Title II
Resolution Strategy Overview

August 2012

Each depositor insured to at least $250,000
Backed by the full faith and credit of the United States government
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Discussion Outline

- Legal Framework
- Resolution Strategy
- International Coordination

Legal Framework:

- Title I – Prudential Oversight and Resolution Plans
- Title II – Orderly Resolution Authority

  5 Key Elements

  - Applicability & Appointment
  - Authority for Immediate and Decisive Action
  - Continuity – Bridge Financial Companies & Related Authorities
  - Access to Liquidity
  - Prohibition on Taxpayer Bailouts

Title I and Title II Relationship

- Under Title II of the Dodd-Frank Act, bankruptcy is the first resolution option in the event of a failure of a systemic financial company.
- To make this prospect achievable, Title I of the act requires that all large, systemic financial companies submit living wills to demonstrate how they would be resolved under the bankruptcy code.
- This will enable both the firms and regulators to understand and rationalize the parts of a SIFI’s business that are not suited for bankruptcy and take the necessary steps to address impediments.
- The objective is to have a credible plan demonstrating how resolution under the bankruptcy code would be orderly and not pose systemic risks.

Orderly Resolution Authority

- Bankruptcy is Primary Resolution Process
- Limited to Potentially Systemic Financial Companies
- Advance Planning is critical
- Special Process to Trigger
- One-Day Stay on Derivatives Netting
- Statutory Minimum Payment
- Judicial Determination of Disputed Claims
- Liquidity Available Through the Orderly Liquidation Fund
- Statutory Bar on Taxpayer Loss

Resolution Strategy - Key Objectives

- Stability
  - Minimize financial instability in the US financial system
  - Consider direct and indirect effects
  - Market and public confidence

- Accountability
  - Ensure the failed company's investors bear the losses arising from failure
  - No potential of taxpayer credit support
  - Potential assessment to the industry to cover "overpayments"
  - Statutory requirement not to retain culpable management

- Viability
  - Successor firm(s) operate with no government support
  - Market confidence established
  - Expedient process for re-privatization
  - Avoid increasing market concentrations

Key Challenges

- Funding, operations, business lines and legal entities are not aligned
- High liquidity needs
- Close-out and netting provisions contained in financial contracts
- Operations in multiple jurisdictions via multiple charters, licenses, etc.
- Intragroup financial positions and obligations
- Rapid dissipation of franchise value
- Execution risk

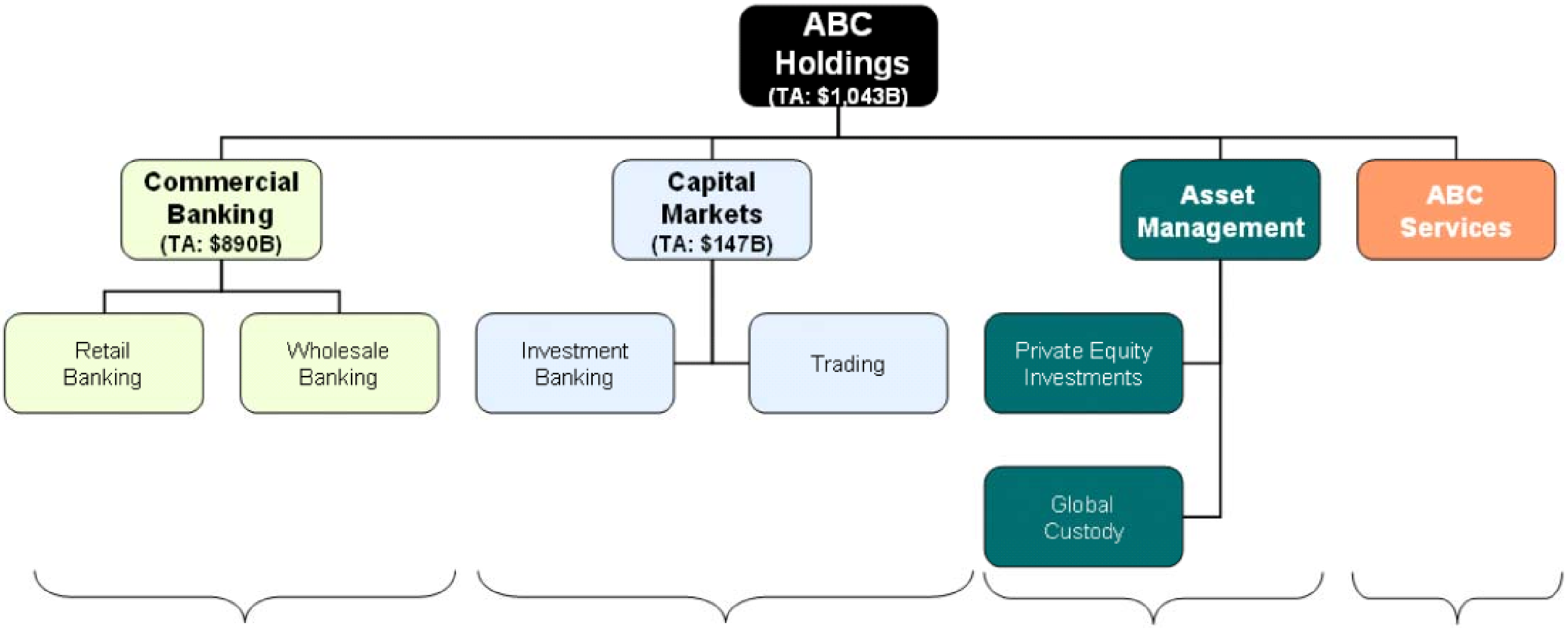
Introduction

- **Hypothetical Company (ABC Holdings) Highlights**
  - Four Primary Lines of Business: Commercial Banking, Capital Markets, Global Asset Management, and Transaction Services
  - 100,000+ employees in 50 countries serving institutions as well as individuals
  - Over 1,500 consolidated subsidiaries and affiliates plus over 5,000 unconsolidated affiliates and investments
  - Net Income $15 billion (2011): Banking – 60%, Capital Markets – 23% Asset Management – 17%
  - Over $30 Trillion notional value of derivative trades, with over 1 million open positions
  - Parent rated – guarantor of contracts through-out the enterprise
- **Systemic Factors**

