Resolution Plan FAQs
Foreign Banking Organizations

An interagency release of the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation • September 2017

In March 2017, the Federal Reserve Board (Board) and the Federal Deposit Insurance Corporation (FDIC and, together, the Agencies) issued Guidance for use in developing the 2018 resolution plan submissions by four foreign-based covered companies[1] that are required to submit resolution plans.

In response to frequently asked questions regarding the Guidance from the foreign banking organizations, the Board and the FDIC staff jointly developed answers and provided those answers to the firms, so that the firms could take them into account in developing their next resolution plan submissions.[2] Those questions and answers are being released to better inform the public about the resolution planning process.

The questions:

- **Comprise common questions asked by various firms.** Not every question is applicable to every firm (i.e., not every aspect of the Guidance applies to each firm's preferred strategy/structure).
- **Pertain to the four foreign-based covered companies only.** Other firms required to file resolution plans should not assume that these questions or answers or other communications apply to them.

FAQs Sorted by Topic

1 Barclays PLC, Credit Suisse Group AG, Deutsche Bank AG, and UBS AG.

2 The FAQs represent the views of staff of the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation and do not bind the Board or the FDIC.

Capital

CAP 1. Capital Pre-Positioning and Balance

Q. How should a firm determine the appropriate balance between resources pre-positioned at the U.S. IHC subsidiaries and held at the U.S. IHC?

A. The 2018 Guidance addresses this issue on pages 5–6. The Agencies are not prescribing a specific percentage allocation of resources pre-positioned at the U.S. IHC subsidiaries versus resources held at the U.S. IHC. In considering the balance between certainty and flexibility, the Agencies note that the risk profile of each U.S. IHC subsidiary should inform the "unanticipated losses" at the entity, which should be taken into account in determining the appropriate balance.

CAP 2. Definition of "Well-Capitalized" Status

Q. How should firms apply the term "well-capitalized"?

A. U.S. non-branch material entities must comply with the capital requirements and expectations of their primary regulator. U.S. non-branch material entities should be recapitalized to meet jurisdictional requirements and to maintain market confidence as required under the U.S. resolution strategy.

CAP 3. RCEN Relationship to DFAST Severely Adverse Scenario

Q. How should the firm's RCEN and RLEN estimates relate to the DFAST Severely Adverse scenario? Can those estimates be recalibrated in actual stress conditions?

A. For resolution plan submission purposes, the estimation of RLEN and RCEN should assume macroeconomic conditions consistent with the DFAST Severely Adverse scenario.

However, the RLEN and RCEN methodologies should have the flexibility to incorporate macroeconomic conditions that may deviate from the DFAST Severely Adverse scenario in order to facilitate execution of the U.S. resolution strategy.

CAP 4. TLAC Rule

Q. Since the plan submission date in 2018 precedes the compliance date in 2019 of the Federal Reserve's final TLAC rule, should firms document their current or future state compliance with the final TLAC rule?

A. The Agencies are not pulling forward the requirements of the final TLAC rule. Firms should document both their current state and their planned future state with respect to IHC TLAC in their discussions of RCAP.

Liquidity

LIQ 1. Inter-Company "Frictions"

Q. Can the Agencies clarify what kinds of frictions might occur between affiliates beyond regulatory ring-fencing?

A. Frictions are *any* impediments to the free flow of funds, collateral and other transactions between material entities. Examples include regulatory, legal, financial (i.e., tax consequences), market, or operational constraints or requirements.

LIQ 2. Distinction between Liquidity Forecasting Periods

Q1. How long is the stabilization period?

A1. The stabilization period begins immediately after the U.S. IHC bankruptcy filing and extends until each material entity reestablishes market confidence. The stabilization period may not be less than 30 days. The reestablishment of market confidence may be reflected by the maintaining, reestablishing, or establishing of investment grade ratings or the equivalent financial condition for each entity. The stabilization period may vary by material entity, given differences in regulatory, counterparty, and other stakeholder interests in each entity.

Q2. How should we distinguish between the runway, resolution, and stabilization periods on the one hand, and RLAP and RLEN on the other, in terms of their length, sequencing, and liquidity thresholds?

A2. The Agencies have not specified a direct mathematical relationship between the runway period, the RLAP model, and RLEN model. As noted in prior guidance, firms may assume a runway period of up to 30 days prior to entering bankruptcy provided the period is sufficient for management to contemplate the necessary actions preceding the filing of bankruptcy. The RLAP model should provide for the adequate sizing and positioning of HQLA at material entities for anticipated net liquidity outflows for a period of at least 30 days. The RLEN model estimates the liquidity needed after the U.S. IHC's bankruptcy filing to stabilize the surviving material entities and to allow those entities to operate post-filing.

