

The Meeting of the Systemic Resolution Advisory Committee

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

June 21, 2011 - 8:35 A.M.

The meeting of the FDIC Systemic Resolution Advisory Committee ("Committee") was called to order by Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation ("Corporation" or "FDIC") Board of Directors.

The members of the Committee present at the meeting were: Anat R. Admati, George G.C. Parker Professor of Finance and Economics, Graduate School of Business, Stanford University, Stanford, California; Michael Bodson, Chief Operating Officer, The Depository Trust & Clearing Corporation ("DTCC"), New York, New York; Charles A. Bowsher, Chairman and Member of the Research Advisory Council, Glass, Lewis & Company, LLC, Bethesda, Maryland; Michael Bradfield, Mercersburg, Pennsylvania; H. Rodgin Cohen, Senior Chairman, Sullivan & Cromwell LLP, New York, New York; William H. Donaldson, Chairman, Donaldson Enterprises, New York, New York; Janine M. Guillot, Chief Operating Investment Officer, CalPERS, Sacramento, California; Richard J. Herring, Jacob Safra Professor of International Banking and Professor of Finance, The Wharton School, University of Pennsylvania, Philadelphia, Pennsylvania; Simon Johnson, Ronald A. Kurtz Professor of Entrepreneurship, MIT Sloan School of Management, Cambridge, Massachusetts; Donald Kohn, Senior Fellow, Economic Studies Program, Brookings Institution, Washington, D.C.; John A. Koskinen, Non-Executive Chairman of the Board, Freddie Mac, Washington, D.C.; Jerry Patchan, Hunting Valley, Ohio; John S. Reed, Chairman, Corporation of MIT, New York, New York; Deven Sharma, President, Standard & Poor's, New York, New York; Gary H. Stern, Director, DTCC, The Dolan Company, and the National

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Council on Economic Education, New York, New York; Paul A. Volcker, Chairman of the Board of Trustees, Group of 30, New York, New York; and David J. Wright, Visiting European Union Fellow, St. Antony's College, Oxford, United Kingdom.

Members Peter R. Fisher, Senior Managing Director, BlackRock, New York, New York; and Raghurman G. Rajan, Eric J. Gleacher Distinguished Service Professor of Finance, Booth School of Business, University of Chicago, Chicago, Illinois, were absent from the meeting.

Members of the Corporation's Board of Directors present at the meeting were: Sheila C. Bair, Chairman; Martin J. Gruenberg, Vice Chairman; and Thomas J. Curry, Director (Appointive).

Corporation staff who attended the meeting included: James H. Angel, Jr., David Barr, Michelle Borzillo, Jason C. Cave, Glenn E. Cobb, Christine M. Davis, Patricia B. Devoti, Doreen R. Eberley, Keith L. Edens, Bret D. Edwards, Diane L. Ellis, Robert E. Feldman, Joseph V. Fellerman, Ralph E. Frable, Shelia K. Gibson, Andrew Gray, Shannon N. Greco, James J. Hone, Kenyon T. Kilber, Michael H. Krimminger, Rose M. Kushmeider, Ellen W. Lazar, Alan W. Levy, Tariq A. Mirza, Arthur J. Murton, Richard J. Osterman, Jr., Mark E. Pearce, Carolyn D. Rebmann, Jack Reidhill, Barbara A. Ryan, R. Penfield Starke, Marc Steckel, F. Angus Tarpley, Jesse O. Villarreal, Cottrell L. Webster, and James R. Wigand.

William A. Rowe, III, Deputy to the Chief of Staff and Liaison to the FDIC, Office of the Comptroller of the Currency ("OCC"); David K. Wilson, Senior Deputy Comptroller for Bank Supervision Policy, OCC; Mark Levonian, Senior Deputy Comptroller for Economics, OCC; Charlotte M. Bahin, Senior Counsel for Special Projects, Office of Thrift Supervision, Anthony J. Dowd, and M. Sterloft were also present at the meeting.

Chairman Bair opened and presided at the meeting. She began by welcoming the attendees to the inaugural meeting of the Committee and noting that the Committee's members bring a wide range of knowledge and expertise that will enhance the Corporation's work and ensure that, if the need should arise, the Corporation will be ready to resolve a systemically important financial company. She then noted that, as guided by the law, the FDIC, the Board of Governors of the Federal Reserve System ("FRB"), and the other banking regulatory authorities have long sought to achieve a delicate balance in the role that

government plays in the banking industry as it carries out the important task of promoting confidence and stability through deposit insurance and functioning as the lender of last resort, and the equally important task of upholding prudential supervision to promote market discipline by limiting the extent of the government's backstop. The FDIC's staff is working to implement an updated statutory mandate under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which includes, among its many provision, the authority for the FDIC to resolve a systemically important financial company, she noted, and, as it does so, there is once again much debate over the lessons of the recent financial crisis and the proper role of the government in the financial sector. On the one hand, she explained, there is the concern that new regulations could impose onerous costs on banks and the economy, stifling financial innovation and economic growth; and, on the other hand, there is genuine alarm regarding the immense scale and seemingly indiscriminate nature of the government assistance provided to large banks and nonbank financial companies during the financial crisis and the effects these actions will have on the competitive landscape of the banking system.

Chairman Bair stated that, in 2008, the United States experienced a failure or near failure of some of the largest financial institutions, and most could not be wound down in an orderly manner when they were no longer viable because major parts of their operations were carried out in nonbank legal entities subject to the commercial bankruptcy laws rather than bank receivership laws, resulting in ad hoc responses by the government that served to reinforce the perception that some financial institutions are too big to fail. In the wake of the recent crisis, Chairman Bair continued, the Dodd-Frank Act was enacted to reform the financial regulatory system and, at its core, are measures that create a new resolution framework for nonbank institutions and entities deemed to be so large, complex, and interconnected that their failure could threaten overall financial stability. She explained that this new resolution framework has three basic elements: the establishment of the Financial Stability Oversight Council ("FSOC"), chaired by the Secretary of the Treasury and comprised of members from the other financial regulatory agencies, with the responsibility of designating systemically important financial companies ("SIFIs" or "covered companies") that will be subject to heightened supervision by the FRB; the requirement for the preparation of detailed resolution plans—often referred to as "living wills"—by covered companies to demonstrate that they are resolvable under the bankruptcy laws if they run into severe

financial stress and provide valuable advance information that will assist in implementing their orderly liquidation, if necessary; and the prohibition of bailouts of individual companies by providing an alternative to bankruptcy with the establishment of an orderly liquidation authority in Title II, which allows the FDIC to resolve nonbank financial companies by using many of the same trustee powers over systemic nonbank financial companies that it has long used to manage failed bank receiverships.

