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Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates

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# Dodd-Frank, FDIC and FSA Rules Require Financial Companies to Develop Global Insolvency Contingency Plans

On September 13, 2011, the Federal Deposit Insurance Corporation (FDIC) approved a rule that requires large bank holding companies and other systemically important financial companies to develop comprehensive contingency plans for the orderly resolution of their affairs under the United States Bankruptcy Code or other applicable insolvency regime (Dodd-Frank Rule).[1] The Dodd-Frank Rule has been forwarded to the Federal Reserve Board (Board) for its review and approval. It is anticipated that the Board likely will approve the rule in the near term, at which time the rule will become law, subject to such change as the Board and FDIC may agree.

This memorandum provides an overview of the Dodd-Frank Rule. It also provides an overview of a separate, "interim final" rule concurrently issued by the FDIC (FDIC Rule) that requires significant insured depository institutions to develop and submit separate plans for resolving their affairs under the bank receivership provisions of the Federal Deposit Insurance Act (FDIA).[2] The commentary to the Dodd-Frank Rule and the FDIC Rule states that they are to operate in tandem. Indeed, many financial enterprises will need to comply with both rules.

Finally, this memorandum provides an overview of similar rules being considered by the United Kingdom Financial Services Authority (FSA) and a summary of the progress of other countries toward similar requirements. While many countries are developing contingency planning rules for financial institutions, the United States and the United Kingdom appear to be farther along than most other nations in doing so. Many financial institutions have global operations and will need to comply with applicable laws in all countries in which they operate. Indeed, both the United States and the United Kingdom rules specifically require companies subject to their jurisdictions to discuss, as part of their resolution plans, how such plans fit into such companies' worldwide contingency plans and the potential ramifications of other countries' differing insolvency regimes.

## 1. Implications of the Rules

These rules require nothing less than the same sort of comprehensive, bottoms-up analysis undertaken by restructuring professionals in assisting troubled enterprises in exploring their strategic options and in preparing for the possibility of commencing formal insolvency proceedings. This process, referred to by restructuring professionals as "contingency planning," requires extensive diligence and planning among company personnel, restructuring financial advisors and restructuring counsel — a process that can take months. Indeed, this process requires the deep involvement of senior management and the company's board of directors, a fact that is recognized by the rules' requirements that any resolution plans developed be approved by a covered company's board.

1 *See Resolution Plans Required*, 12 CFR Part 381 (September 9, 2011).

2 *See Resolution Plans Required for Insured Depository Institutions with $50 billion or More in Total Assets*, 12 CFR Part 360 (September 9, 2011).

*If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.*


**Jay M. Goffman**
New York
212.735.2120
jay.goffman@skadden.com

**Chris Mallon**
London
44.20.7519.7236
chris.mallon@skadden.com

**Mark A. McDermott**
New York
212.735.2290
mark.mcdermott@skadden.com

**William J. Sweet, Jr.**
Washington, D.C.
202.371.7030
william.sweet@skadden.com

**David M. Turetsky**
New York
212.735.2569
david.turetsky@skadden.com


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Four Times Square, New York, NY 10036
Telephone: 212.735.3000

WWW.SKADDEN.COM

As described below, the process of developing resolution plans that are satisfactory to regulators clearly will be iterative and, hopefully, will evolve over time to a point at which industry participants and regulators agree upon a generally accepted approach and form. There may be significant challenges, however. Developing a resolution plan for a large and complex financial institution itself promises to be a challenging and time-consuming process. Moreover, there are some requirements with which compliance may be especially difficult. For example, the Dodd-Frank Rule and the FDIC Rule require an analysis of a covered company's anticipated funding, liquidity and capital resources during times of financial duress; its strategy for maintaining such funding, liquidity and capital resources; and how core business lines and critical operations can be resolved and transferred to potential acquirers.

Experienced restructuring professionals understand that contingency plans of the kind contemplated by these rules always must be subject to change, and that they oftentimes must be changed frequently and rapidly in the face of very fluid circumstances. This was especially so when the financial crisis reached its zenith during the fall of 2008 in the wake of Lehman Brothers' bankruptcy filing. Moreover, contingency plans during an actual economic crisis are never developed in a vacuum. They require the input of major creditors, other stakeholders and government agencies based upon existing facts and circumstances. Plans regarding the funding and disposition of assets are difficult to develop without some sense of the extent to which capital markets can or will support funding, the terms on which such funding will be supported (if at all), and whether there are potential acquirers with the wherewithal, at a time of great market uncertainty, to actually propose and consummate an acquisition.