Size	Leverage and Liquidity	Interconnections	Complexity	Substitutability	Other Resolvability Considerations
$1.0 trillion in total assets, $700 billion US assets, with a significant global presence in the UK and Japan. Over $5 Trillion in assets under custody	Dependent upon market funding via unsecured short and intermediate term borrowing for a material portion of its operations	Material US and global footprint with off balance sheet exposures	Diversity of product offerings; interconnections across jurisdictions, counterparties, and entities	The sheer size and scope of its operation would require significant time for clients to move their business to other competitors. The continuity of credit availability to US customers through alternative means is another area of concern.	Will require close coordination with foreign central banks, regulators, resolution authorities, and FMUs to mitigate knock-on effects and minimize disruption. Intercompany debt and back to back derivative transactions.

- **Resolution Considerations:**
  - A global commercial bank presence with a material global broker-dealer footprint,
  - Dependent upon deposits as a primary funding source with alternative funding sources in the form of repo and securities lending,
  - Significant deposits related to sweep activities booked in the Cayman Islands,
  - A large derivatives book that is managed among at least four operating units in the U.S. and abroad in the U.K., Ireland, Japan, China and Mauritius
  - Company operates as one enterprise

Organization Structure by Lines of Business & Jurisdiction



Location:
- **Americas**
  - New York (Head Office)
  - Toronto
  - San Paolo
- **EMEA**
  - London (Regional H.O.)
  - Dublin
- **Asia**
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Location:
- **Americas**
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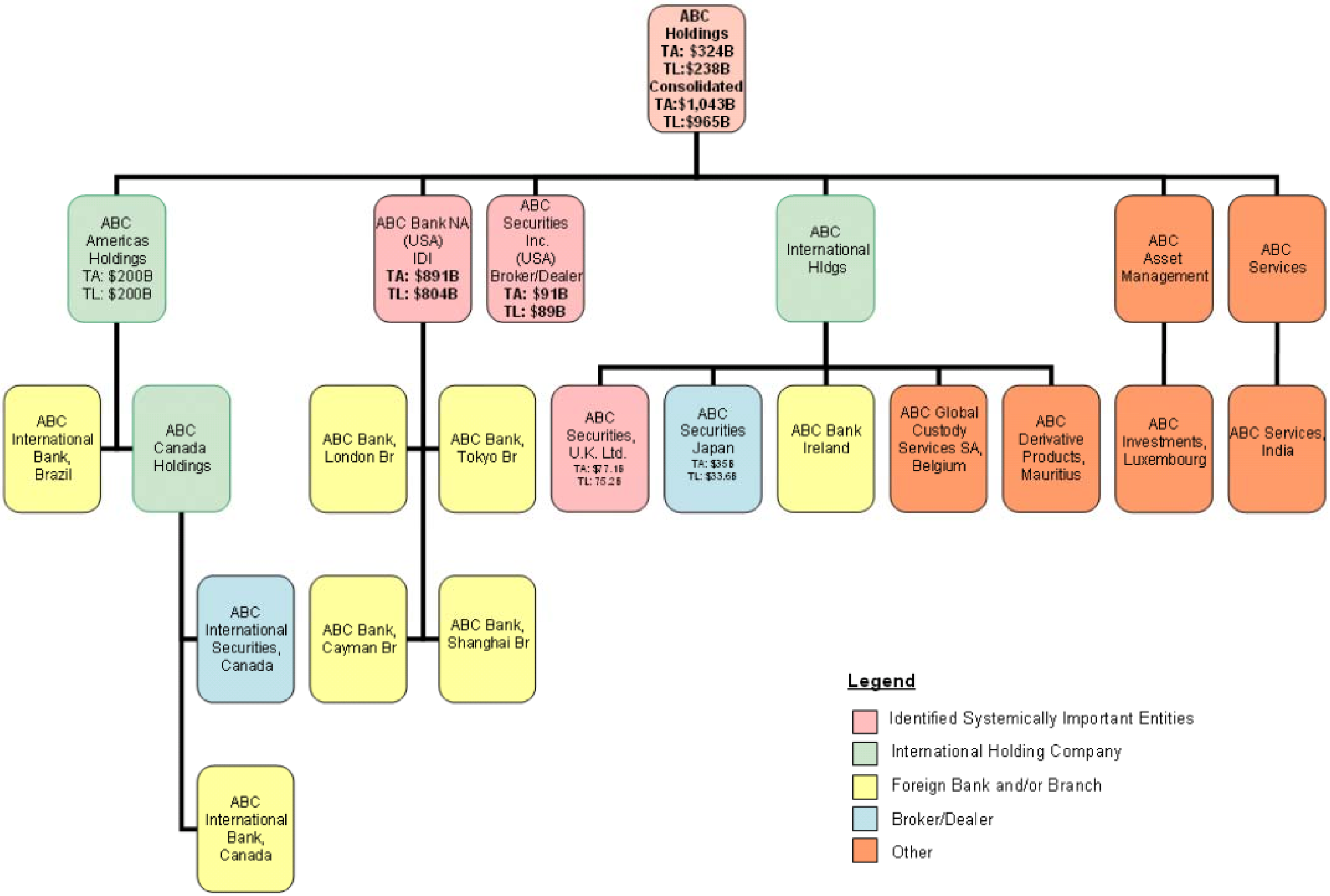
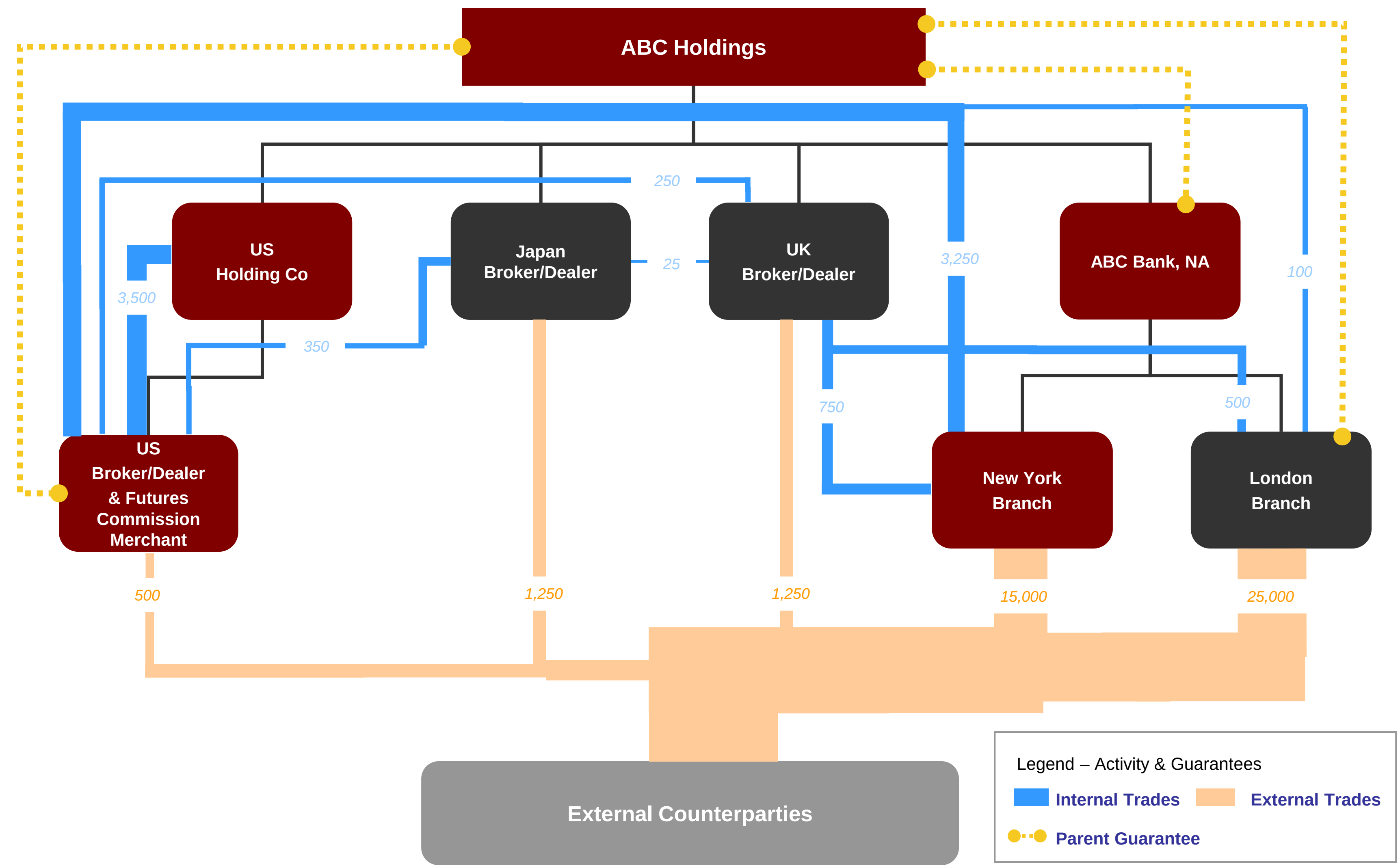
Location:
- **Asia**
  - Mumbai
  - Mauritius

Organization Structure by Legal Entity



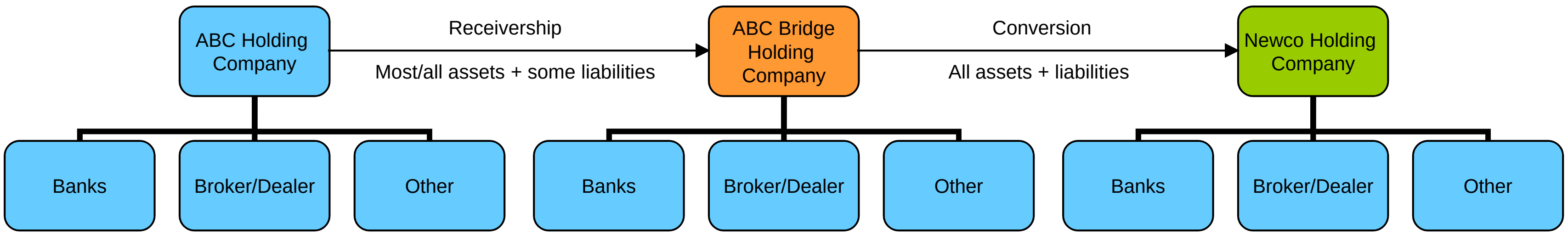
ABC Holdings – Booking Practices (Notional $billions)