After noting that the Committee will provide advice and recommendations on a broad range of issues relevant to the failure and resolution of a systemically important financial company, including the evaluation of different resolution strategies, Chairman Bair provided a brief overview of the meeting agenda and introduced Vice Chairman Gruenberg and Director Curry.

Vice Chairman Gruenberg thanked the Committee members for agreeing to serve on the Committee and noted that it is an exceptionally distinguished group, which reflects in some measure the importance of the Corporation's responsibilities under the Dodd-Frank Act with regard to both the preparation of living wills and the execution of the orderly liquidation authority under Title II. He stated that the advice of the Committee is viewed as a key element in the Corporation's efforts to implement those new and unprecedented authorities. Director Curry also thanked the Committee members for participating and stated that will be very helpful for the Corporation's Board to have the Committee's input and advice.

Next, Chairman Bair introduced James R. Wigand, Director, Office of Complex Financial Institutions ("OCFI"), FDIC, and Michael H. Krimminger, General Counsel, FDIC, to present an overview of the Corporation's systemic resolution framework. Mr. Wigand began by providing a brief summary of some of the key components of Title I of the Dodd-Frank Act, which establishes some of the groundwork for building a framework to minimize the probability of the failure of a large systemically important financial company. One element of Title I, he explained, was the creation of the FSOC, which serves as a coordinating body concerning issues related to systemically important companies and systemic risks, has the authority to designate certain nonbank financial companies to be covered companies, and makes recommendations to the FRB concerning prudential standards and mechanisms for earlier remediation requirements analogous to prompt corrective action requirements currently used by the bank

regulatory agencies to impose restrictions on problem depository institutions as they become more distressed. He also explained that a critical component of Title I was the requirement for covered companies to prepare resolution plans or living wills, which would allow for the unwinding or orderly resolution of a covered company through the bankruptcy code in a manner that does not pose a systemic risk.

Mr. Wigand continued, emphasizing that the preparation of the resolution plans should be undertaken in conformance with the bankruptcy code rather than in reliance on the orderly liquidation authority of Title II, and that it is expected to be an iterative process. He advised that the resolution plans have an informational component to provide information on counterparty exposures, alignment of legal entities with business units, and funding mechanisms, and a strategic planning component to provide a strategic analysis that outlines a conceptual framework for advanced planning with respect to how the entity is going to respond upon its failure; that if the resolution plan is ultimately determined not to be credible, the FDIC and the FRB may take certain actions, such as imposing capital or restructuring requirements on the entity; and that, in the event that resolution plan still does not facilitate an orderly non-systemic resolution under the bankruptcy code, then ultimately, the FDIC and the FRB may force a divestiture of some of the business lines associated with the entity.

Next, Mr. Krimminger presented a brief summary of the key provisions of Title II of the Dodd-Frank Act. He emphasized that the bankruptcy code remains the primary option for the resolution of a covered company, but that Title II provides an alternative to the bankruptcy code for resolving a covered company; that Title II is no bailout mechanism, with taxpayers being barred from absorbing any losses; that, under Title II, the company's shareholders and unsecured creditors bear any losses, and, if the receivership assets are insufficient to cover all of the costs of orderly liquidation, then any deficiencies are recovered through assessments on the financial industry; and that Title II requires that the management of the firm be replaced. He then briefly outlined the process for using the orderly liquidation authority under Title II, explaining that the process is initiated by a recommendation by a two-thirds majority vote by the boards of the FDIC and the FRB; that the recommendation is delivered to the Secretary of Treasury, who then, in consultation with the President, makes a determination as to whether to appoint the FDIC as receiver of the covered company; that the decision is made by the Secretary

of the Treasury as to whether the covered company should be placed into receivership under Title II, who must then file a petition with the U.S. District Court for the District of Columbia seeking judicial review of that decision; that, if the court does not make a determination within 24 hours of receipt of the Secretary of Treasury's petition, the petition is granted by operation of law, and the FDIC is appointed as receiver of the covered company; and that the covered company's board of directors or other aggrieved parties have 30 days to appeal the FDIC's appointment as receiver. He also explained that the provisions of Title II offer four notable elements that differ from bankruptcy code provisions: the ability to have advance planning provided by the resolution plans; the ability to act quickly to resolve the entity or establish a bridge entity; the ability to provide continuity with respect to the entity's ongoing operations in order to maximize the value of its assets; and the ability to provide liquidity from the orderly liquidation fund. He emphasized that, as the receiver for a resolution under Title II, the FDIC is instructed by the Dodd-Frank Act to liquidate the covered company in a manner that maximizes the value of the assets, minimizes losses, mitigates risk, and minimizes moral hazards.