It is, therefore, clear that developing contingency resolution plans will require serious work by covered companies and their boards, management and professionals. Indeed, the potentially disastrous consequences of a major financial crisis can be mitigated only through thoughtful, advance planning. Perhaps most significantly, analyses of this sort can assist companies during the good times as well, as they foster a serious assessment of corporate governance and risk mitigation strategies that can benefit the entire enterprise and all its stakeholders.

## 2. Overview of Dodd-Frank and the FSMA 2000 Contingency Planning Requirements

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Act) provides for enhanced supervision of, and prudential standards for, large, systemically important financial companies. The purpose of the Act is "to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure … of large, interconnected financial companies."[3] As part of this supervisory oversight, Section 165(d) of the Act states that bank holding companies with total consolidated assets equal to or greater than $50 billion, plus other, systemically significant, nonbank financial companies supervised by the Board (and to be identified by the Financial Stability Oversight Council (FSOC)), periodically must report to the Board and the FDIC "the plan of such company for rapid and orderly resolution in the event of material financial distress or failure."[4] In particular, the resolution plan must "facilitate an orderly resolution of the company" under the United States Bankruptcy Code.[5] Section 165(d) of the Act directs the Board and the FDIC to jointly issue rules implementing this so-called "living will" provision by January 21, 2012.

In the U.K., one of the reforms contained in the Financial Services Act 2010 was an amendment to the Financial Services and Markets Act 2000 (FSMA 2000) requiring the FSA to implement rules

3 Act § 165(a)(1).

4 Act § 165(d)(1).

5 Act § 165(d)(4).

requiring entities authorized under the FSMA 2000 to "prepare, and keep up-to-date, a recovery plan."[6] Authorization under the FSMA 2000 is required for any company offering banking or investment services. Through late 2010 and early 2011, the FSA conducted a pilot program with the assistance of a number of large U.K. banks during which the participant banks worked with the FSA to establish an appropriate and effective approach to contingency planning. The FSA now has publicized its proposed contingency planning requirements in its consultation paper released on August 9, 2010. The FSA states in the consultation paper that it proposes to implement the rules in the first quarter of 2012 and to permit institutions covered by the requirements to produce contingency plans and other materials by June 2012.[7] Public comment on the proposals in the consultation paper closes on November 9, 2011.

While the U.S. and the U.K. are leading the way in implementing rules requiring resolution plans, current reform proposals within the European Union and also amongst the G20 countries contain similar requirements. Ultimately, financial institutions likely will be required to produce resolution plans in respect of their operations in every jurisdiction in which they maintain a presence.

## 3. Overview of the Dodd-Frank Rule

The Dodd-Frank Rule requires "covered financial companies" (defined below) to undertake comprehensive strategic analyses of their operations and to prepare and submit to the Board and the FDIC detailed contingency plans for reorganizing or liquidating their affairs under the Bankruptcy Code or other applicable insolvency regimes. The Dodd-Frank Rule's purpose is to afford companies and regulatory authorities with the information, advance preparation and planning necessary to respond quickly and efficiently in the event of a crisis. It is estimated that 124 institutions will need to comply with the Dodd-Frank Rule, 98 of which are foreign-based companies.

The Dodd-Frank Rule dovetails with other aspects of the Act. In particular, Title II of the Act, titled "Orderly Liquidation Authority," establishes a comprehensive regime for resolving insolvent financial companies.[8] This regime is an alternative to the Bankruptcy Code and existing laws governing the insolvencies of broker-dealers. Pursuant to Title II, the FDIC may be appointed receiver of a failed financial company, charged with the duty of liquidating the company in a manner designed to mitigate disruptions to the economy as a whole due to the collapse of a systemically important financial enterprise.

In determining whether to place a financial company into receivership under Title II, regulators are required to assess whether the Bankruptcy Code provides an appropriate alternative for resolving the company's affairs. The information provided by a company's resolution plan pursuant to the Dodd-Frank Rule, which must be updated at least annually, clearly will be critical to this assessment.

### a. Scope of the Dodd-Frank Rule/Timelines

The Dodd-Frank Rule applies to "covered companies," which is defined to include (i) any U.S. bank holding company that has $50 billion or more in consolidated assets, (ii) any foreign bank or company that is a bank holding company, or that is treated as a bank holding company, with $50 billion or more in total consolidated assets, and (iii) any nonbank financial company supervised by the Board (such entities will be identified by the FSOC this fall).

