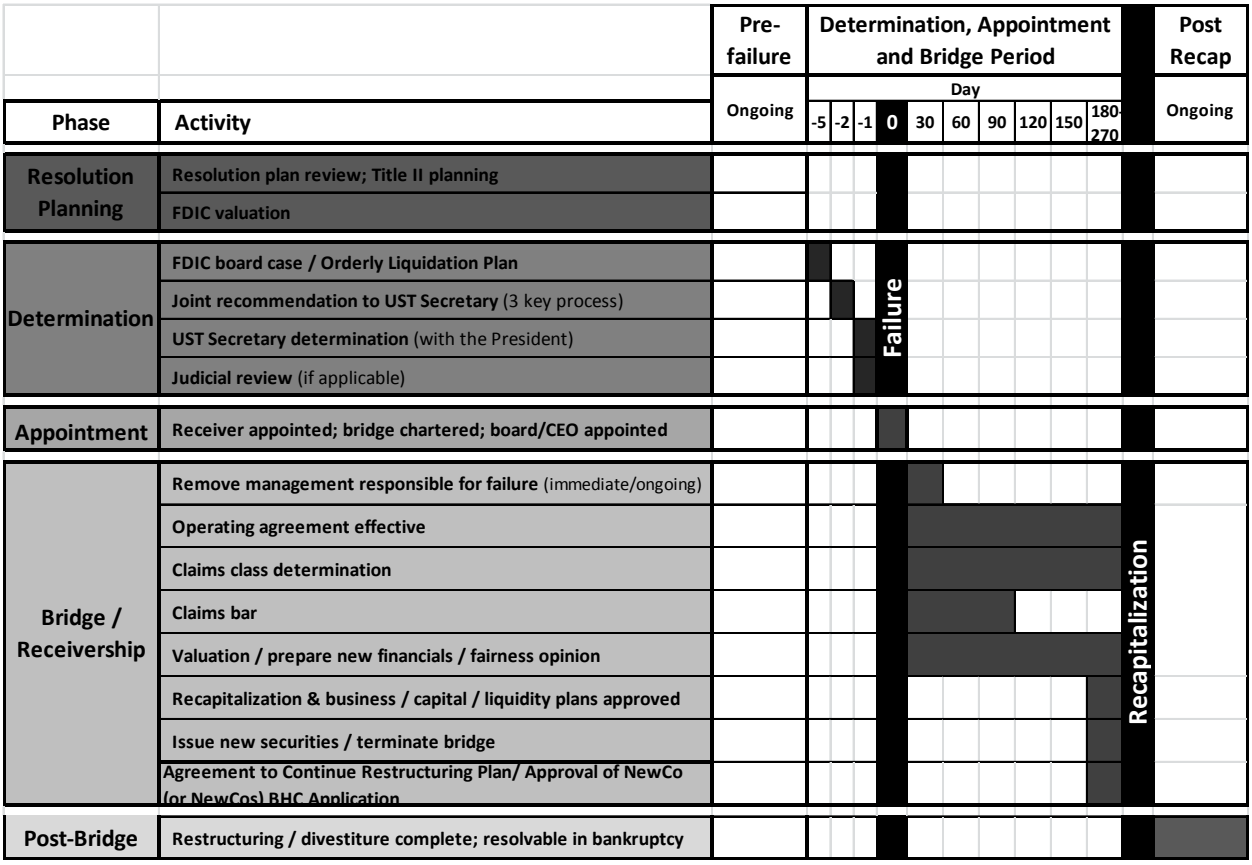
Before terminating the bridge financial company and turning its operations over to the private sector, the FDIC would require the board of directors and management of the bridge financial company—as part of the initial operating agreement—to formulate a plan and a timeframe for restructuring that would make the company resolvable under the Bankruptcy Code. The board of directors and management of the company must stipulate that all of its successors would complete all requirements providing for divestiture, restructuring and reorganization of the company. The bridge financial company would also be required to prepare a new living will that meets all requirements, and that might include detailed project plans, with specified timeframes, to make NewCo (or NewCos) resolvable in bankruptcy.[9] Finally, the board(s) of directors and management(s) of NewCo (or NewCos) would be expected to enter into an agreement (or agreements) with the company's (or companies') primary financial regulatory agency to continue the plan for restructuring developed as part of the initial operating agreement as a condition for approval of its (their) holding company application(s).