See "LIQ 4. RLEN and Minimum Operating Liquidity (MOL)," Question 1, for further detail on the components of the RLEN model.

Q3. What is the resolution period?

A3. The resolution period begins immediately after the U.S. IHC's bankruptcy filing and extends through the completion of the U.S. strategy. After the stabilization period (see "LIQ 2. Distinction between Liquidity Forecasting Periods," Question 1, regarding "stabilization period"), financial statements and projections may be provided at quarterly intervals through the remainder of the resolution period.

LIQ 3. Inter-Affiliate Transaction Assumptions

Q. Does inter-affiliate funding refer to all kinds of intercompany transactions, including both unsecured and secured?

A. Yes.

LIQ 4. RLEN and Minimum Operating Liquidity (MOL)

Q1. How should firms distinguish between the minimum operating liquidity (MOL) and peak funding needs during the RLEN period?

A1. The peak funding needs represent the peak cumulative net outflows during the stabilization period. The components of peak funding needs, including the monetization of assets and other management actions, should be transparent in the RLEN projections. The peak funding needs should be supported by projections of daily sources and uses of cash for each U.S. IHC subsidiary, incorporating inter-affiliate and third-party exposures. In mathematical terms, RLEN = MOL + peak funding needs during the stabilization period. RLEN should also incorporate liquidity execution needs of the U.S. resolution strategy for derivatives (see "DER 1. U.S. Resolution Strategy and Wind-Down Scenarios" in the Derivatives and Trading Activities section).

Q2. Should the MOL per entity make explicit the allocation for intraday liquidity requirements, inter-affiliate and other funding frictions, operating expenses, and working capital needs?

A2. Yes, the components of the MOL estimates for each surviving U.S. IHC subsidiary should be transparent and supported.

Q3. Can MOLs decrease as surviving U.S. IHC subsidiaries wind down?

A3. MOL estimates can decline as long as they are sufficiently supported by the firm's methodology and assumptions.

LIQ 5. RLAP, RLEN, and the Runway

Q. The August 2014 feedback letters instructed firms to make the following liquidity assumptions related to the LCR: "…assumptions during the runway period should be at least as severe as the outflow, inflow, and haircut assumptions contained in the …LCR Proposal". How should firms reconcile those instructions with the RLAP and RLEN expectations in the 2018 Guidance?

A. The August 2014 feedback letter instruction related to liquidity assumptions during the runway period no longer applies.

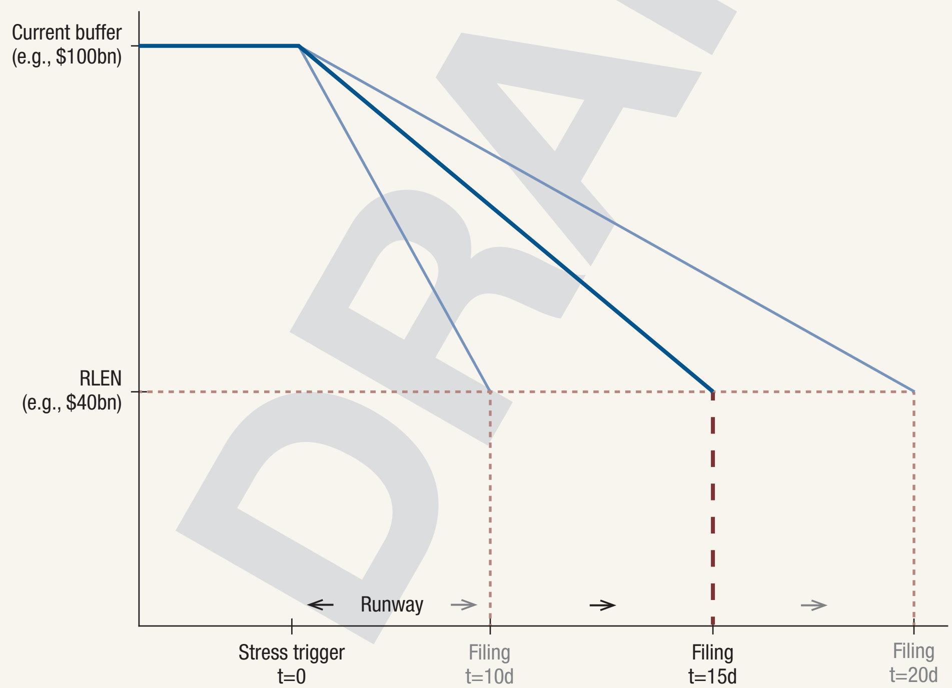
Liquidity projections during the runway period. The RLAP and RLEN expectations articulated in the 2018 Guidance supersede the instruction that assumptions during the runway period should be at least as severe as the LCR. The Agencies will *not* focus on firms' liquidity projections during the runway period. Consistent with prior feedback, your 2018 Plan must not assume that during the period of stress prior to the time of failure your firm will be able materially to reduce its size or interconnectedness or otherwise take similar steps that would have the effect of significantly mitigating the risks that the failure of your firm currently presents to the financial stability of the United States.