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6 Section 139B of the FSMA 2000.

7 FSA Consultation Paper, [1.22].

8 For an in-depth discussion, see *Skadden Commentary on the Dodd-Frank Act*, "Orderly Liquidation Authority," July 9, 2010.

Implementing Section 165(d) of the Act, the Dodd-Frank Rule requires that each covered company periodically submit to the Board and the FDIC a plan for the "rapid and orderly resolution of the covered company in the event of material financial distress at or failure of the covered company." The phrase "rapid and orderly resolution" means a "reorganization or liquidation of the covered company … under the Bankruptcy Code that can be accomplished within a reasonable period of time and in a manner that substantially mitigates the risk that the failure of the covered company would have serious adverse effects on financial stability in the United States."

The commentary to the Dodd-Frank Rule states that if a covered company is subject to an insolvency regime other than the Bankruptcy Code, then the resolution plan for such entity should be in reference to such other insolvency regime. In this regard, insured depository institutions cannot file bankruptcy under the Bankruptcy Code. Rather, they are subject to the insolvency regime contained in the FDIA pursuant to which the FDIC is appointed receiver for insolvent banks. Insurance companies also cannot file bankruptcy under the Bankruptcy Code. They are instead subject to state insurance insolvency and rehabilitation statutes. The U.S. branches of foreign banks are subject to separate insolvency regimes under state or federal banking law, depending on whether they are chartered by state or federal banking regulators. Finally, regulated broker-dealers may liquidate under the Bankruptcy Code or pursuant to the liquidation regime established by the Securities Investor Protection Act (SIPA).

The Dodd-Frank Rule provides a staggered schedule by which each covered company must submit its first resolution plan to the Board and the FDIC:

- July 1, 2012: covered companies with total nonbank assets of $250 billion or more (or, in the case of foreign-based covered companies, $250 billion or more in total U.S. nonbank assets[9]);
- July 1, 2013: covered companies with total nonbank assets between $100 billion and $250 billion (or, in the case of foreign-based covered companies, between $100 billion and $250 billion in total U.S. nonbank assets); and
- December 31, 2013: covered companies with total nonbank assets of less than $100 billion (or, in the case of foreign-based covered companies, less than $100 billion in total U.S. nonbank assets).

Thereafter, each covered company must submit a resolution plan annually on or before the anniversary of its initial resolution plan submission date. If a covered company experiences a material change requiring modification of its initial plan, it must submit a notice of this event within 45 days of the event that summarizes the resulting changes that are required in the plan. The covered company's next annual resolution plan must be revised to take account of such event.[10] The Board and the FDIC may require more frequent reporting and extend time periods for submitting reports or notices following a material event.

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9 Neither the Act nor the Dodd-Frank Rule define "nonbank assets," and commentary to the Dodd-Frank Rule does not provide guidance as to what may ultimately be considered a nonbank asset. Some insight may be available from the usage of the term by the FDIC or the Board in similar contexts. For example, in collecting certain information from depository institutions, the Board defines "nonbank assets" to include assets of all foreign and domestic nonbank subsidiaries and their majority-owned direct and indirect subsidiaries. In turn, "nonbank subsidiaries" excludes "all banks (including commercial, savings and industrial banks that file the commercial bank Reports of Condition and Income) and their subsidiaries; Edge and Agreement corporations and their subsidiaries that are held through a bank subsidiary." *See Micro Data Reference Manual (US Federal Reserve Board)*, Data Dictionary, Item Number 4778.

10 The commentary to the Dodd-Frank Rule clarifies that a covered company need only give notice of a material change when an event results in, or could reasonably be foreseen to have, a material effect on the resolution plan of the covered company, such as to render the resolution plan ineffective, in whole or in part, until revisions are made to the plan.

### b. Contents of Resolution Plans

(i) *Strategic Analysis*

The most important aspect of a resolution plan is the "strategic analysis." The strategic analysis must include "detailed descriptions" of the "[r]ange of specific actions to be taken by the covered company" if it finds itself in distress; a covered company's "strategy in the event of a failure or discontinuation of a material entity, core business line or critical operation, and the actions that will be taken by the covered company to prevent or mitigate any adverse effects of such failure or discontinuation on the financial stability of the United States"; and the "time period(s)" necessary to "successfully execute each material aspect and step" of the plan.