Figure 2 demonstrates the FDIC's anticipated time line for the resolution of a SIFI under Title II authorities. As the figure shows, pre-failure resolution planning will be critical, including the information obtained as a result of the review of the Title I plans. The window between imminent failure and placement into a Title II receivership would be very short and the FDIC anticipates having the bridge financial company ready to be terminated 180-270 days following its chartering, subject to the conditions described above.

[9] While NewCo (or NewCos) would no longer be systemic, it is still likely to fall under the requirement to file a Title I plan due to having assets greater than $50 billion.

Figure 2

Timeline of a Title II Resolution



Reporting

The FDIC recognizes the importance of providing transparent reporting to the public, financial markets, Congress, and the international community. The FDIC intends to execute its resolution strategy in a manner consistent with these objectives.

The FDIC would provide the best available information regarding the financial condition of the bridge financial company to creditors of the covered financial company. The bridge

financial company would comply with all disclosure and reporting requirements under applicable securities laws, provided that if all standards cannot be met because audited financial statements are not available with respect to the bridge financial company, the FDIC would work with the SEC to set appropriate disclosure standards. The receiver of the covered financial company would also make appropriate disclosures. The FDIC and bridge financial company would provide reports and disclosures containing meaningful and useful information to stakeholders in compliance with applicable standards.

The FDIC anticipates that the bridge financial company would retain the covered financial company's existing financial reporting systems, policies and procedures, unless the FDIC or other regulators of the covered financial company have identified material weaknesses in such systems, policies or procedures. The bridge financial company and its operating companies would be required to satisfy applicable regulatory reporting requirements, including the preparation of consolidated reports of condition and income (call reports). The new board of directors would retain direct oversight over the financial reporting functions of the bridge financial company and would be responsible for engaging an independent accounting firm and overseeing the completion of audited consolidated financial statements of the bridge financial company as promptly as possible.

The FDIC would fully comply with the Dodd-Frank Act requirement that the FDIC, not later than sixty (60) days after its appointment as receiver for a covered financial company, file a report with the Senate and House banking committees. The FDIC's report must provide information on the financial condition of the covered financial company; describe the FDIC's

plan for resolving the covered financial company and its actions taken to date; give reasons for using proceeds from the OLF for the receivership; project the costs of the orderly liquidation of the covered financial company; explain which claimants in the receivership have been treated differently from other similarly situated claimants and the amount of any additional payments; and explain any waivers of conflict of interest rules with regard to the FDIC's hiring of private sector persons who are providing services to the receivership of the covered financial company.

The FDIC anticipates making a public version of its Congressional report available on its website and providing necessary updates on at least a quarterly basis. In addition, if requested by Congress, the FDIC and the primary financial regulatory agency of the covered financial company will testify before Congress no later than thirty (30) days after the FDIC files its first report. The FDIC also anticipates that the bridge financial company or NewCo (or NewCos) would provide additional information to the public in connection with any issuance of securities, as previously discussed.

Request for Comment

To implement its authority under Title II, the FDIC is developing the SPOE strategy. In developing and refining this strategy to this point, the FDIC has engaged with numerous stakeholders and other interested parties to describe its plans for the use of the SPOE strategy and to seek reaction. During the course of this process, a number of issues have been identified that speak to the question of how a Title II resolution strategy can be most effective in achieving the dual objectives of promoting market discipline and maintaining financial stability. The FDIC seeks public comments on these and other issues.

Disparate Treatment

The issue of disparate treatment has been raised regarding the lack of a creditors' committee under a Title II resolution and the fact that creditor approval is not necessary for the FDIC to apply disparate treatment. The FDIC, however, has by regulation, expressly limited its discretion to treat similarly situated creditors differently and the application of such treatment would require the determination by the Board of Directors of the FDIC that it is necessary and lawful.[10] Further, under the Dodd-Frank Act, each creditor affected by such treatment must receive at least the amount that he/she would have received if the FDIC had not been appointed as receiver and the company had been liquidated under Chapter 7 of the Bankruptcy Code or

[10] The FDIC has stated that it would not exercise its discretion to treat similarly situated creditors differently in a manner that would result in preferential treatment to holders of long-term senior debt (defined as unsecured debt with a term of longer than one year), subordinated debt, or equity holders.

other applicable insolvency regime. The identity of creditors that have received additional payments and the amount of any additional payments made to them must be reported to Congress.