Following the presentation, Committee members discussed a number of issues, including the interrelationship of Title I and Title II, the monitoring of counterparty credit exposure, the resolution planning process, and the FDIC's exercise of its orderly liquidation authority. Mr. Herring expressed concern that there appears to be an inherent logical inconsistency in the relationship of Title I and Title II because if all of the institutions are resolvable under bankruptcy, then how can it suddenly be argued that they cannot be liquidated under bankruptcy and must be resolved under Title II; and that there is the possibility that the FDIC could suddenly have to resolve a large, complex nonbank financial institution because it appears systemic. In response, Mr. Wigand explained that Title I and Title II are interrelated, with the analytical and detailed resolution planning process of Title I serving as a risk management tool to mitigate the probability of an institution's failure and the resolution authority of Title II providing a backstop; and, Mr. Krimminger, emphasizing that the interrelationships between Title I and Title II are very vital, explained that the resolution planning process under Title I ultimately should lead to companies taking a comprehensive look at the complexity of their operations if they are going to meet the Title I standard to be resolved under the bankruptcy code, since the goal is to ensure that the Title II resolution

authority is needed less often. With respect to counterparty credit exposures, Mr. Reed asked whether the FDIC has any surveillance mechanisms in place to alert it, on a real-time basis, to the development of dangerous concentrations of counterparty credit exposure or usages. Mr. Wigand responded by noting that, on a macro basis, the newly created Office of Financial Research is examining counterparty exposures to determine where there may be risk concentrations among counterparties for certain products, and that, on a specific institution basis, part of the resolution planning process requires the submittal of information on counterparty credit exposures. Mr. Krimminger added that OCFI has staff monitoring the risks of various large institutions over time, and that there are a number of domestic and international efforts to enhance the monitoring of counterparty exposures for derivatives and other types of securities activities.

Noting that the Title I resolution planning process focuses on individual institutions, Mr. Wright suggested that a greater concern is the position of the whole market; and that this points to the need for a real-time reporting system for all systemic financial institutions that will identify sudden changes in counterparty exposure concentrations. Mr. Krimminger stated that one of the FDIC's objectives is to be able to spot unusual or developing activity in a particular trading area in order to understand how the market is reacting to various events and to identify where there may be a market reaction against a particular institution; and Mr. Wigand, elaborating on Mr. Krimminger's response, emphasized that real-time information is critical in the resolution planning process because the ability to resolve a company seamlessly is largely dependent on the accuracy and currency of that information, and that part of the resolution planning process involves analyzing a covered company's ability to produce that type of information on a real-time, or at least timely, basis.

Next, Mr. Bodson indicated that there are conflicting interests when determining which counterparties to protect at the point of a failure; that bridge entity financing is not established instantly; that it is important to understand the ramifications of the sale of assets in a resolution; and that advance planning and coordination is critical. In response, Mr. Krimminger emphasized that the reason for having the Title II authority is to prevent the systemic consequences that bankruptcy liquidation might create, and that conflicting elements always exist when attempting to maximize recoveries and minimize losses in the context of minimizing moral hazards. Mr.

Wigand stressed that the Title II authority does not provide protection in the manner that the Deposit Insurance Fund protects insured deposits; that bailouts are precluded by Title II; and that there is no opportunity for public funds to subsidize creditors' losses. In response to a comment by Mr. Johnson that it is difficult to avoid the perception that public funds are not at risk if the FDIC is borrowing from the U.S. Treasury to provide liquidity to the financial system, Mr. Krimminger explained that there is no statutory basis for taxpayer funds to be put in jeopardy because losses are required to be recovered from the creditors of the failed institution or through claw backs and assessments on the financial industry.

With respect to the resolution planning process, Ms. Admati suggested that there is no incentive to provide a credible living will; and that the 30-day period within which to challenge the Title II receivership is likely to adversely affect an orderly liquidation by creating uncertainty regarding whether or not the company is insolvent. In response, Mr. Krimminger noted that there currently is a 30-day appeal period for challenging a decision that the FDIC's appointment as receiver for a failed bank was arbitrary and capricious; that the 30-day appeal period does not stop the receivership from going forward; and that it is the marketplace that ultimately decides whether the company is insolvent by refusing to provide funding. He also emphasized that the FDIC and the FRB have the authority to take increasingly severe actions, including requiring the divestiture of certain assets and operations, in order to compel a covered company to provide a living will that is credible. Mr. Wigand advised that, based on the initial feedback from companies that have already started the process, many are finding that the resolution planning process is a risk management tool, but that he expects any resistance to the process is likely to surface when results of the analysis of the resolution plan indicates problems that require certain changes. Mr. Reed stated that it is important that companies' boards of directors be held accountable for good resolution plans; and several Committee members indicated that it will be difficult to determine whether a complex resolution plan is credible, and that a determination by the FDIC and the FRB that a plan is inadequate or requires changes may result in a lawsuit challenging the decision. In response to Mr. Bradfield's inquiry as to whether a nonbank financial company can opt for a Chapter 11 bankruptcy rather than going through the Title II resolution process, Mr. Krimminger explained that, even if a company has already filed for bankruptcy under Chapter 11, the company can be pulled out of bankruptcy and resolved under Title

II, if it is determined that the bankruptcy process would create systemic consequences.

Agreeing with the positions that have been expressed with respect to the importance of resolution plans, as well as the recognition of their inherent limitations, Mr. Cohen stressed that planning is essential; and that the resolution plans are only one half of the equation, with the other half of the equation consisting of the government's plan as to how it will exercise its orderly liquidation authority, and whether the FDIC has its own plans—a Plan A, Plan B, and a Plan C—in the event it needs to resolve a covered company. Mr. Wigand responded by noting that there will be information in the Title I resolution plans that will have some utility if the FDIC is called upon to exercise its resolution authority under Title II, but he emphasized that the FDIC will need a different plan to resolve the entity. He also noted that the FDIC is going through its own planning exercises to prepare for the resolution of the systemically important companies using the Title II mechanism and the tools available under the statute to resolve the entity. Elaborating on Mr. Cohen's comments, Mr. Johnson agreed that it is essential to have effective planning and asked whether the FDIC will build its plans interactively with real participants playing roles in a simulation exercise. Mr. Krimminger agreed that it is essential to do the type of planning analogous to war game planning scenarios to put the FDIC in the best informational and strategic position to respond to likely scenarios; and that the FDIC has the benefit of flexibility, since it is not bound by a resolution plan that is ineffective. In response to Mr. Bodson's observations that living wills are similar to any disaster recovery planning and that, regardless of the amount of scenario planning, there will still be judgment calls throughout the process, Mr. Wigand noted that the FDIC's use of war gaming simulation exercises for failed banks in the period from 2004 through 2007 proved to be very beneficial to its ability to handle the crisis that started in 2008.