The development and implementation of an RLEN model make the scenario under which a firm fails, and the duration of runway, less critical in assessing the executability of that firm's resolution plan from a liquidity standpoint. Whether a firm experiences a rapid run or a long drawn out stress over the runway period should not impact the amount of liquidity required by a firm to successfully execute its U.S. resolution strategy (RLEN).

Rather, the only factor that should be impacted by the severity of runway period outflows should be the *timing* of the filing. This concept is illustrated in figure 1, which shows that more severe outflows during the runway period – the steeper downward sloping line – should simply result in a shorter runway period, say, 10 days as opposed to 15 days, and vice versa.

Thus for liquidity purposes in SPOE, the RLEN estimate effectively represents the firm's condition at failure as referenced in the August 2014 feedback letter. Rather than estimate that failure condition indirectly via an estimate of runway outflows, under the 2018 Guidance firms should estimate it directly via RLEN.

Figure 1. RLEN and filing



Relationship of RLAP to runway and RLEN. As noted in "LIQ 2. Distinction between Liquidity Forecasting Periods," Question 2, the Agencies have not specified a direct mathematical relationship between the runway period, the RLAP model, and RLEN model. To elaborate, a firm's RLAP is a distinct standalone estimate. RLAP and RLEN should be calculated independently of each other. The RLAP estimate should simply inform the necessary amount and positioning of a firm's liquidity to mitigate risks related to resolution stresses, such as ring fencing risk.[3]

Separately, the RLEN estimate should reflect how much liquidity each surviving U.S. IHC subsidiary needs to execute the firm's U.S. strategy post-filing and thus inform the timing of when a firm's U.S. IHC should file for bankruptcy.

With regards to liquidity, these two estimates—RLAP and RLEN—are the most critical to the executability of a firm's resolution strategy, and as such are the focus of the Agencies.

LIQ 6. Inter-Affiliate Transactions with Optionality

Q. How should firms treat an inter-affiliate transaction with an embedded option that may affect the contractual maturity date?

A. For the purpose of calculating a firm's net liquidity position at a material entity, RLAP and RLEN models should assume that these transactions mature at the earliest possible exercise date; this adjusted maturity should be applied symmetrically to both material entities involved in the transaction.

LIQ 7. Stabilization and Regulatory Liquidity Requirements

Q. As it relates to the RLEN model and actions necessary to re-establish market confidence, what assumptions should firms make regarding compliance with regulatory liquidity requirements?

A. Firms should consider the applicable regulatory expectations for each U.S. IHC subsidiary to achieve the stabilization needed to execute the U.S. resolution strategy. Firms' assumptions in the RLEN model regarding the actions necessary to reestablish market confidence during the stabilization period may vary by U.S. IHC subsidiary, for example, based on differences in regulatory, counterparty, other stakeholder interests, and based on the U.S. resolution strategy for each U.S. IHC subsidiary. See also "LIQ 2. Distinction between Liquidity Forecasting Periods."

LIQ 8. HQLA and Assets Not Eligible as HQLA in RLAP and RLEN Models

Q. The 2018 Guidance states that HQLA should be used to meet estimated net liquidity deficits in the RLAP model and that the RLEN estimate should be based on the minimum amount of HQLA required to facilitate the execution of the firm's U.S. resolution strategy. How should firms incorporate any expected liquidity value of assets that are not eligible as HQLA (non-HQLA) into RLAP and RLEN models?

A. A firm's RLAP model should assume that only HQLA are available to meet net liquidity deficits at U.S. IHC subsidiaries. For a firm's RLEN model, firms may incorporate conservative estimates of potential liquidity that may be generated through the monetization of non-HQLA. The estimated liquidity value of non-HQLA should be supported by thorough analysis of the potential market constraints and asset value haircuts that may be required. Assump-

[3] Note, the Agencies do *not* expect firms to hold sufficient HQLA to cover LCR outflows plus RLEN. A firm's liquidity buffer and positioning should be informed by its RLAP model.

tions for the monetization of non-HQLA should be consistent with the U.S. resolution strategy for each U.S. IHC subsidiary.

