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A Dodd-Frank Living Wills Primer: What You Need to Know Now

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A living will, a legal document traditionally associated with individual end-of-life decision-making, is now a term widely heard in connection with strategic planning for financial institutions. While living wills, in an everyday setting, refer to documents that indicate how people would prefer to be medically treated in the event that they lose the capacity to instruct family or medical professionals themselves (*i.e.*, if they become incapacitated), a living will referenced in the restructuring and turnaround community now refers to a bank or financial institution's plan for reorganization or liquidation in the event of a major financial disaster or demise. This concept is relatively new in the restructuring world, as it is a result of new FDIC regulations created in the wake of the Lehman collapse in 2008.

How Did We Get Here?

In the aftermath of the unplanned bankruptcy of Lehman Brothers in the fall of 2008 and the Great Recession that followed, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law in July 2010. The Dodd-Frank Act's official aim, according to its title page, is "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."

As part of the goal to remove the risks to the financial system posed by "too big to fail" institutions, § 165(d) of the Dodd-Frank Act requires "systematically important financial institutions" to create "living wills" to facilitate "rapid and orderly resolution, in the event of material financial distress or failure." In the fall of 2011, the Federal Deposit Insurance Corp. (FDIC) issued rules implementing § 165, requiring "covered financial companies" to develop and periodically submit to the FDIC and the Federal Reserve Board comprehensive resolution plans (*i.e.*, living wills) for the orderly resolution of their affairs under the Bankruptcy Code or other insolvency regimes. In addition, the FDIC concurrently issued a separate rule requiring insured depository institutions with $50 billion or more in total assets to submit to the FDIC periodic contingency plans for resolution in the event of the institution's failure. These rules went into effect on Sept. 13, 2011. The first set of living wills were filed on July 1, 2012, and additional reports will be due at periodic intervals after that date.

Who Should Care?

The "covered financial companies" that must submit living wills on a periodic basis include (1) any U.S. bank holding company that has $50 billion or more in consolidated assets; (2) any foreign bank or company that is a bank holding company, or that is treated as a bank holding company, with $50 billion or more in total consolidated assets; and (3) any nonbank financial company supervised by the Federal Reserve Board. There are three deadlines for covered companies to submit living wills: July 1, 2012, for covered companies with total nonbank assets of $250 billion or more (or in the case of foreign covered companies, $250 billion or more in total U.S. nonbank assets); July 1, 2013, for covered companies with total nonbank assets between $100 billion and $250 billion (or in the case of foreign covered companies, between $100 billion and $250 billion in total U.S. nonbank assets); and Dec. 31, 2013, for covered companies with total nonbank assets of less than $100 billion (or in the case of

foreign covered companies, less than $100 billion in total U.S. nonbank assets).

These contingency plans must include information about the financial institution's structure, operations, cash flows, financial responsibilities and areas of risk exposure, including counterparty risk. The goal of the plan is to explain how the FDIC would provide depositors access to their deposits within one business day of the institution's failure (two business days if the failure occurs on a day other than Friday), maximize the net value return from the sale or disposition of the company's assets and minimize any losses for the organization's creditors.

The Financial Stability Oversight Council (FSOC) is in charge of determining which nonbank financial companies should be considered systemic or likely to become systemic, and on April 3 it issued its final rule and interpretive guidance governing this process. This determination will consider several factors, including the monetary value of transactions, risk exposures, relationship of the company to other critical companies and the effect that the company's failure would have on the financial system. The FSOC uses a three-stage process for evaluating the designation of a company as systemic. The first stage is data-driven, and the second is a more in-depth review with a focus on qualitative factors, including industry- and company-specific metrics. In the third stage, the FSOC will formally notify companies that are being considered for a proposed determination as a SIFI and require submission of financial information the FSOC will use in its analysis.

Despite the detailed evaluation process, there is still some controversy about which companies qualify as "covered." Market-watchers posit that some companies to which the rules apply will be foreign bank holding companies or U.S. subsidiaries of foreign-owned banks, further complicating both the enforcement of the rule as well as the evaluation of the sufficiency of the living will plans. For example, not all jurisdictions have procedures in place to recognize foreign proceedings, which could hamper a company's capacity to manage the operations of a foreign subsidiary and, ultimately, to reorganize or liquidate according to a plan laid out in a living will.

In addition, the FDIC, pursuant to its authority under the Federal Deposit Insurance Act (FDIA), concurrently has issued a rule that requires insurance depository institutions with $50 billion or more in total assets to develop and submit separate plans for resolution in the event of the institution's failure. These resolution plans will enable the FDIC, as a receiver under the FDIA, to resolve the institution in a manner that ensures that depositors will have access to their insured deposits within one business day of the institution's failure (two business days if the failure occurs on a day other than a Friday), maximizes the net-present-value return from the sale or disposition of its assets, and minimizes creditors' losses.

Living Wills: In Practice

A living will, as required by the Dodd-Frank Act, must describe the company's plan for how it could be resolved in a bankruptcy proceeding or an applicable insolvency regime, such as a state insurance liquidation statute. A resolution strategy must be included for the holding company and any subsidiary that conducts core business lines or critical operations. The goal of a living will is to achieve a rapid and orderly resolution of an organization in such a way as not to cause a systemic risk to the financial system.

The final rule also sets specific standards for the resolution plans, including requiring a strategic analysis of the plan's components, a description of the range of specific actions to be taken in the resolution and analyses of the company's organization, material entities, interconnections and interdependencies, and management information systems, among other elements. (Smaller, less-complex covered companies may be able to file a tailored resolution plan.)

In essence, preparing a living will is both akin to preparing for a bankruptcy and similar to preparing a detailed information-management system. As such, the preparation of living wills requires the involvement of top executives and can benefit from the involvement of third-party companies skilled at administering complex bankruptcies and restructurings.

Living wills by nature require a massive data-gathering effort and can be aided greatly by partnership with either a company's sophisticated internal IT department or with an external administrator with a significant data-gathering capacity. Creating a living will is likely to involve first creating a "data map" of the organization if one does not exist already. This data map should list all of the required entities for FDIC reporting. Existing information can be leveraged, but must often be knitted together with the assistance of a discovery-like process. This map then enables the creation of recovery and liquidation plans, which can be combined into the final, comprehensive living will document.

Conclusion

While the Dodd-Frank Act and living wills may be here to stay, the question remains as to whether they will work. If one can extrapolate anything from how chapter 11 bankruptcies, restructurings and liquidations typically proceed, even the most well-structured plans can hit major roadblocks in bankruptcy due to unforeseen circumstances. It is then critical that the same kind of care be taken in crafting a thorough and well-considered living will as a company might take in planning a restructuring.

Planning for a bankruptcy and creating a living will have many similarities, and expertise with bankruptcy administration can aid in living will preparation. Unlike bankruptcy planning, however, living will planning takes place outside the "crisis mode" of a bankruptcy. It is, therefore, in the best interests of covered companies to take full advantage of the benefits of crisis planning absent a crisis. Financial institutions should undertake living will preparation with care, as this will be the only time that they can consider a contingency plan while not under the gun of tight timelines, public scrutiny and looming deadlines. abi

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