In response to a question from Mr. Herring regarding how the FDIC would resolve one of these very large failed entities without creating a larger and more complicated entity that may raise systemic issues in the future or create a system that is much more vulnerable, Mr. Wigand indicated that there is no desire to create a more complex and more systemic entity as a result of resolving one; and that the Title II authority provides the ability to create a bridge entity that would allow for a spinoff of some of the failed entity's operations or a recapitalization of some part of the entity. Mr. Krimminger

advised that another option would be the sale of parts of the failed entity to different purchasers in order to avoid the issue of increased concentration resulting from a merger of the whole entity with another large or larger entity; and Chairman Bair suggested that a situation where a sale of the whole failed entity to another large entity offers greater value than would be achieved through a breakup strategy raises an interesting policy issue concerning the selection of resolution strategies and the question of whether additional costs, such as the additional costs of putting an even larger, more opaque, and more complex institution into the market, could be factored into the bidding process. Mr. Johnson questioned whether the merger of a failed \$2 trillion bank with another \$2 trillion bank, for example, would be favorably viewed from the standpoint of systemic risk, particularly in view of the difficulties managing that scale of enterprise in a time of crisis; and Mr. Kohn, in response, suggested that regulators approving any such transaction could require the spinoff of certain business lines in a manner similar to the requirements being discussed by European bank regulators for certain large mergers. Responding to an observation by Mr. Johnson that larger banks have an advantage when bidding for assets if there is the perception of a "too big to fail" subsidy or an implicit subsidy in the form of lower funding costs, Mr. Krimminger stated that the provisions of Title I and Title II are designed to help reduce the perception of any subsidy by eliminating the bailout option and by making it less desirable to be large through regulatory pressures, such as the Basel III surcharge on SIFIs and the resolution planning requirements of Title I, which favor more efficient operations. Mr. Johnson noted that Europe has many banks that are very large relative to their economies, and he suggested that when a bank that large fails it is going to have a large taxpayer cost one way or another because of potential credit losses. Chairman Bair responded by commenting that, based on the capital structure of these large institutions, the losses would have to be extreme to go through all of the shareholder equity, subordinated debt, and unsecured debt and still end up with losses; and that, as a result, if a large institution fails, she does not believe there would be an ultimate taxpayer cost from any net loss that, at least temporarily, the U.S. Treasury would have to carry through its lending capability to the FDIC under Title II. She also noted that there would be an assessment on the industry to absorb any such losses, and that there are other funding mechanisms, such as FDIC-guaranteed debt, available to the FDIC without any borrowing from the U.S. Treasury line of credit.

In response to a question from Mr. Bowsher regarding how the resolution plans will be kept confidential, Mr. Krimminger explained that there will be some publicly disclosed components of the plans because of securities law requirements, but that confidential supervisory information, trade secrets, and other confidential information provided with the plans would be protected from disclosure under the FDIC's proposed regulations and existing statutes. Regarding which creditors bear the losses of a failed company, Mr. Krimminger, in response to a question from Ms. Admati, explained that the FDIC has emphasized in its resolution-related regulations that all creditors are exposed to loss, and that any creditor can expect to absorb losses in a resolution, based on the priority structure established in Title II; and that, as a result, the market will adjust over time to the changed expectations of no more bailouts. Responding to a question from Mr. Bradfield asking whether one of the negative impacts of the resolution process will be that companies, particularly nonbank financial companies, will not be able to fund themselves with unsecured debt, but only with secured debt that will be exempt from this new resolution structure, Mr. Krimminger noted that funding with unsecured debt may cost more, but that it should not make it uneconomical to use unsecured debt. In response to concerns raised by several Committee members regarding restrictions on the ability of the Federal Reserve banks to extend funding for troubled institutions, Mr. Krimminger explained that, while the Dodd-Frank Act placed constraints on targeted support to bailout an individual institution, the statute allows for broad, system-wide liquidity support. Mr. Volcker concluded the discussion by noting several additional issues raised by the new resolution regime, including that considerable skepticism remains over whether the Dodd-Frank Act has removed the government's authority for a "too big to fail" bailout; that living wills may give rise to legal challenges, particularly when changes are required to parts of the company in which there are synergistic relationships, but which the FDIC and FRB believe should be broken up; and that there needs to be some understanding among international regulators to address situations where a foreign organization has substantial operations in the U.S. and its home country.

Chairman Bair then announced that the meeting would briefly recess. Accordingly, at 10:38 a.m., the meeting stood in recess.

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The meeting reconvened at 10:56 a.m. that same day, at which time Mr. Wigand introduced Arthur J. Murton, Director, Division of Insurance and Research ("DIR"); Jack Reidhill, Chief, Special Studies Section, DIR, FDIC; Joseph Fellerman, Senior Program Analyst, DIR; and F. Angus Tarpley, III, Counsel, Receivership Policy Unit, Litigation and Resolutions Branch, Legal Division, to present a panel discussion of a paper prepared by FDIC staff that examines how the FDIC could have structured a resolution of Lehman Brothers Holdings Inc. ("Lehman") under the orderly liquidation authority of Title II of the Dodd-Frank Act.