Resolution Strategy: Single Receivership-Parent Company Entry

- Single entry "top of house" resolution
  - Title II receivership at parent holding company
    - Transfer receivership assets (primarily investments in subsidiaries and loans to subsidiaries) to bridge holding company
    - Subordinated debt and equity remain in receivership, certain other senior unsecured debt and contingent liabilities may or may not pass to bridge holding company
  - Equity solvent subsidiaries remain open
    - Receiver provides funds/guarantees, as necessary, to bridge holding company through the OLF to provide liquidity
    - Bridge holding company serves as "source of strength" recapitalizing subsidiaries, as necessary
    - Bridge holding company will downstream liquidity, as necessary, to subsidiaries through intra-company advances
- In a single receivership model, only the parent company is placed into receivership and, consequently, its creditors will be subject to haircuts. Equity solvent subsidiaries will continue to operate and conduct business. Operational restructuring and any divestitures occur over time through supervisory agreements.

Single Receivership – Corporate Entity Flow



Holding Co. Balance Sheets In Millions of USD

ABC Holding Co.	
ASSETS	
Investments in Subsidiaries	182,000
Advances to Subsidiaries	141,000
Total Assets	**$ 323,000**
LIABILITIES	
Sr. Unsecured Debt	$ 199,000
Subordinated Debt	39,000
Total Liabilities	**238,000**
Total Equity	**85,000**
Total Liab. & SH Equity	**$ 323,000**

ABC Bridge Holding Co.	
ASSETS	
Cash	$ 50,000
Investments in Subsidiaries	182,000
Advances to Subsidiaries	141,000
Total Assets	**$ 373,000**
LIABILITIES	
OLF Liabilities	$ 50,000
Total Liabilities	**50,000**
Total Equity	**323,000**
Total Liab. & SH Equity	**$ 373,000**

- **Assets are transferred from the receivership to the bridge, liabilities remain behind**
- **OLF borrowings from the U.S. Treasury are advanced to ABC Bridge Holding Company**

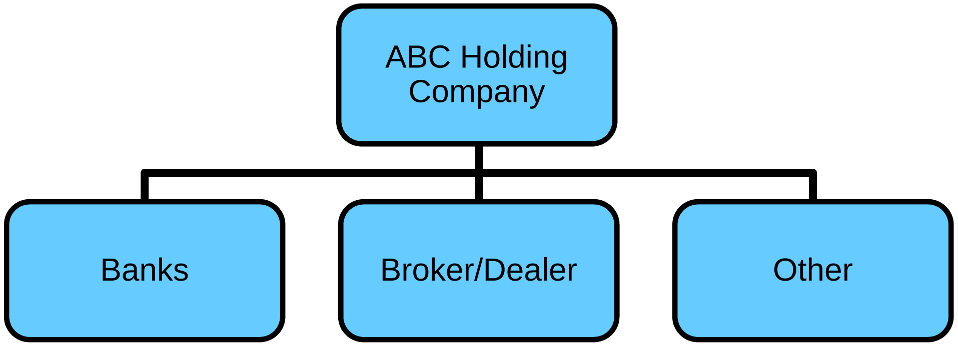
ABC Bridge Holding Co.	
ASSETS	
Cash	$ -
Investments in Subsidiaries	132,000
Advances to Subsidiaries	111,000
Total Assets	**$ 243,000**
LIABILITIES	
OLF Liabilities	$ 50,000
Total Liabilities	**50,000**
Total Equity	**193,000**
Total Liab. & SH Equity	**$ 243,000**

- **$50,000 of cash is advanced to subsidiaries to meet heightened liquidity needs**
- **$130,000 write down of investments in subsidiaries occurs**
- **$80,000 of advances to subsidiaries is converted from debt to equity**

New Co. Holding Co.	
ASSETS	
Investments in Subsidiaries	132,000
Advances to Subsidiaries	61,000
Total Assets	**$ 193,000**
LIABILITIES	
New Co. Unsecured Debt	$ 113,000
New Co. Convertible Subdebt	10,000
Total Liabilities	**123,000**
Total Equity	**70,000**
Total Liab. & SH Equity	**$ 193,000**

- **$50,000 of cash is returned from subsidiaries and repaid to the U.S. Treasury prior to conversion to New Co.**
- **New Co. liabilities are structured to consist of $70,000 of equity, $10,000 of convertible subdebt, and $113,000 of unsecured debt; securities are distributed to ABC Holding Company unsecured claimants**

Single Receivership – Corporate Entity Flow



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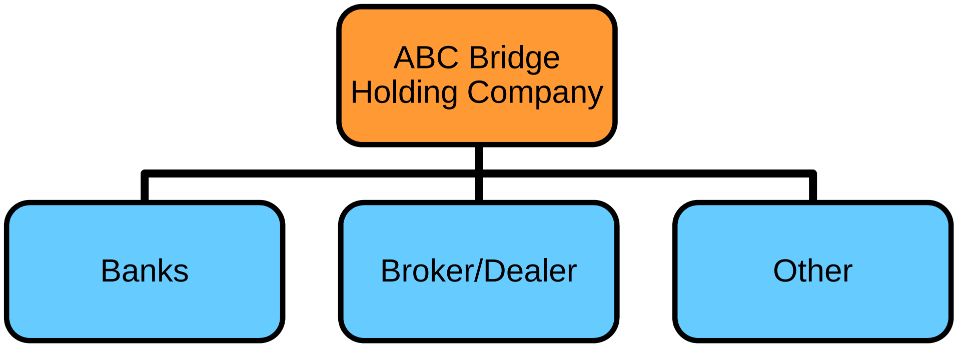

