

## Is the FDIC Contemplating the Proactive Use of Living Will Authority?

Among the requirements imposed by Title I of the Dodd-Frank Act on large bank holding companies and designated nonbank financial companies (together, systemically important financial companies or SIFIs) is the obligation to draft a plan for a company's rapid and orderly resolution in the event of its material financial distress, often referred to as a "living will." Recent statements by the Federal Deposit Insurance Corporation (FDIC) suggest that the agency may use this requirement as a lever to compel SIFIs to engage in significant reorganizations and make significant divestitures.

Living wills can serve dual functions. First, they can provide the Federal Deposit Insurance Corporation (FDIC) in its role as receiver under Title II of the Act with a roadmap to use if it is called upon to deal with a SIFI's failure. For this purpose, the information the FDIC needs must be focused on management systems, corporate and business relationships and short-term funding for operations. Second, living wills may be used as prudential supervisory tools to require SIFIs to restructure themselves, jettison certain operations and control risk so that they may avoid a financial crisis entirely and do not need to be liquidated. The latter role may be the more significant of the two because it has the potential to affect the size, organization and operations of a significant number of SIFIs, as recent statements by the FDIC demonstrate.

The FDIC took note of its ability to restructure SIFIs through the exercise of its authority to review living wills in a notice of proposed rulemaking to adopt Title II procedures:

[A]dvance planning, a well-developed resolution plan, and access to supporting information . . . has been a critical component of the FDIC's ability to smoothly resolve failing banks. This critical issue is

addressed in the Dodd-Frank Act in provisions that . . . require the largest companies to submit so-called "living wills." . . . If the company cannot submit a credible resolution plan, the statute permits the FDIC and the Federal Reserve to jointly impose increasingly stringent requirements that can lead to divestiture of assets or operations . . .

75 *Fed. Reg.* 64173 (Oct. 19, 2010). See our October 2010 *DechertOnPoint* "[FDIC Begins Action on Its Super-Resolution Rules for Covered Financial Companies.](#)"

Subsequently, in a speech to the Securities Industry and Financial Markets Association, FDIC Chairman Sheila C. Bair raised this possibility again: "And let us be clear: we will require these institutions to make substantial changes to their structure and activities if necessary to ensure orderly resolution." She then reminded her listeners that proscriptive regulation can only go so far to eliminate unsafe and unsound practices when organizations are too big to fail. The following day, in an interview with *American Banker*, Chairman Bair discussed her priorities for her remaining term.

Effective resolution procedures, including resolution planning, were her top priority. In that regard, she stated that SIFIs “may have to do some structural reorganization to demonstrate that they can be resolved” and that “living wills can be the lever to force banks to shrink and simplify.”

The sum of these statements suggests that the FDIC is considering using its supervisory authority with regard to living wills, in conjunction with the Federal Reserve, to compel the divestiture of assets and operations that they agency believes would unreasonably interfere with an orderly liquidation. This may create complex issues for the directors and officers of SIFIs who must act in the best interests of shareholders and, in certain cases, bondholders. The living will requirements in Title I and

the procedural rules in Title II of the Act point toward facilitating a rapid resolution at minimal cost and with minimal disruption. Breaking up SIFIs as a prophylactic measure may be massively disruptive and reduce competitiveness and profitability. The full ramifications of the FDIC’s exercise of its authority with regard to living wills are still unknown, but it has the potential to shape the future of American banking and finance.



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