Mr. Murton began by providing a brief summary of the events leading up to Lehman's bankruptcy. He noted that, beginning in 2006, Lehman adopted a more risky growth strategy of taking risks on its balance sheet; that, after the failure of Bear Stearns and its acquisition by JPMorgan Chase in March 2008, Lehman was viewed by many as the next most vulnerable investment firm and Lehman began to seek additional capital or an acquisition offer; that discussions with Bank of America, MetLife, and other potential acquirers in the summer of 2008 did not result in an acquisition, but due diligence by these entities identified some assets in Lehman's structure that were problematic to an acquisition; that, after Fannie Mae and Freddie Mac were placed into conservatorship in late summer 2008, Lehman's liquidity problems became acute and counterparties began requiring more collateral; that Barclays, a large U.K. commercial and investment bank, approached Lehman in early September 2008 to discuss a possible acquisition; that Barclays' due diligence identified an estimated \$52 billion of assets that it would not acquire; that Barclay's abandoned the transaction on September 14, 2008, after it could not get regulatory approval from the U.K. authorities; that Lehman filed for Chapter 11 bankruptcy on September 15, 2008; and that, shortly after Lehman filed for bankruptcy protection, Lehman's broker-dealer in the U.K. was placed in administration, and Lehman's U.S. broker-dealer was placed in liquidation under the Securities Investor Protection Act. Continuing, Mr. Murton emphasized that the Lehman bankruptcy had an immediate and very disruptive effect on U.S. financial stability, including the disruption of the money market mutual fund industry when one of Lehman's largest creditors, the Reserve Primary Fund—a \$62 billion money market fund that held \$785 million of Lehman's commercial paper—sustained a loss of value that caused it to "break the buck" and required the U.S. Treasury to temporarily guarantee money market funds. The Lehman bankruptcy is not yet resolved, he added, and Lehman's general unsecured creditors are

expected to recover approximately 20 cents for every dollar of their claims.

Next, Mr. Murton described how the FDIC could have resolved Lehman under the Title II orderly liquidation authority, stating that the FDIC would have been on site at Lehman in early 2008, working with the FRB to gather information to supplement and update Lehman's resolution plans; that the FDIC would have been in discussions with Lehman's management and board of directors to emphasize that raising capital or pursuing a sale of the company—notwithstanding that any acquisition would be dilutive in nature—would be a better alternative for shareholders than an FDIC receivership; that the FDIC would have been identifying Lehman's problems assets and gathering information on its systems in order to plan a Title II resolution transaction and bid structure with which in could seek potential acquirers; and that the FDIC would have contacted appropriate foreign authorities to discuss potential issues, such as the impact of a resolution transaction, and to address any concerns on the eligibility of potential foreign acquirers. In the event Lehman's management was unable to raise capital or find an acquirer, Mr. Murton continued, the FDIC would have conducted a bidding process to find an acquirer for the company, in a manner similar to the process that typically occurs for a failed depository institution. He briefly outlined the bid structure and process that would have occurred, noting that potential bidders for Lehman would have included parties previously interested in the company, such as Barclays; that, based on an estimate of \$50-70 billion of problem assets, the FDIC would have offered the option of a "good bank-bad bank" resolution—in which the problematic assets would be segregated and retained for later disposition and the "good bank" would be transferred to the acquirer—or the option of a loss-share arrangement—in which the acquirer purchases all of the company's assets, but shares in the losses on the pool of problem assets; and that, if a winning bidder, such as Barclays, was selected, Lehman would have been placed into receivership and the FDIC, as receiver, would have sold Lehman's U.S. and U.K. broker-dealer operations or other parts of the company out of the receivership to Barclays.

With respect to the treatment of Lehman's creditors, Mr. Murton explained that Lehman had \$20 billion of equity at the time of its failure; that Lehman had \$15 billion of subordinated debt, and \$175 billion of other senior debt, including \$90 billion of intra-company liabilities; and that, if losses on the \$50-70 billion pool of problem assets had been \$40 billion,

Lehman's general unsecured creditors would have had a recovery rate of 90-97 cents for every dollar of their claims, depending on the distribution of those losses among the senior debt and intra-company debt. He concluded by noting that the FDIC staff believes that a Title II resolution of Lehman would have preserved the ongoing value of the franchise, imposed losses on the shareholders, removed management responsible for the losses, and provided policy makers with a realistic alternative to a bailout or disorderly bankruptcy.

Responding to a question from Mr. Donaldson regarding the U.K. authorities' position on a resolution transaction with Barclays, Mr. Murton stated that the FDIC would have discussed with the U.K. authorities any concerns they may have with the acquisition of Lehman's problematic assets by Barclay, and the FDIC would have structured the resolution transaction in a manner that removed those assets, or the risk of those assets, and allowed Lehman's U.K. broker-dealer to continue to operate within Barclays. In response to concerns raised by Mr. Volcker regarding what would have happened on the second, third, and fourth days immediately after the FDIC completed a resolution of Lehman, and whether the FDIC expected that there would have been collateral effects on other firms, Mr. Wigand indicated that, assuming that it was the winning bidder, Barclays would have stepped in as the acquirer and operated the institution; and that there could be unforeseen collateral effects on the markets resulting from a Title II resolution that may be difficult to address, such as the signaling effects resulting from a lack of confidence in the valuation of derivatives or mortgage-related types of securities that ripples to other firms and precipitates the unwinding of contracts at fire sale prices. Mr. Volcker suggested that, even if Lehman was resolved by the FDIC under Title II, what was at stake here was not about Lehman in some sense, but that its failure impressed upon the market that there was \$1 trillion of bad credits in the market. Once the market understood the extent of the problem, Mr. Volcker continued, everyone wanted more collateral and did not want to invest in these other investment banks, and, even if the FDIC had had the Title II resolution authority, the FDIC possibly would have had to apply it to other major financial companies. In response to Mr. Volcker's comments, Mr. Murton stressed that there arguably would have been less creditor losses and disruption with an FDIC resolution; and Mr. Reidhill added that the Reserve Primary Fund may not have experienced the losses that disrupted the money market funds, since the FDIC could have paid an advanced dividend to provide it with sufficient cash, or Barclays may have chosen to hold the commercial paper.