Holding Co. Balance Sheets In Millions of USD

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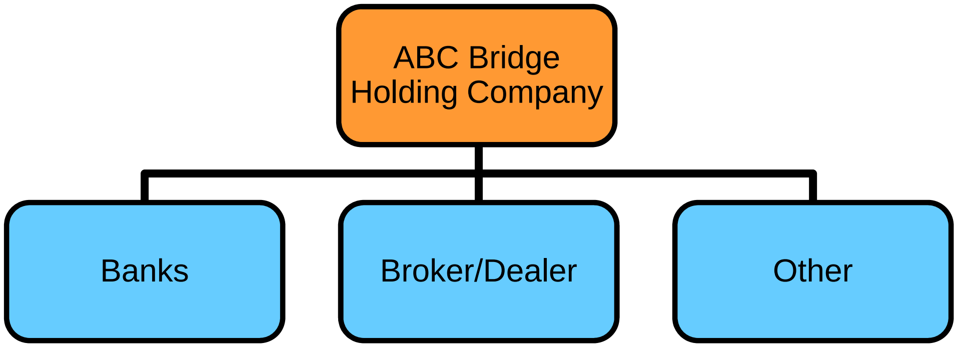
OLF borrowings from the U.S. Treasury are advanced to ABC Bridge Holding Company

All other liabilities remain behind in the ABC Holding Company receivership

Single Receivership – Corporate Entity Flow



Holding Co. Balance Sheets In Millions of USD

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Cash	$ -
Investments in Subsidiaries	182,000
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Total Assets	**$ 373,000**
LIABILITIES	
OLF Liabilities	$ 50,000
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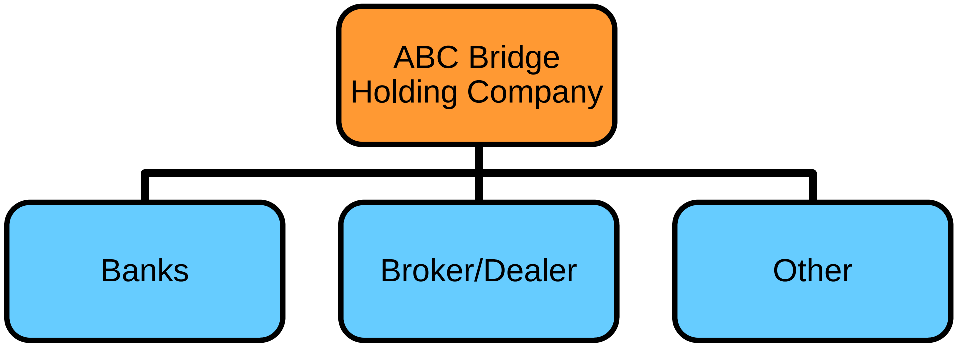
$50,000 of cash is advanced to subsidiaries to meet heightened liquidity needs

Single Receivership – Corporate Entity Flow



Holding Co. Balance Sheets In Millions of USD

ABC Bridge Holding Co.	
ASSETS	
Cash	$ -
Investments in Subsidiaries	52,000
Advances to Subsidiaries	191,000
Total Assets	**$ 243,000**
LIABILITIES	
OLF Liabilities	$ 50,000
Total Liabilities	**50,000**
Total Equity	**193,000**
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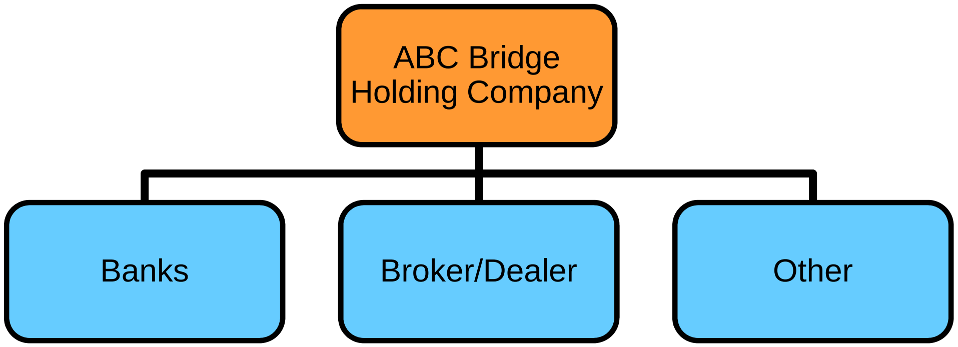
Investments in subsidiaries are written down according to the $130,000 asset valuation loss at the subsidiary level; equity decreases accordingly

Single Receivership – Corporate Entity Flow



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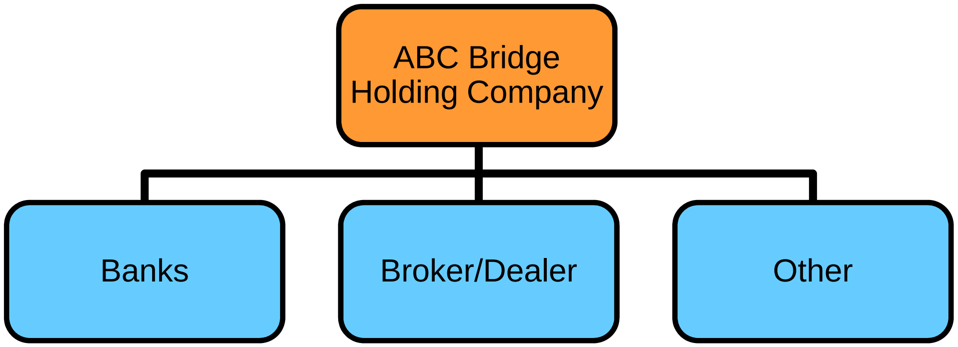
$80,000 of Advances to Subsidiaries are converted from debt to equity held by ABC Bridge Holding Company to recapitalize subsidiaries that have experienced asset valuation losses