For purposes of the foregoing, the Dodd-Frank Rule defines "core business line" as one that, in the view of the covered company, "upon failure would result in a material loss of revenue, profit or franchise value." The phrase "critical operations" means those operations, the "failure or discontinuance of which, in the view of the covered company or as jointly directed by the Board and the [FDIC], would pose a threat to the financial stability of the United States."

Covered U.S. companies must provide information relating to subsidiaries and operations domiciled in the U.S., "as well as [their] foreign subsidiaries, offices and operations." Foreign-based covered companies must provide information relating to their U.S. operations; describe the interconnections and interdependencies among their core and critical U.S. operations and foreign affiliates; and explain how their resolution plans for their U.S. operations are "integrated into [their] overall resolution or other contingency planning process." Accordingly, both U.S. and foreign covered company resolution plans must analyze the potential ramifications of differing insolvency regimes among the various jurisdictions in which they operate.

A covered company may exclude from that portion of its plan the strategic analysis that relates to its contingency plans for addressing the failure or discontinuation of a material entity, but only if the entity is subject to an insolvency regime other than the Bankruptcy Code, has less than $50 billion in assets, and does not conduct any critical operations. However, if the material entity is subject to an insolvency regime other than the Bankruptcy Code and has $50 billion or more in total assets or conducts a critical operation, then the resolution plan must describe the actions and strategy to be taken under such other insolvency regime.

The strategic analysis will require the combined assistance of professionals having bank regulatory and restructuring expertise. Restructuring advisors in particular provide strategic advice as a matter of course to companies seeking to restructure their affairs, with possible strategies in the financial sector including, among others, "holdco" Chapter 11 reorganization plans implemented through a "prepackaged," "prearranged," or "traditional" Chapter 11 case; sales of bank stock or other assets in one or more "363 sales" under the Bankruptcy Code; and dispositions of broker-dealers under the Securities Investor Protection Act. In each case, close coordination with regulators will be required. Skadden has employed each of these strategies on behalf of financial companies, in close coordination with and the support of regulators, including with respect to CIT in the largest ever prepackaged Chapter 11 case of a bank holding company; with respect to Refco in the largest ever bankruptcy of a global, regulated, commodities broker; with respect to a consortium who acquired the stock of American West in the first ever 363 sale of bank stock; and with respect a consortium of 14 Wall Street banks, the $3.6 billion bail-out of Long Term Capital Management.

(ii) *Other Information Requirements*

In addition to the strategic analysis, a resolution plan also must include a wealth of other information about a covered company, including a "detailed description" of "all material entities;" a "mapping of the covered company's critical operations and core business lines, including material asset holdings and liabilities to such critical operations and core business lines, to material entities"; a description of the "material components" of the covered company that separately identifies the types and amounts of its liabilities; a description of any material off-balance sheet exposures; and a description of the covered company's and its material subsidiaries' practices related to the booking of trading and derivatives activities.

The resolution plan also must contain a description of all of the covered company's and its material entities' material hedges related to trading and derivatives activities; a description of the covered company's major counterparties and "the interconnections, interdependencies and relationships with such major counterparties," as well as an analysis of "whether the failure of each major counterparty would likely have an adverse impact on or result in the material financial distress or failure of the covered company."

In preparing its resolution plan, a covered company is prohibited from assuming as part of its plan that the U.S. or any other government will provide "extraordinary support" to the company or its subsidiaries to prevent its failure. Moreover, the plan must take into account the possibility that its financial distress or failure may occur under "baseline, adverse and severely adverse economic conditions," which are the conditions/scenarios provided to the covered company by the Board in conjunction with the conduct of annual stress tests.[11] A covered company may submit its initial plan assuming the baseline condition only or, if a baseline scenario is not then available, a reasonable substitute developed by the covered company.[12]

The commentary accompanying the Dodd-Frank Rule clarifies that the Board and the FDIC expect that resolution planning will be an evolving and iterative process over time, involving an "ongoing dialogue with firms." The Board and FDIC expect that no initial plans will be found deficient. Rather, the initial plans will serve as foundations for more robust annual plans submitted in following years. Plans will vary by company, and the evaluation of plans by the Board and FDIC will take into account variances in companies' complexity. Accordingly, plans of more complex companies will be more complex and require information that may not be relevant for smaller, less complex companies.