The discussion continued with Mr. Reed commenting that, if it had had the Title II resolution authority earlier, the FDIC probably would have had to intervene with the resolution of five or six major entities; and Mr. Bodson emphasized that the FDIC would be running the most leveraged hedge fund on the face of the earth, since it would have to provide the funding for these failing entities. Mr. Wigand responded by noting that the FDIC has the ability in a resolution to quickly monetize creditors' claims using the failed entities' assets to mitigate any potential ripple effects or disruption of the market. Mr. Volcker noted that the extent of the FDIC's resolution authority may effectively be limited when the banking system is already burdened with problematic assets. In response, Chairman Bair stressed that the FDIC's resolution authority by itself cannot address the lack of lending standards, lack of transparency, and mischaracterizations in asset securitizations and collateralized debt obligations, which never should have gone into the market in the first place; that there has to be supervisory reforms, including enforcement of higher capital standards that will provide a more stable base to prevent institutions from having all of this toxicity on their balance sheets going forward; and that there needs to be market discipline to complement the supervisory process for these institutions. In response to Mr. Reed observing that risk-based models contribute to large concentrations of mortgage-related securities which can lead to systemic risks, Chairman Bair noted that some of this problem is driven by regulation and regulatory treatment of risk-weighted capital standards, which the FDIC has long sought to reform.

Chairman Bair then announced that the meeting would recess for lunch. Accordingly, at 12:01 p.m., the meeting stood in recess.

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The meeting reconvened at 1:32 p.m. that same day, with Mr. Wigand introducing Mr. Krimminger and R. Penfield Starke, Senior Counsel, Receivership Policy Unit, Litigation and Resolutions Branch, Legal Division, FDIC, to discuss cross-border resolution issues. Mr. Krimminger began by advising that there is no binding international insolvency framework to deal with cross-border financial institutions; and that cross-border financial institutions include banks and nonbank financial companies that have a subsidiary in a foreign country, an operational entity in a foreign country without being a separate subsidiary, or assets and liabilities in foreign jurisdictions, and may also include

institutions that are dependent upon certain operational services provided by entities in foreign jurisdictions. Noting that the Dodd-Frank Act provides a foundation for regulators in the international community to discuss cross-border issues, Mr. Krimminger advised that, since 2007, he has co-chaired a working group involved with a committee on banking supervision called the Cross-Border Resolutions Group ("CBRG"), which issued recommendations in March 2010 to address, in a holistic manner, three major issues: the powers that a resolution authority receiver or trustee in bankruptcy might need to effectively resolve both domestic and cross-border failures; the areas where it is possible to establish processes for improving cross-border coordination and information sharing; and the ways to improve systemic resiliency and the ability to resolve system resiliency issues, such as the ability to delay the termination and netting of derivatives contracts. He also advised that the CBRG's recommendations have been endorsed by the FSOC; that the FSOC's recommendation of those recommendations has been endorsed by the G20 leaders; and that the CBRG will soon be issuing a report on the progress to date regarding efforts by the G20 and other countries around the globe to implement those recommendations. As a preview of the CBRG's report, Mr. Krimminger advised that numerous countries have adopted a number of the resolution powers to provide themselves with the capabilities they have had for domestic institutions, which represents a step forward on dealing with cross-border issues because it will allow greater harmonization in the understanding of how the resolution process works, as well as harmonization of the legal infrastructure; that there has been considerable discussion among international authorities on how to provide a more coordinated international resolution process, including the possibility in the distant future of an international treaty that would create a binding international framework; and that the European Union has made progress in its efforts to create a more coordinated, centralized process for dealing with systemic issues and bank resolutions.

Next, with respect to the ability to implement a Title II resolution, Mr. Krimminger summarized the key cross-border legal conflicts that must be addressed: foreign authorities would need to recognize the FDIC's appointment as receiver of a failed institution and, if necessary, to recognize a newly-created financial company as the new owner and operator of the failed institution's operations in that foreign jurisdiction; automatic triggers existing in some foreign jurisdiction's laws that allow the termination of netting of contracts upon an institution's insolvency would need to be eliminated; foreign authorities

would need to cooperate in allowing a bridge financial company to operate, to own and operate a subsidiary or branch, and to meet capital and other requirements applicable to those operations within that foreign jurisdiction; and foreign jurisdictions would need to be able to recognize the transfer of ownership of assets held by the bridge financial company, receivership, and third parties. He advised that the FDIC has been working with its counterpart in the U.K. to identify a number of ways under U.K. law to implement a Title II resolution for a U.S. institution's operations in the U.K.; that the FDIC is beginning similar initiatives with additional jurisdictions around the globe; and that these initiatives are viewed as a practical means to build a more cooperative resolution process using the FDIC's authority under the Dodd-Frank Act or the Federal Deposit Insurance Act ("FDI Act"). He further advised that the goal of these initiatives is to identify potential conflicts and find ways to work through those conflicts, and to identify, on a firm-specific basis, the franchise value of a U.S. institution's operations in a particular foreign location in relation to its overall franchise value, which will aid the FDIC as receiver in its understanding of the trade-offs and risks associated with continuing an the institution's operations in that jurisdiction.

During the discussion of cross-border issues that followed, Mr. Krimminger, in response to a question from Ms. Guillot, advised that the FDIC's Title II resolution authority would apply to a major subsidiary of a foreign bank operating in the U.S., if it met the criteria of being a financial company and was a systemic to the U.S. economy; and that this raises a broader issue, which is the need for international cooperation regarding the relationship between a resolution plan in the home jurisdiction of a foreign company and the resolution plan for its U.S. operations. Regarding ongoing efforts directed toward harmonization, Mr. Wright offered a brief European perspective on cross-border resolution issues, noting that the European Commission will be considering a detailed proposal on a crisis management framework for the financial sector that covers, among other things, tool kits, early intervention, and resolutions; that the proposed framework emphasizes the need for harmonization of both tools and processes; and that the European authorities share a great deal of common thinking with respect to the legal framework in the U.S., providing a timely opportunity for cooperation between the European countries and the U.S. to build a parallel policy framework. With respect to Europe, Ms. Admati observed that it is difficult to harmonize the different resolution processes, in part, because Europe has

many different countries and nationalities with different laws; and that these jurisdictions often have different objectives, such as Germany's resolution process introduced last year, which differs from the U.S. or U.K. resolution process because it focuses more on creditors' rights than systemic stability. Mr. Krimminger emphasized that Germany's recently introduced resolution process represents substantial progress from its previous process that was more typical of a corporate bankruptcy process, and that it incorporates a number of the features discussed in the CBRG's recommendations and the Dodd-Frank Act.