Single Receivership – Corporate Entity Flow



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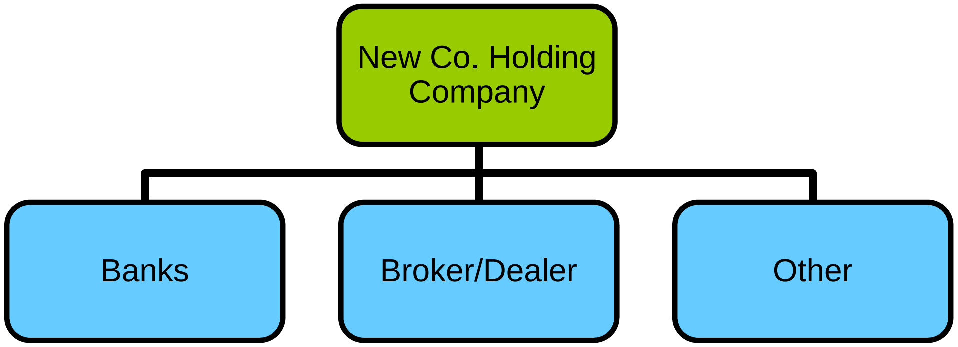
$50,000 of cash advanced to subsidiaries is returned to ABC Bridge Holding Company as heightened liquidity stresses dissipate and market funding returns

Single Receivership – Corporate Entity Flow



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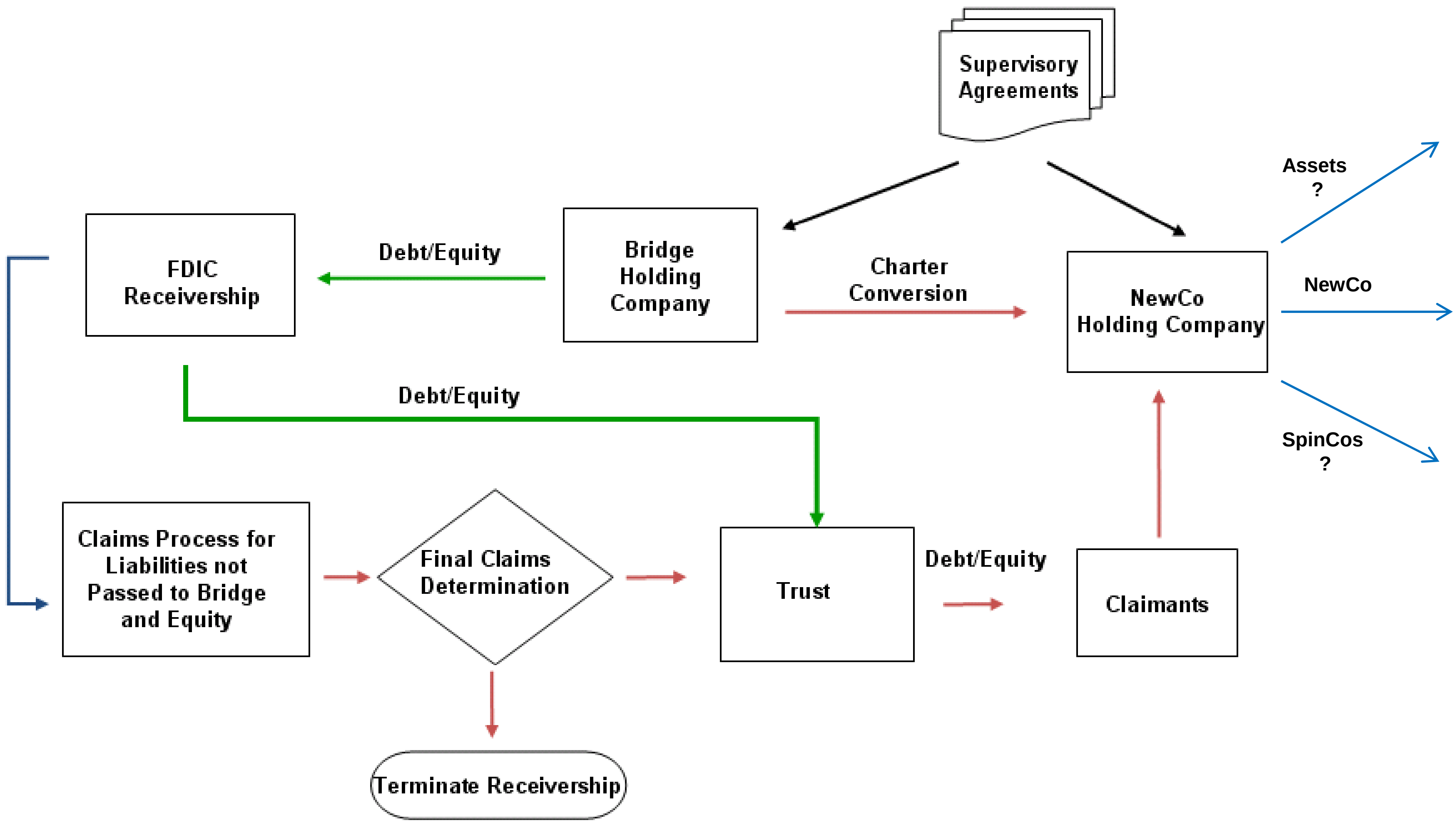
Total Liabilities	**123,000**
Total Equity	**70,000**
Total Liab. & SH Equity	**$ 193,000**