In this regard, and in response to extensive public comment on the proposed rule, especially by foreign institutions, the Dodd-Frank Rule allows smaller, less complex U.S. and foreign covered companies to prepare "tailored" resolution plans that require less information, and that focus only on a company's nonbanking business. In particular, a covered company may prepare a tailored plan if (a) it has less than $100 billion in total nonbank assets (or, in the case of a foreign covered company, less than $100 billion in U.S. nonbank assets) and (b) the total insured depository institution assets of which comprise 85 percent or more of the company's total consolidated assets (or, in the case of a foreign covered company, the assets of the U.S. insured depository institution operations, branches and agencies comprise 85 percent or more of such company's U.S. total consolidated assets).

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11 12 U.S.C. § 5365(i)(1)(B). Details regarding the baseline, adverse, and severely adverse conditions are not yet available.

12 Subsequent plans should assume that the failure of the covered company will occur under the same economic conditions consistent with the Board's rule implementing annual "stress tests."

A tailored plan's executive summary, strategic analysis, overview of the covered company's organizational and corporate governance structures, and descriptions of its management information systems need only relate to the covered company itself and its material, nonbanking entities. Moreover, a tailored plan must identify and map interconnections and interdependencies that if disrupted would materially affect funding or operations, but only with respect to the covered company itself, its insured depository institutions and its material, nonbank entities.

(iii) *Confidentiality*

Finally, in response to public comments on the proposed rule, the Dodd-Frank Rule contains confidentiality provisions designed to protect internal proprietary information that could, if subject to public disclosure, impede the quality and extent of information provided by covered companies. In order to address concerns, resolution plans must be divided into two sections: a public section and a confidential section. The public section must include, among other things, descriptions of a covered company's core business lines, derivatives activities, foreign operations, governance structure, management information systems and, "at a high level," the company's resolution strategy.

To the extent permitted by law, information comprising the confidential section will be treated as confidential. Confidentiality shall be determined in accordance with, among other things, the Freedom of Information Act (FOIA). A covered company desiring confidential treatment may file a request for such treatment in accordance with FOIA and each of the Board's and FDIC's rules regarding availability and disclosure of information.

### c. Review/Penalties for Noncompliance

Both the Act and the Dodd-Frank Rule include detailed provisions regarding the review of a covered company's resolution plan and the penalties that may be imposed if a covered company fails to submit a credible plan. As an initial matter, each covered company must provide the Board and the FDIC with such information and access to personnel as the Board and the FDIC determine is "necessary to assess the credibility" of the resolution plan. A multistage review of each resolution plan is contemplated. First, within 60 days of receiving a covered company's resolution plan, the Board and FDIC must determine whether the plan satisfies the minimum information requirements and should be accepted for further review. To the extent that a resolution plan is determined to lack the minimum required information, the covered company must submit a revised plan within 30 days after being notified of the informational deficiencies.

Once a resolution plan is accepted for more detailed review, the Board and FDIC will review the plan to assess its credibility and whether or not the plan would facilitate an orderly resolution of the covered company. In the event that the Board and the FDIC jointly determine that a resolution plan is not credible or would not facilitate an orderly resolution of the covered company, they will jointly notify the covered company of such determination in writing, identifying those aspects of the resolution plan that have been determined to be deficient. A covered company must, thereafter, address any deficiencies identified by the Board and FDIC within 90 days after notice of same, or such shorter period as the Board and the FDIC may jointly determine.

In addition to submitting a revised resolution plan that addresses the deficiencies, the revised plan also should discuss in detail the revisions made to address the deficiencies; changes to business operations and corporate structure that the covered company proposes to undertake to facilitate implementation of the revised plan (including an implementation timeline); and details as to why the covered company believes the revised plan is credible and would result in an orderly resolution.

Should a covered company fail to resubmit a satisfactory plan, or should the Board and the FDIC jointly determine that the revised plan does not adequately remedy the deficiencies, the Board and the FDIC may jointly impose "more stringent capital, leverage or liquidation requirements, or restrictions on the growth, activities or operations of the covered company." If a covered company fails to remedy such deficiencies within two years, the Board and the FDIC jointly may direct the company to divest assets if they jointly determine that divestiture is necessary to facilitate an orderly resolution of the covered company.

While the penalties for noncompliance appear potentially harsh, the commentary to the Dodd-Frank Rule makes clear that such penalties are unlikely to be imposed in connection with initial plans. In particular, as noted above, the review process will evolve as covered companies gain more experience in preparing their plans, and there is no expectation that initial plans will be found to be deficient.