The FDIC expects that disparate treatment of creditors would occur only in very limited circumstances. It is permissible under the statute only if such an action is necessary to continue operations essential to the receivership or the bridge financial company, or to maximize recoveries. For example, such treatment could be used to provide payment for amounts due to certain vendors whose goods or services are critical to the operations of the bridge financial company and in this sense would be analogous to the "first-day" orders in bankruptcy where the bankruptcy court approves payment of pre-petition amounts due to certain vendors whose goods or services are critical to the debtor's operations during the bankruptcy process. To the extent that operational contracts and other critical agreements are obligations of subsidiaries of the bridge financial company, they would not be affected by the appointment of the FDIC as receiver of the holding company under the SPOE strategy. The FDIC is interested in commenters' views on whether there should be further limits or other ways to assure creditors of our prospective use of disparate treatment.

Use of the OLF

Another issue is that the existence of the OLF and the FDIC's ability to access it in a resolution might be considered equivalent to a public "bail-out" of the company. There are a number of points to be made in this regard.

From the outset, the bridge financial company would be created by transferring sufficient assets from the receivership to ensure that it is well-capitalized. The well-capitalized bridge financial company should be able to fund its ordinary operations through customary private market sources. The FDIC's explicit objective is to ensure that the bridge financial company can secure private-sector funding as soon as possible after it is established and, if possible, avoid any use of the OLF.

It might be necessary, however, in the initial days following the creation of the bridge financial company for the FDIC to use the OLF to provide limited funding or to guarantee borrowings to the bridge financial company in order to ensure a smooth transition for its establishment. The FDIC expects that OLF guarantees or funding would be used only for a brief transitional period, in limited amounts with the specific objective of discontinuing its use as soon as possible.

OLF resources can only be used for liquidity purposes, and may not be used to provide capital support to the bridge company. OLF borrowings would be fully secured through the pledge of assets of the bridge financial company and its subsidiaries. The OLF is to be repaid ahead of other general creditors of the Title II receivership making it likely that it would be repaid out of the sale or refinancing of the receivership's assets. In the unlikely event that these sources are insufficient to repay the borrowings, the receiver has the authority to impose risk-based assessments on eligible financial companies—bank holding companies with $50 billion or more in total assets and nonbank financial companies designated by the Financial Stability

Oversight Council—to repay the Treasury. Section 214(c) of the Dodd-Frank Act requires that taxpayers shall bear no losses from the exercise of any authority under Title II.

The FDIC is interested in commenters' views on the FDIC's efforts to address the liquidity needs of the bridge financial company.

Funding Advantage of SIFIs

SIFIs have a widely perceived funding advantage over their smaller competitors. This perception arises from a market expectation that a SIFI would receive public support in the event of financial difficulties. This expectation causes unsecured creditors to view their investments at a SIFI as safer than at a smaller financial institution, which is not perceived as benefitting from an expectation of public support. One goal of the SPOE strategy is to undercut this advantage by allowing for the orderly liquidation of the top-tier U.S. holding company of a SIFI with losses imposed on that company's shareholders and unsecured creditors. Such action should result in removal of market expectations of public support.

The successful use of the SPOE strategy would allow the subsidiaries of the holding company to remain open and operating. As noted, losses would first be imposed on the holding company's shareholders and unsecured creditors, not on the unsecured creditors of subsidiaries. This is consistent with the longstanding source of strength doctrine which holds the parent company accountable for losses at operating subsidiaries.

This outcome raises issues about whether creditors, including uninsured depositors, of subsidiaries of SIFIs would be inappropriately protected from loss even though this protection comes from the resources of the parent company and not from public support. Creditors and shareholders must bear the losses of the financial company in accordance with statutory priorities, and if there are circumstances under which the losses cannot be fully absorbed by the holding company's shareholders and creditors, then the subsidiaries with the greatest losses would have to be placed into receivership, exposing those subsidiary's creditors,

potentially including uninsured depositors, to loss. An operating subsidiary that is insolvent and cannot be recapitalized might be closed as a separate receivership. Creditors, including uninsured depositors, of operating subsidiaries therefore, should not expect with certainty that they would be protected from loss in the event of financial difficulties.

