



Americans for Financial Reform
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June 10, 2011

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Connecticut Ave, NW
Washington, DC 20551

Re: *Resolution Plans And Credit Exposure Reports Required*, RIN 7100–AD73

Dear Ms. Johnson:

American for Financial Reform (“AFR”) appreciates this opportunity to comment on the Proposed Rule regarding Resolution Plans and Credit Exposure Reports. AFR is a coalition of over 250 national, state, local groups who have come together to advocate for reform of the financial sector. Members of the AFR include consumer, civil rights, investor, retiree, labor, religious and business groups along with prominent economists and other experts.

This Proposed Rule implements the requirement in the Dodd-Frank Wall Street Reform Act (DFA) that large, systemically significant bank holding companies and those nonbank financial companies designated by the Financial Stability Oversight Council submit annual resolution plans (“Living Wills”) and quarterly credit exposure reports to the Federal Reserve Board of Governors and the Federal Deposit Insurance Corporation. The Living Wills would describe in detail covered companies strategies for rapid and orderly resolution in times of “material financial distress”. The quarterly credit exposure reports would describe the nature and extent of companies’ credit exposure to other large financial companies.

As the Lehman bankruptcy – the largest and most complex bankruptcy procedure in U.S. history – drags on, it is clear that the size and complexity of systemically important financial institutions (SIFIs) creates a major barrier to effective resolution. The experience of 2008 shows that in crisis situations, the unpredictable consequences of the bankruptcy of a major financial institution create enormous incentives for regulators to provide taxpayer support to failing SIFIs. This creates the expectation of a guarantee for such institutions and is a core source of moral hazard in the financial markets.

Resolution plans are far from a panacea for either systemic risk or the threat of bank failure. No individual bank has the enough information to measure the potential contagion effects of its own failure on the macro economy. This is a task for regulators. The circumstances under which a

bank will fail are inherently unpredictable and involve multiple jurisdictional issues. Regardless of advance planning such failures can still confront regulators with very difficult choices about the prevention of financial panic. But properly implemented, the resolution plans and credit exposure reports called for in the Dodd-Frank Act can still provide the regulators with information that is vital in the event of the failure of a SIFI. Perhaps even more important, the information in these plans can help regulators understand when a SIFI has grown “too big to fail” -- in other words, its failure would pose unacceptable economic risks. In such a case, regulators can use the authority granted in Section 121 of the Dodd-Frank Act to require the bank to divest activities.

A resolution planning requirement can also improve the management of SIFIs by requiring top executives to gather information and institute procedures that can protect the bank and its counterparties in times of economic distress.

Major financial institutions have more complex corporate structures than almost any other type of corporation. As the scholar Richard Herring has pointed out:

“The sixteen large, complex international financial institutions identified by the IMF and the Bank of England have 2.5 times more majority-owned subsidiaries than the 16 largest multinational manufacturing firms..... The most complex SIFI has 2,435 majority-owned subsidiaries, 50% of them chartered abroad”¹

This complexity – which often exists for reasons of regulatory or tax arbitrage, not economic efficiency – makes it clear how much information and advance planning is necessary for a rapid, effective resolution of such a company. Furthermore, the company itself does not face large incentives to do such bankruptcy or resolution planning. In the event of a bankruptcy the company will have failed and current management may be let go. Clearly the incentive for company management is to look to profit-making opportunities in situations where the company is still operating. There may be some benefit to the company in bankruptcy planning that helps reassure lenders that the company is creditworthy, but the major benefits of such planning are to society as a whole, in potentially reducing the externalities created by the failure of a SIFI. This makes resolution planning a highly appropriate area for regulatory mandates.

Furthermore, the information on corporate structure and credit exposure gained through these reporting requirements will be critical inputs in implementing the new restrictions on credit exposure in Sections 156, 609, 610, and 611 of the Dodd-Frank Act, which are vital in preventing transmission and magnification of financial distress in the event of bank failure.

For all the reasons above, AFR supports this proposal to implement the important resolution plan requirement in the Dodd-Frank Act. We believe the resolution planning requirements laid out in this rule include a wide variety of important information for regulators, including extensive and critical information on corporate structure and both on and off-balance sheet subsidiaries. However, we have several recommendations for improving these requirements:

¹ Herring, Richard J., “[Wind-Down Plans as An Alternative to Bailouts](#)”, Pew Financial Reform Project Briefing Paper #15, Pew Charitable Trusts, 2010.

- The resolution planning requirements would benefit from a stronger definition of “material distress”, including the possibility of a run on bank liabilities.
- Corporate governance requirements should also include requirements for consistently maintaining accurate asset valuations. Without such procedures resolution plans will not be reliable and bank management will not have sufficient early warning of material distress to take action and limit losses.
- In addition, the data production requirements in the rule should explicitly include a requirement that SIFIs develop the capacity for rapid, ongoing tracking of counterparty and loan exposures disaggregated by borrower, counterparty, and legal entity.
- This data capacity should then be used to expand the information on credit exposure reports beyond simple end of quarter reporting. Experience prior to and during the financial crisis shows that this end of quarter reporting is clearly inadequate. Credit exposure reporting should represent credit exposures throughout the quarter.