## 4. Overview of the FDIC Rule/Intersection with the Dodd-Frank Rule

Pursuant to its authority under the FDIA, the FDIC has issued the FDIC Rule which, if approved in final form, will apply to insured depository institutions with total assets of $50 billion or more (each, a covered insured depository institution, or CIDI). Under the FDIC Rule, a CIDI must prepare a resolution plan that will enable the FDIC, as receiver of the CIDI under the FDIA, to resolve the CIDI pursuant to the bank receivership provisions contained in Sections 11 and 13 of the FDIA in a manner that ensures depositors will receive access to their insured deposits within one business day of the CIDI's failure,[13] maximizes the net present value return from the sale or disposition of its assets and minimizes the amount of losses by the institution's creditors.

The FDIC Rule complements the Dodd-Frank Rule. Resolution plans for CIDIs are due on the same timetable as those due under the Dodd-Frank Rule,[14] with annual plans due every year thereafter. The provisions under the Dodd-Frank Rule regarding the obligation to update resolution plans upon the occurrence of material events are mirrored in the FDIC Rule. The Board and the FDIC anticipate that the resolution plan under the Dodd-Frank Rule of a covered company that is a bank holding company will be harmonized with the resolution plan for its corresponding CIDI. In order to facilitate such harmonization, the FDIC Rule provides that a CIDI's plan may incorporate data and other information from a resolution plan filed by its parent company under the Dodd-Frank Rule.[15]

For example, the Dodd-Frank Rule requires that a covered company must provide a strategy that assumes that its CIDI will fail. It also requires a strategy that assumes that all of its insured depository institutions, regardless of whether any qualify as CIDIs, are not the cause of its failure. The Dodd-Frank Rule also provides that the resolution plan must set forth how the covered company will ensure that its insured depository institutions subsidiaries will be protected adequately from risks arising from the activities of any nonbank subsidiaries of the covered company.

In addition to a strategic analysis, the FDIC Rule requires the inclusion of certain information in a CIDI's resolution plan. Much of the required information mirrors the information required by the

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13 Two business days if the failure occurs on a day other than Friday.

14 In particular, a CIDI whose parent company has $250 billion or more in nonbank assets (or, in the case of a foreign-based parent company, $250 billion or more in U.S. nonbank assets) is required to submit a resolution plan by July 1, 2012. A CIDI whose parent company has between $100 and $250 billion in nonbank assets (or, in the case of a foreign-based parent company, $100 billion or more in U.S. nonbank assets) is required to submit a resolution plan by July 1, 2013. A CIDI whose parent company has less than $100 billion in nonbank assets (or, in the case of a foreign-based parent company, less than $100 billion in U.S. nonbank assets) is required to submit a resolution plan by December 31, 2013.

15 Also as in the Dodd-Frank Rule, in preparing its resolution plan a CIDI must take into account the baseline, adverse and severely adverse economic scenarios developed by the Board pursuant to 12 U.S.C. § 5365(i)(1)(B), but may submit its initial plan assuming the baseline condition only or, if applicable, a reasonable substitute developed by the CIDI.

Dodd-Frank Rule. Thus, the CIDI's resolution plan must include an executive summary, a description of its core business lines, and a description of its practices related to the booking of trading and derivative activities. The CIDI's plan also should include descriptions of any unique aspects of the CIDI's depository base or underlying systems that may create operational complexity for the FDIC, or may result in exceptional resolution expenses.

A CIDI's plan also must identify interconnections between the CIDI and its parent holding company, including how the parent funds the CIDI; the strategy to unwind and separate the CIDI from its parent in a cost-effective and timely fashion; and cross-border elements of the CIDI's structure. It also must provide a strategy for the sale or disposition of its deposit franchise, business lines and assets. It must describe its processes for assessing its plans, "under idiosyncratic and industry-wide scenarios," for executing any sales, divestitures, restructurings, recapitalizations, or similar actions contemplated in its plan. Finally, the CIDI must identify its major counterparties and analyze whether the failure of any of them likely would have an adverse impact on or result in material financial distress or failure of the CIDI.

As with the Dodd-Frank Rule, "core business lines" means those business lines, in the view of the CIDI, whose failure would result in material loss of revenue, profit or franchise value. However, the term "critical services" is not tied to systemic risk, as is the case under the Dodd-Frank Rule, but instead is defined as those services and operations, including technology and human resources, that are necessary to continue the day-to-day operations of the CIDI. The FDIC Rule, like the Dodd-Frank Rule, provides that the resolution plan should contain both a public portion and a confidential portion, with the same means for protecting confidential information.