Recalling that one of the issues in the Lehman bankruptcy was that the assets got trapped in New York rather than London, Mr. Kohn stressed that this illustrates how difficult it is to build cooperation between countries because there is a tendency for each country to ring fence and secure as many assets as possible, and two resolution authorities exist at the same time. In response, Mr. Krimminger explained that there may not be the need for two resolution authorities if there is an agreement during the resolution process or the pre-planning process that cooperation among the authorities will achieve a better result; and Mr. Wigand suggested that the best approach to resolving this issue may be to have discussions, on a case-by-case basis, between regulators to consider the costs and benefits of one particular resolution strategy vis-à-vis another, and to analyze the impact that a jurisdiction's ring fencing of assets may have on the entire resolution strategy. Noting that he supports an international resolution approach because there is unlikely to be any resolution for these large institutions without it being international, Mr. Cohen stressed that it is an extremely difficult task to seek the cooperation of European countries as long as the U.S. has domestic depositor preference that, in effect, makes a foreign depositor at a U.K. branch of a U.S. bank a subordinated creditor; and that this is an issue that needs to be addressed with a legislative remedy. To the extent a resolving authority has concerns with respect to the treatment of their domestic depositors vis-à-vis those of the U.S. depositors, Mr. Wigand responded by suggesting that those concerns would have to be addressed, at least in the short term, in a discussion focusing on the quid pro quo associated with the treatment of those depositors.

Emphasizing that it is constitutionally impossible for some countries' regulatory authorities to intervene until an institution is declared legally insolvent, Mr. Herring suggested that this raises a concern regarding the harmonization of the point of insolvency and the flow of information in cross-border

situations because primary regulators have a natural tendency to keep information from other regulators to avoid losing their discretion to rehabilitate or resolve a troubled institution under their supervision. Citing the FDIC's experiences in dealing with the resolution of a domestic bank with operations in Hong Kong and a subsidiary in China, Mr. Wigand stated that the seamless resolution of that bank both domestically and abroad was due, in part, to the FDIC's discussion of the structure of the bank's resolution with the foreign regulators in advance of the bank's failure; and that it was important in those discussions to segregate supervisory information relating to the probability of the bank's default from the contingency planning information related to the resolution. With respect to a question from Mr. Koskinen regarding whether there is any harmonization of resolution plans for cross-border institutions, Mr. Krimminger explained that one of the issues being addressed by the crisis management groups that have been established by the U.S. and international regulators for all of the large internationally active U.S. and non-U.S. financial companies is the resolution planning process, including how to harmonize resolution planning that a particular home jurisdiction may be requiring for one of its home companies and the effects that any such plans would have on a jurisdiction hosting subsidiaries or branch operations of those companies.

Continuing the discussion on cross-border resolution issues, Mr. Volcker asked how the resolution planning process takes into account the possibilities of regulatory arbitrage, which allows some large financial institutions to operate in different countries with little supervision by their home jurisdiction or to relocate to a different country to avoid intrusive supervision by a host jurisdiction. Acknowledging that the issue of regulatory arbitrage raises concerns regarding the reliance on the supervision of a consolidated supervisory authority from a home jurisdiction, as well as broader implications related to an overall level playing field and the balance of the competitive nature of the international system, Mr. Krimminger stated that these concerns highlight the need for the Basel Committee, FSOC, and others in the international community to maintain high capital standards across the globe, and the importance for home jurisdictions to have strong standards that increase systemic resiliency. With respect to the Mr. Volcker's question regarding how the FDIC would handle the resolution of a large global financial company, such as HSBC, which has operations all over the world, Mr. Wigand emphasized that the FDIC's mandate under the Dodd-Frank Act is focused on the systemic risk that is posed to the U.S., which

limits its ability to control that risk to operations located in the U.S.; and that, through cross-border discussions, the FDIC is able to point out the systemic risk issues arising from the home country resolution process that would impact the resolution process in the U.S. Ms. Guillot suggested that market discipline may play a role in limiting regulatory arbitrage because, in theory, stronger regulatory environments should benefit from a lower cost of funding.

Mr. Krimminger, in response to Chairman Bair suggesting that large global companies could simplify their international operations, noted that one option for controlling risk in host companies, particularly in the context of consolidated supervision, would be the establishment of requirement that companies could only do business in the host jurisdiction through subsidiaries. Elaborating on the option of requiring subsidiaries in host jurisdictions, Mr. Krimminger explained that, from the industry perspective, there are concerns with the loss of the efficiencies in the ability to raise funds on a global basis and loss of the benefits, such as higher ratings, that operating branches and other operations may derive from their home entity; and that, from a host jurisdiction's perspective—particularly a small country that has less influence over the consolidated supervisor of a large global company—there are the benefits of having control over the capital, liquidity, and other aspects of the subsidiary that allow the host jurisdiction to manage risk. Based on the experiences of 2008, he continued, whether an entity is a branch or a subsidiary is often meaningless because, in a crisis, host jurisdictions will take the entity apart as if it is a subsidiary, whenever it is in their own interests, in a manner that is very much akin to ring fencing.

Chairman Bair then announced that the meeting would briefly recess. Accordingly, at 2:29 p.m., the meeting stood in recess.