ABC Bridge Holding Company is converted into a privately owned New Co. after $50,000 of OLF borrowings are paid back to the U.S. Treasury

New Co. liabilities are structured to consist of $70,000 of equity, $10,000 of convertible subdebt, and $113,000 of unsecured debt; securities are distributed to ABC Holding Company unsecured claimants

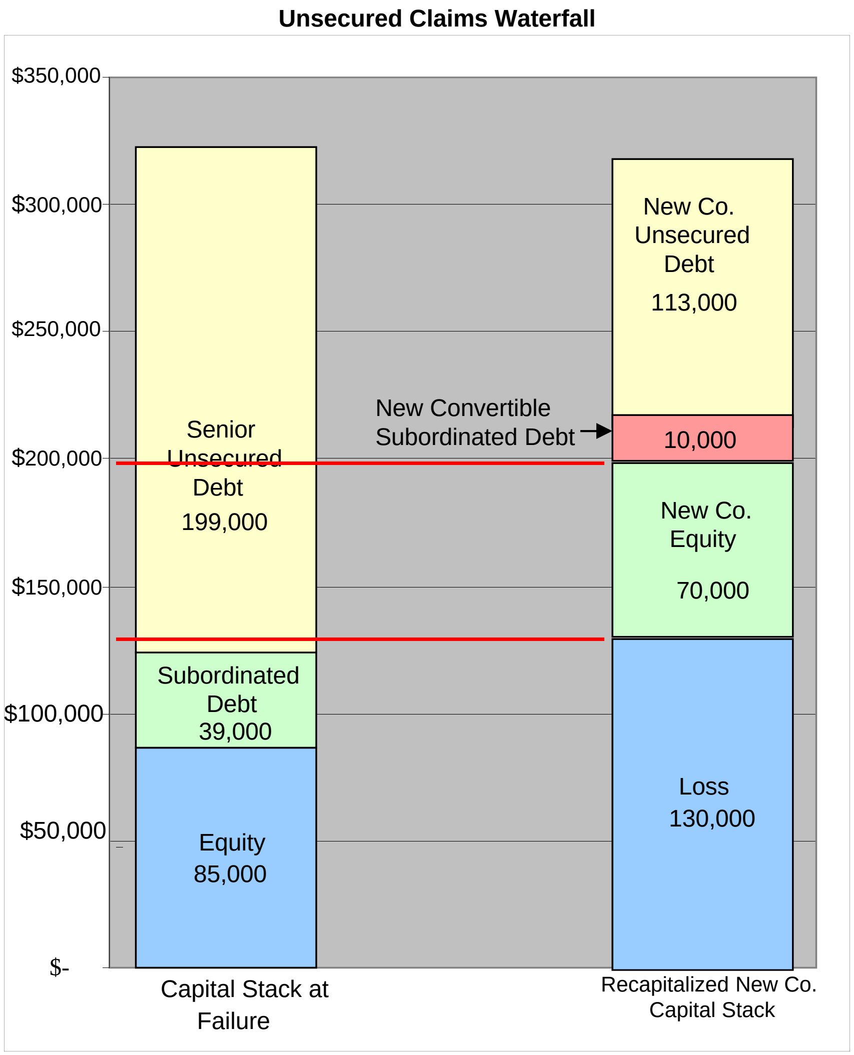
SIFI Resolution: Exit Process



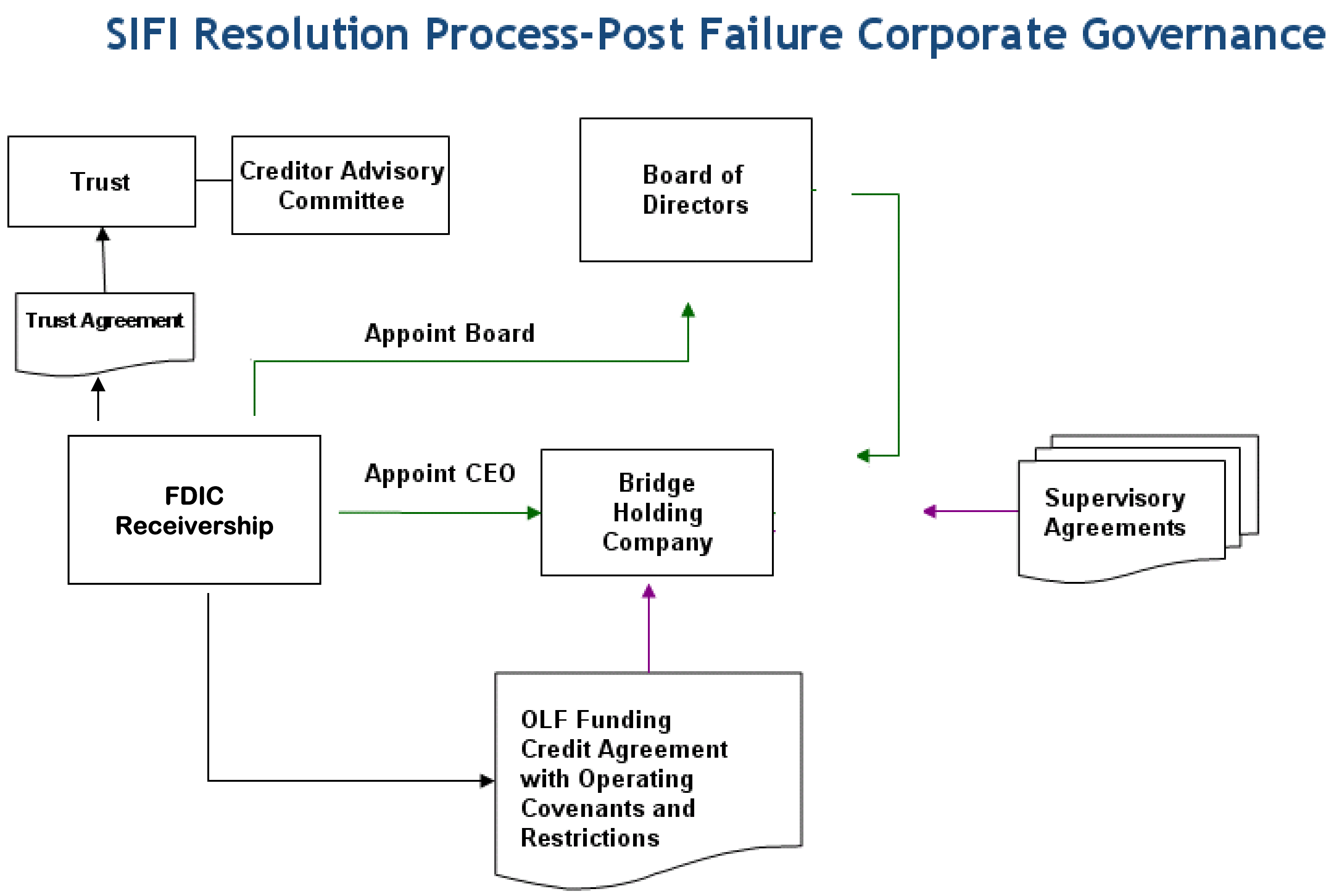
Loss Absorption and Recapitalization

Hypothetical Loss Estimate

- Company's assets decrease to $810B due to 10% liquidity run and loss on assets
- Estimated Loss Range $120B-$135B
  - Market Based Asset Valuations
  - Franchise value estimates for business lines
  - Market Credibility
- Senior Unsecured General Creditors haircut 3%
- Senior Unsecured General Creditors exchange claims for:
  - New debt instruments
  - Convertible debt instruments
  - Equity (preferred/common)
- Former subordinated debt and equity holders could receive either:
  - Call options on financial instruments to be distributed to senior classes
  - Warrants or other contingent value rights



Corporate Governance



Supervisory Agreement

- Parties to the Agreement may include:
  - The FRB and the Bridge Financial Company (BFC) / Newco
  - Potentially the FDIC
- Key provisions of the Agreement may require the Bridge/Newco to:
  - Review risk management and business model to determine cause of failure and develop and implement plan to mitigate those risks
  - Develop a business plan acceptable to regulators including capital and liquidity requirements
  - Obtain approval for major deviations from the business plans
  - Develop and implement plans to divest or spin-off assets, businesses and/or subsidiaries to ensure resolvability under bankruptcy (Title I)
- Additional Supervisory Agreements between other regulators and certain key subsidiaries may be required
  - Broker/dealer, Insured Depository Institution, etc.

Heat Map Exercise – A Few Findings

- For each of the top 5 U.S. SIFIS:
  - over 90% of the "total reported foreign activity" is located in 1 to 3 foreign jurisdictions.
  - Over 80% of the "total reported foreign activity" comes from legal entities located in the United Kingdom and Ireland.
- 6 jurisdictions cover over 96% of "total reported foreign activity" of the top 5 U.S. SIFIs.