The FDIC, in conjunction with certain sister agencies, will review the resolution plan of each CIDI for credibility. A plan is credible if its strategies for resolving the CIDI, and the detailed information that must be included in the plan, are "well-founded and based upon information related to the CIDI that is observable or otherwise verifiable." In particular, projections must be reasonable and based upon current and historic conditions within the broader financial markets. The FDIC will employ the same two-step process employed in the review of resolution plans under the Dodd-Frank Rule. A CIDI must provide the FDIC with such information and access to its personnel as the FDIC determines is necessary to assess a resolution plan's credibility, the same informational and access requirements to which covered companies are subject under the Dodd-Frank Rule.

## 5. The Proposed U.K. Rules

The resolution plans produced by covered financial companies under the Dodd-Frank Rule and the FDIC Rule will need to dovetail with any plan produced to foreign regulators, including the U.K. FSA. As explained above, the Dodd-Frank Rule will require covered companies to include in their plans information about any foreign subsidiaries or operations. It is likely that similar requirements will be contained in the final rules adopted in the U.K.

Unlike the approach contained in the Dodd-Frank Rule and the FDIC Rule, the U.K. proposals have a greater focus on providing the regulators with the information needed for them to intervene quickly and effectively in the event of material financial distress or failure of the firm. Plans to be produced under the proposed U.K. rules are required to identify options for separating or resolving the firm's businesses, but unlike the Dodd-Frank Rule, there is less emphasis on the firm's proposal for how it will resolve any financial distress. Rather there is a greater focus on what options are available to the regulators in the event of possible firm failure. The information contained in the plans will enable the regulators to effectively implement the stabilization powers contained in the U.K. Banking Act 2009 (described below).

### a. Coverage

The FSA consultation paper proposes rules to be implemented by the FSA as required by the amendments made to the FSMA 2000 by the Financial Services Act 2010. The FSA is required by the terms of that act to implement rules requiring resolution plans (known as recovery and resolution plans, or RRPs in the U.K.) from all U.K. incorporated FSA authorized deposit takers. However the consultation paper indicates that the FSA proposes to extend the rules to also cover large investment companies. The consultation paper proceeds on the assumption that firms categorized as "full-scope BIPRU 730k investment firms" under the U.K. regulations (the category into which the largest investment firms fall) that hold assets exceeding £15 billion will be covered by the final rules.

The FSA consultation paper states that the FSA will not require RRPs to be produced by foreign incorporated entities operating in the U.K. However the FSA indicates that it will expect to be provided with the RRP (or equivalent) produced by such a foreign entity under its home-state regulation.

The FSA has indicated in its consultation paper that it will require RRPs produced pursuant to the rules to address the operations of all significant members of the corporate group, both U.K. and foreign, and both regulated (by the FSA) and unregulated. U.K. headquartered groups will be able to consolidate the planning requirements for all U.K. incorporated group members and submit a single, group-wide, recovery plan.

### b. Structure of the RRP

Annexed to the consultation paper produced by the FSA is the "RRP Guidance Pack for Firms" (guidance pack), which sets out the information and analysis required, and how that content is to be structured in the RRP. The information and analysis required by the guidance pack is broadly the same as that required by the Dodd-Frank Rule discussed above; however the guidance pack is significantly more prescriptive as to how that information is to be presented.

The guidance pack requires RRPs to contain the following "modules":

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| Module 1: | Executive summary |
| Module 2: | Recovery plan |
| Module 3: | Group structure and key legal entity information |
| Module 4: | U.K. economic function identification matrix |
| Module 5: | U.K. critical economic function contingency analysis |
| Module 6: | Plans to overcome barriers to satisfactory resolution |

In addition to containing a summary of the contents of the RRP, the executive summary is required to contain confirmation that the board of directors has reviewed and approved the RRP, is comfortable that the economic function contingency analysis contained in the RRP (described further below) is appropriate, and is satisfied that any issues identified in the implementation of the RRP can be adequately addressed.

The recovery plan contained in Module 2 is described in the guidance pack as being the firm's "menu of options" in the event of extreme financial stress. Module 2 requires much of the analysis that is to be included in the "strategic analysis" component of resolution plans produced under the Dodd-Frank Rule described above. Module 2 must contain details of the firm's complete list of recovery options, the triggers which would indicate that the recovery plan should be implemented and also

an assessment of the financial benefit (on a post-tax basis) of each option. The guidance pack states that the plan must consider all possible options, "even those which would only be contemplated in extremely stressed circumstances," such as whole firm disposal. The recovery plan also will have to address how the overall RRP fits within the firm's existing risk management framework. The recovery plan module is, effectively, the firm's opportunity to set out the steps it will take prior to, and potentially to avoid, intervention by the regulators.