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The meeting reconvened at 2:45 p.m. that same day with Mr. Wigand advising that Marc Steckel, Associate Director, Financial Risk Management Branch, DIR, FDIC, Mr. Krimminger, and Mr. Starke would present the final panel discussion of the Committee's meeting, which would focus on derivatives and qualified financial contracts ("QFCs") in the resolution process. Noting that the Dodd-Frank Act requires a number of changes in the way that derivatives are transacted, Mr. Steckel began by explaining that the panel's discussion would cover how

derivatives and repurchase agreements are treated in both the bankruptcy process and the Title II resolution process. He advised that derivatives and repurchase agreements receive preferential treatment in bankruptcy and are not subject to the automatic stay or avoidance provisions of the bankruptcy code; that, upon an entity's bankruptcy, solvent counterparties of derivatives and repurchase agreements are able to move quickly to protect their interests; that contracts for derivatives and repurchase agreements are aggregated by counterparty and the counterparty's affiliates and handled as a group for netting; and that the rationale behind this treatment of derivatives and repurchase agreements is that it avoids the possibility of cascading bankruptcies or systemic problems that otherwise could be caused by staying these transactions.

Mr. Steckel continued, explaining that the Dodd-Frank Act envisions similarities between a Title II resolution and how the FDIC as receiver of a failed bank has handled derivatives and repurchase agreements; that the FDIC as receiver of a failed bank has one business day to determine how derivatives and repurchase agreements will be handled; and that the FDIC as receiver of a failed bank has three options, which are governed by the least-cost test of the FDI Act: to pass all of the counterparties' positions to a bridge bank or acquirer; to repudiate all of the contracts; or to leave all of the contracts in the receivership to be handled under the receivership claims process. He also advised that the FDIC, in 2009, began requiring certain troubled banks to demonstrate the capacity to organize and present information in a manner that will allow the FDIC as receiver to make timely QFC determinations, and that the Dodd-Frank Act requires that this recordkeeping be expanded more broadly to include bank holding companies and nonbank financial companies.

Mr. Krimminger continued the panel's discussion of the treatment of derivatives by observing that the netting protections for derivatives in insolvency laws represent one of the most successful examples of legal harmonization because the International Swaps and Derivatives Association, Inc., and a number of other trade associations in the U.S., Europe, and Asia have succeeded in getting virtually all of the major industrialized countries to adopt provisions in derivative contracts that protect the netting rights of counterparties upon insolvency. He indicated that the ability to determine and net derivative contracts may work effectively when there is an idiosyncratic failure or the absence of widespread loss of value in the market similar to that which occurred in 2008, but the

failure of a very large participant or a period of widespread distress arguably can have some very deleterious effects upon systemic civility, particularly if multiple firms sell their collateral on the market simultaneously, creating a downward spiral in the value of that collateral and making an illiquid market even more illiquid. Mr. Krimminger also indicated that one of the most important aspects of the FDI Act for failed banks, and the Dodd-Frank Act in the case of nonbank financial companies, is the ability of the FDIC as receiver to transfer derivative contracts where it would add value to the bridge bank or bridge company, or to a third party, which avoids adding collateral to an illiquid market and mitigates any systemic effects on other firms; and that this represents another area where it is important to have cross-border harmonization because the incorporation of a brief delay in termination netting incorporated into both contractual provisions and other countries' laws will provide more stabilization in the market.

Mr. Herring commented that the protections for derivative contracts have become too broad in preserving all derivatives in the resolution process and need to be changed by, for example, protecting only derivatives collateralized by cash. In response, Chairman Bair noted that the FDIC's regulations strongly emphasize that counterparties not collateralized by liquid collateral, such as Treasury notes or Treasury-backed securities, will be subject to haircuts in the receivership process; and Mr. Krimminger suggested that another approach to dealing with overly broad protection of derivatives may be to narrow the definitions of the types of contracts included in the netting pool. Mr. Cohen noted that the role of derivatives has changed radically and their volume has grown explosively since the provisions allowing netting went into effect in the 1990's, and he suggested that a better approach would be to reduce the gambling aspect of derivatives through the regulatory process rather than providing broad authority to distinguish between types of derivative contracts on an ad hoc basis during the resolution process. Mr. Krimminger, in agreement, emphasized that it is better to have as much certainty and clarity as possible in the definitions for determining what would be included, and what would not be included, in the netting pool than to leave that question open to an ad hoc decision making process; and Mr. Reed suggested that narrower is better because the market will treat it differently if it is clear that a contract will be outside of any bankruptcy protection. While the resolution planning process is expected to provide a better understanding of counterparty credit exposure concentrations, Mr. Herring observed, the presence of credit default swaps can

make it difficult to ascertain which counterparty holds the risk. Mr. Cohen noted that this may make a resolution under the orderly liquidation authority preferable over the bankruptcy process because, if creditor consent is required, the actual creditors may have totally different interests; and Mr. Krimminger agreed, noting that the FDIC has seen this problem in major bankruptcies where the creditors' committee is comprised of creditors who formally have a credit exposure but no real risk because they are protected through credit default swaps and other types of structures, and have interests in other aspects of the transactions.

Chairman Bair thanked the Committee members for dedicating the time to provide their valuable contributions to the FDIC and the Committee's initial meeting. She emphasized that the issues discussed at today's meeting are difficult ones that are solvable with a lot of hard work, and noted that it will be helpful to have the Committee members' input. Vice Chairman Gruenberg stated that the establishment of the Committee is one of the many legacy contributions that Chairman Bair has made to the FDIC. He noted that this initial meeting has already proven the value of the Committee, and stated that he looks forward to continuing to work with the Committee members.

There being no further business, the meeting was adjourned.



Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
And Committee Management Officer
FDIC Systemic Resolution Advisory
Committee

Minutes
of
The Meeting of the Systemic Resolution Advisory Committee
of the
Federal Deposit Insurance Corporation

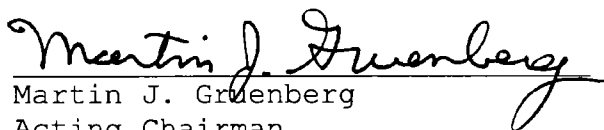
Held in the Board Room

Federal Deposit Insurance Corporation Building
Washington, D.C.

Open to Public Observation

June 21, 2011 - 8:35 A.M.

I hereby certify that, to the best of my knowledge, the attached minutes are accurate and complete.


Martin J. Gruenberg
Acting Chairman
Board of Directors
Federal Deposit Insurance Corporation