- Over 85% of each SIFI's "total reported foreign activity" generally comes from 2 to 4 legal entities.

Prerequisites for Implementation

- Structural
  - Adequate amount of unsecured long-term debt issued at holding company level to absorb loss and recapitalize the firm – two tiers: subordinate (for recap/loss) and senior (for tail risk)
  - Operations and short-term borrowing at subsidiary level
  - Subsidiaries are not guarantors for contracts/obligations of holding company
- Operational
  - Liquidity needs assessment for post-resolution operations
  - Pool of potential CEOs and board members
  - Key jurisdictions identified – statutory framework known
  - Pre-planning and coordination with supervisors and regulators
  - Marketplace and public knowledgeable about the process
  - Communication plan

Summary: Key Challenges

- Funding, operations, business lines and legal entities are not aligned
  - Limit resolution to the holding company – only one legal entity fails
- High liquidity needs
  - Use the OLF to guaranty debt issued by the Bridge Holdco - Fee charged for the guaranty (TLGP example)
  - For immediate “day one” liquidity needs, OLF lends to Bridge Holdco – Punitive loan rate
- Close-out and netting provisions contained in financial contracts
  - Derivative contracts at subsidiary level – min. foreign close-out
  - Holding company guaranties assumed by Bridge Holdco
- Operations in multiple jurisdictions via multiple charters, licenses, etc
  - Charters, licenses, etc. at subsidiary level
  - Recognition of Bridge Holdco, change of control, “fit and proper,” issues addressed through pre-planning with supervisors/regulators

Summary: Key Challenges continued

- Intragroup financial positions and obligations
  - Subsidiaries remain going concerns – no cross claims
  - Operational and trade counterparties unaffected
- Rapid dissipation of franchise value
  - Run-off and shrinkage immediately pre- and post-failure
  - Initially maintain “business as usual” with corrective actions
  - Orderly divestitures may occur over time – avoid fire-sales
- Execution risk
  - One failed entity – reopens as a bridge company
  - Interim CEO and Board operate the business
  - Operating entities continue as going concerns
  - Diligent pre-planning
  - Identified sources of liquidity and capital support
  - Communication plan