Module 3 of a U.K. RRP requires detailed information regarding the structure of the company or group. The information provided must include the legal structure, an analysis of how the various entities in the group provide the "economic functions" (distinct business functions) provided by the group, an analysis of the interconnectedness and dependencies both between group members and with other banks or financial institutions, and an unconsolidated group balance sheet. The guidance pack provides *pro forma* schedules to be completed as part of Module 3, which contain detailed quantitative information about the amount and type of the group's financial exposure to other firms, as well as whether those firms are high or low impact for the group.

The U.K. economic function identification matrix contained in Module 4 requires the planning firm to go beyond an analysis of its own business and operations and to assess the significance of that business to the economy of the U.K. The module requires a description of the major economic functions provided by the firm or group as well as financial and other metrics which will assist in identifying the scale of that economic function. The firm or group is required to provide high-level commentary on the potential impact on the economy of the U.K. of the closure of each economic function. The analysis contained in this module will assist the firm and the regulators to determine which economic functions are "critical economic functions" and which are therefore required to be analyzed in Module 5.

In Module 5, the firm or group is required to produce an analysis of how the critical economic functions of the group may be separated from the group "over a weekend." The plan is required to address financial, infrastructure and legal barriers to an effective separation. This section of the guidance pack makes clear that the regulators will develop their own resolution plan for the firm's failure based on the information provided in Module 5 and the rest of the RRP. The guidance pack highlights, however, that a comprehensive and effective contingency analysis, which gives the regulators confidence that the resolution of the firm is possible in the event of failure, may enable the firm to avoid early intervention by the regulators in the event of financial stress.

In Module 6, the firm is required to identify and analyze potential barriers to effective separation and resolution of its critical economic functions. The firm is required to address the potential options to address such barriers, the cost of such options and its preferred solution. The information contained in this part of the RRP will form the basis for the firm's ongoing discussions with the regulators.

### c. The CASS RP

In the U.K., investment firms holding client assets or money also are subject to the terms of CASS, the FSA's Client Assets sourcebook. As part of the current U.K. proposals contained in the consultation paper, the FSA proposes to amend CASS to require that firms holding client assets produce a CASS Resolution Plan (CASS RP). A CASS RP will be an information source to be available in the event of the failure of the entity holding client assets. The CASS RP must contain information that will enable key documents and records relating to the client assets and money to be located by an insolvency practitioner on 48 hours' notice. The purpose of the CASS RP is to ensure that an insolvency practitioner appointed to the firm is able to locate and manage client assets and money as quickly as possible so as to minimize the wider economic cost of firm failure.

### d. The Special Resolution Regime

The information provided in U.K. RRPs will form the basis for the implementation, should financial stress arise, of the "stabilization measures" contained in the U.K. Banking Act 2009 (U.K. Act). The U.K. Act created new powers for U.K. regulators to intervene and compel a transfer of part or all of a failing bank to a private sector purchaser, a bridge bank or to temporary public ownership. The implementation of these measures is supported by adapted forms of the U.K. administration and liquidation procedure that require the administrator or liquidator to prioritize assisting the regulators' intervention.

## 6. European and Other Reform Proposals

The U.S. and the U.K. are not the only jurisdictions pursuing proposals for resolution plans. European countries, through the European Commission, and G20 countries, through the work of the Financial Stability Board (FSB), are each separately consulting on proposals that would require resolution plans to be produced. In each case, the requirements for resolution plans are being considered along with other significant bank resolution reforms such as creating bank and financial institution specific insolvency processes.

The European Commission announced plans for an EU framework for financial sector crisis management in its communication on October 20, 2010. Consultation on this proposal was conducted on the basis of the Internal Markets and Services Directorate General working paper in early 2011, and it is expected that the Commission will adopt a legislative proposal implementing the proposals in the third quarter of 2011.

Since the G20 Toronto Summit in June 2010, the FSB has been considering "policy recommendations to effectively address problems associated with, and resolve, systemically important financial institutions." The policy recommendations under consideration include proposals for resolution plans. The FSB recently has completed a consultation process on its proposed recommendations and will present its final recommendations at the G20 meeting in November 2011.