Finally, AFR is somewhat concerned that the generality of the mandate and the lack of priorities given may lead to broad and unfocused reporting. It may be helpful for regulators to provide guidance as to the most important or significant areas for detailed reporting. Such prioritization may be developed over the course of experience with resolution planning.

Material Distress Definition

“Material Financial Distress” is a key term and a trigger for putting into place the Living Will. Material Financial Distress is defined as a situation in which:

- (i) the Covered Company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion; (ii) the assets of the Covered Company are, or are likely to be, less than its obligations to creditors and others; or (iii) the Covered Company is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.

This definition is highly general and provides almost no guidance as to the broader economic situation the bank should plan to face. The rule does state that banks should “take into account” that material financial distress could occur during a period of market stress, but does not require such planning and also does not specify what type of market stress would be involved or the extent of market stress.

In fact, it is very likely that material distress for a large SIFI would coincide with broader market stress. If the SIFI is a major participant in a specific asset market, then material distress for the SIFI could potentially leading to a general run on that market. The regulation should explicitly instruct the financial institution to plan for significant broader market stress and also to take into

account the impact of any asset sales by the SIFI on overall market prices. This will help both regulators and management spot cases in which the institution is insufficiently diversified.

Finally, the definition of “material financial distress” should explicitly include the possibility of a run on the bank’s liabilities by creditors, and should require planning for ways in which the management would seek to restore confidence in the institution in the event of creditor loss of confidence.

Consistent and Accurate Asset Valuation

As demonstrated in the case of Lehman Brothers and other institutions, a major issue in creating material distress is the inaccurate valuation of bank assets. A resolution plan that is based on inaccurate valuations of assets will not be feasible to execute. If assets are inaccurately valued it also becomes very difficult for bank management to adjust bank strategies in time limit material distress and losses. Such inaccurate valuations also lead creditors to lose confidence in the institution.

Corporate governance standards in this resolution planning should therefore include procedures for consistent and accurate asset valuation and require that such procedures are linked to the valuations assumed in resolution plans. These procedures should ensure that asset valuation techniques remain consistent over time and circumstances – in other words, that the bank does not begin to value assets more optimistically in times when they are under threat of material distress. Naturally, these procedures must also seek to value assets accurately.

Of course, such asset valuation procedures are also called for under many other areas of prudential regulation and bank management. But in the case of resolution planning it is particularly important that asset valuations are linked to resolution assumptions and do not vary depending on the material circumstances of the bank.

Tracking of Loan and Counterparty Exposures; Expansion of Credit Exposure Reporting Beyond End of Quarter Reporting

Section 4(k) of the Proposed Rule properly includes a requirement that the SIFI develop the capacity to produce all data underlying the report. We suggest this requirement be expanded to specify that the SIFI develop a continuously updated database of total counterparty credit and loan exposures that can be immediately disaggregated by counterparty or borrower and legal entity, and also includes information on the collateral for each exposure.

There are several reasons for this requirement. First, this credit information is the crucial data to determine the types of financial contagion that could occur in the event of material distress at a major SIFI. It is likely that this information will be a crucial input for regulators to determine the implications of a bankruptcy or indeed to implement a Title II resolution procedure. Second, it is prudent to ensure that the top management of a SIFI understands the full range of credit exposures across the entire institution.

Finally, the maintenance of this information would allow the credit exposure reports mandated in this rule to be expanded beyond simple end of quarter reporting. As we know from the ways “Repo 105” and similar short-term borrowing transactions were used to camouflage true leverage ratios at Wall Street banks, such end of quarter reporting can be easily manipulated.² Furthermore, many of the credit exposure issues during the 2008 financial crisis were created by extremely short term exposures, even including intraday exposures through repo transactions.

The rule as written appears to require only reports on credit exposures at the end of the quarter. To the degree this is the case, the credit exposure reporting must be expanded to include metrics of the maximum, minimum, and typical credit exposures to various counterparties throughout the quarter.

Thank you for the opportunity to comment on this proposed rule. If you have any further questions, please contact Marcus Stanley, AFR’s policy director, at marcus@ourfinancialsecurity.org or (202) 466-3672.

Sincerely,

Americans for Financial Reform

² For background on this issue, see AFR’s February 22nd letter to the Securities and Exchange Commission on Short Term Borrowing Disclosures (File Number S7-22-10), available at <http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2011/02/AFR-Short-Term-Borrowing-2-22-11.pdf> .

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- A New Way Forward
- AARP
- AFL-CIO
- AFSCME
- Alliance For Justice
- Americans for Democratic Action, Inc
- American Income Life Insurance
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Affairs Bureau/Dollars & Sense
- Economic Policy Institute
- Essential Action
- Greenlining Institute
- Good Business International

- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National People's Action
- National Council of Women's Organizations
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- United Food and Commercial Workers

- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

Partial list of State and Local Signers

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville AR
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR

- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People, Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY

- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