The FDIC is interested in commenters' views on the perceived funding advantage of SIFIs and the effect of this perception on non-SIFIs. Specifically, does the potential to use the OLF in a Title II resolution create a funding advantage for a SIFI and its operating companies? Would any potential funding advantage contribute to consolidation among the banking industry that otherwise would not occur? Additionally, are there other measures and methods that could be used to address any perceived funding advantage?

Capital and Debt Levels at the Holding Company

The SPOE strategy is intended to minimize market disruption by isolating the failure and associated losses in a SIFI to the top-tier holding company while maintaining operations at the subsidiary level. In this manner, the resolution would be confined to one legal entity, the holding company, and would not trigger the need for resolution or bankruptcy across the operating subsidiaries, multiple business lines, or various sovereign jurisdictions. For this resolution strategy to be successful, it is critical that the top-tier holding company maintain a sufficient amount of equity and unsecured debt that would be available to recapitalize (and insulate) the operating subsidiaries and allow termination of the bridge financial company and establishment of NewCo (or NewCos). In a resolution, the holding company's equity and debt would be used

to absorb losses, recapitalize the operating subsidiaries, and allow establishment of NewCo (or NewCos).

The discussion of the appropriate amount of equity and unsecured debt at the holding company that would be needed to successfully implement a SPOE resolution has begun. Regulators are considering minimum unsecured debt requirements in conjunction with minimum capital requirements for SIFIs. In addition, consideration of the appropriate pre-positioning of the proceeds from the holding company's debt issuance is a critical issue for the successful implementation of the SPOE strategy.

The FDIC is interested in commenters' views on the amount of equity and unsecured debt that would be needed to effectuate a SPOE resolution and establish a NewCo (or NewCos). Additionally, the FDIC seeks comment on what types of debt and what maturity structure would be optimal to effectuate a SPOE resolution. The FDIC notes that there is a long-standing debate over the efficacy of using risk-based capital when determining appropriate and safe capital levels. The FDIC is interested in commenters' views whether the leverage ratio would provide a more meaningful measure of capital during a financial crisis where historical models have proven to be less accurate.

Treatment of Foreign Operations of the Bridge Financial Company

Differences in laws and practices across sovereign jurisdictions complicate the resolvability of a SIFI. These cross-border differences include settlement practices involving derivative instruments, credit swaps, and payment clearing-and-processing activities. In the critical moment of a financial crisis, foreign authorities might ring-fence a SIFI's operations in their jurisdictions to protect their interests, which could impair the effectiveness of the SPOE strategy. A key challenge for a successful resolution of a SIFI under the SPOE strategy, therefore, will be to avoid or minimize any potential negative effects of ring fencing of the SIFI's foreign operations by foreign supervisors in those jurisdictions.

SIFIs operate in foreign jurisdictions primarily through two forms of organization—subsidiaries or branches of the IDI. Foreign subsidiaries are independent entities, separately chartered or licensed in their respective countries, with their own capital base and funding sources. As long as foreign subsidiaries can demonstrate that they are well-capitalized and self-sustaining, the FDIC would expect them to remain open and operating and able to fund their operations from customary sources of credit through normal borrowing facilities. As to the issue of foreign branches, their operations are included in the U.S. IDI's balance sheet, and there would be no reason to expect the operations of the foreign branches to change since the parent IDI remains open and well-capitalized under the SPOE strategy. The FDIC is working with foreign regulators to ensure that a SIFI's operating subsidiaries and foreign branches of the IDI would remain open and operating while a resolution of the parent holding company proceeds.

A multiple point of entry (MPOE) resolution strategy has been suggested as an alternative to the SPOE resolution strategy. To minimize possible disruption to the company and the financial system as a whole, an MPOE resolution involving the cross-border operations of a SIFI would require having those operations housed within subsidiaries that would be sufficiently independent so as to allow for their individual resolution without resulting in knock-on effects. Independent subsidiaries could also arguably facilitate a SPOE strategy by having well-capitalized subsidiaries with strong liquidity that would continue operating while the parent holding company was placed in resolution.

A subsidiarization requirement could resolve some problems associated with the need for international coordination. However, it is not clear that such a requirement would resolve all of the issues associated with resolving a SIFI with foreign operations, such as those of interconnectedness or of needing the cooperation of foreign authorities to maintain certain services or operations.

The FDIC would welcome comments on whether a subsidiarization requirement would facilitate the resolution of a SIFI under the MPOE or SPOE strategies, or under the Bankruptcy Code. The FDIC would also welcome comments that address the potential advantages and disadvantages for resolvability of a SIFI of a requirement that SIFIs conduct their foreign operations through subsidiaries and whether a subsidiarization requirement for foreign operations would reduce the likelihood of ring fencing and improve the resolvability of a SIFI. Additionally, would a subsidiarization requirement work to limit the spread of contagion across

jurisdictions in a financial crisis, and what are the potential costs (financial and operational) of requiring subsidiarization?

The FDIC would also welcome comments on the impact a branch structure might have on a banking organization's ability to withstand adverse economic conditions that do not threaten the viability of the group, for example, by enabling the organization to transfer funds from healthy affiliates to others that suffer losses in a manner that is consistent with 23A and 23B of the Federal Reserve Act.[11] In addition, the FDIC requests comments on the extent to which a branch model might provide flexibility to manage liquidity and credit risks globally and whether funding costs for these institutions might be lower under the branch structure.

Cross-Border Cooperation

Cross-border cooperation and coordination with foreign regulatory authorities are a priority for the successful execution of the SPOE strategy. The FDIC continues to work with our foreign counterparts and has made significant progress in the last three years. The FDIC has had extensive engagement with authorities in the United Kingdom and has issued a joint paper with the Bank of England describing our common strategic approach to systemic resolution. Working relationships have also been developed with authorities in other countries, including Switzerland, Germany and Japan. The FDIC has established a joint working group on resolution and deposit

[11]Sections 23A and 23B restrict the ability of an insured depository institution to fund an affiliate through direct investment, loans, or other covered transactions that might expose the insured depository institution to risk.

insurance issues with the European Commission and continues to work with the Financial Stability Board and its Resolution Steering Group.

An important example of cross-border coordination on resolution issues is a joint letter the FDIC, the Bank of England, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the Swiss Financial Market Supervisory Authority (FINMA) sent to the International Swaps and Derivatives Association (ISDA) on November 5, 2013. The letter calls for standardizing ISDA documentation to provide for a short-term suspension of early termination rights and other remedies with respect to derivatives transactions following the commencement of insolvency or resolution proceedings or exercise of a resolution power with respect to a counterparty or its specified entity, guarantor, or credit support facility.

The FDIC welcomes comment on the most important additional steps that can be taken with foreign regulatory authorities to achieve a successful resolution using the SPOE strategy.

Additional Questions

In addition to the issues highlighted above, comments are solicited on the following:

Securities-for-Claims Exchange. This Notice describes how NewCo (or NewCos) would be capitalized by converting the debt of the top-tier holding company into NewCo (or NewCos) equity. Are there particular creditors or groups of creditors for whom the securities-

for-claims exchange strategy would present a particular difficulty or be unreasonably burdensome?

Valuation. This Notice describes how the assets of the bridge financial company would be valued and how uncertainty regarding such valuation could be addressed. Would the issuance to creditors of contingent value securities, such as warrants, be an effective tool to accommodate inevitable uncertainties in valuation? What characteristics—such as, term or option pricing, among others—would be useful in structuring such securities, and what is an appropriate methodology to determine these characteristics?

Information. This Notice recognizes the importance of financial reporting to the resolution process. What information, reports or disclosures by the bridge financial company are most important to claimants, the public, or other stakeholders? What additional information or explanation about the administrative claims process would be useful in addition to the information already provided by regulation or this Notice?

Effectiveness of the SPOE Strategy. This Notice describes factors that would form the basis of the initial determination as to whether the SPOE strategy would be effective for a particular covered financial company. Are there additional factors that should be considered? Is there an alternative to the SPOE strategy that would, in general, provide better results considering the goals of mitigating systemic risk to the financial system and ensuring that taxpayers would not be called upon to bail out the company?

Dated at Washington, D.C., this 10th day of December, 2013.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

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