LIQ 9. Components of Minimum Operating Liquidity

Q. Do the Agencies have particular definitions of the “intraday liquidity requirements,” “operating expenses,” and “working capital needs” components of minimum operating liquidity (MOL) estimates?

A. No. A firm may use its internal definitions of the components of MOL estimates. The components of MOL estimates should be well-supported by a firm’s internal methodologies and calibrated to the specifics of each U.S. IHC subsidiary.

LIQ 10. RLEN Model and Net Revenue Recognition

Q. Can firms assume in the RLEN model that cash-based net revenue generated by U.S. IHC subsidiaries after the U.S. IHC’s bankruptcy filing is available to offset estimated liquidity needs?

A. Yes. Firms may incorporate cash revenue generated by U.S. IHC subsidiaries in the RLEN model. Cash revenue projections should be conservatively estimated and consistent with the operating environment and the U.S. strategy for each U.S. IHC subsidiary.

LIQ 11. RLEN Model and Inter-Affiliate Frictions

Q. Can a firm modify its assumptions regarding one or more inter-affiliate frictions during the stabilization or post-stabilization period in the RLEN model?

A. Once a U.S. IHC subsidiary has achieved market confidence necessary for stabilization consistent with the U.S. resolution strategy, a firm may modify one or more inter-affiliate frictions, provided the firm provides sufficient analysis to support this assumption.

LIQ 12. RLEN Relationship to DFAST Severely Adverse scenario

(See “CAP 3. RCEN Relationship to DFAST Severely Adverse Scenario” in the Capital section.)

LIQ 13. Liquidity Positioning and Foreign Parent Support

Q. May firms consider available liquidity at the foreign parent for meeting RLAP and RLEN estimates for U.S. non-branch material entities?

A. For a 30-day RLAP model, firms should use the requirements of Regulation YY in estimating the standalone liquidity position of each U.S. non-branch material entity. Firms should not rely on available liquidity at the foreign parent to meet net liquidity outflows of U.S. non-branch material entities. The firm's RLAP model should ensure that the consolidated U.S. IHC holds sufficient HQLA to cover net liquidity outflows of the U.S. non-branch material entities. For an RLAP model that extends beyond 30 days, firms may consider (after 30 days) available liquidity at the foreign parent to meet the needs for U.S. non-branch material entities.

To meet the liquidity needs informed by the RLEN methodology, firms may either fully pre-position liquidity in the U.S. non-branch material entities or develop a mechanism for planned foreign parent support of any amount not pre-positioned for the successful execution of the U.S. strategy. Mechanisms to support readily available liquidity may include a term liquidity facility between the U.S. IHC and the foreign parent that can be drawn as needed. If a firm's plan relies on foreign parent support, the plan should include analysis of how the U.S. IHC/foreign parent facility is funded or buffered for by the foreign parent.

LIQ 14. RLAP Model Time Horizon and Inter-Affiliate Transactions

Q. How should firms treat cash flow sources from affiliates in the RLAP model for models that use time periods in excess of 30 days, given the affiliate cash flow calculation requirements in section 252.157(c)(2)(iv) of Regulation YY?

A. An RLAP model that includes time periods beyond 30 days is not required to adopt the affiliate cash flow calculation requirements in section 252.157(c)(2)(iv) of Regulation YY for inter-affiliate cash flows beyond 30 days. However, beyond 30 days, the RLAP methodology still should take into account for each of the U.S. IHC, U.S. IHC subsidiaries, and any branch that is a material entity the considerations detailed in (A), (B), and (C) on page 9 of the 2018 Guidance.

LIQ 15. U.S. Branches and Agencies Liquidity Modeling

Q1. Are firms required to develop a RLAP model for U.S. branches and agencies?

A1. Firms are not required to develop a RLAP model for material U.S. branches and agencies; however, as described on page 22 of the 2018 Guidance, a firm should maintain a liquidity buffer sufficient to meet the net cash outflows for its U.S. branches and agencies on an aggregate basis for the first 14 days of a 30-day stress horizon. These expectations are consistent with the stress testing and liquidity buffer requirements in section 252.157(c)(3) of Regulation YY.

Q2. The Guidance states that in calculating RLAP estimates the U.S. IHC should calculate its liquidity position with respect to its foreign parent, branches and agencies, and other affiliates separately from its liquidity position with respect to third parties. How should firms interpret the RLAP requirements since RLAP is not required for U.S. branches and agencies?

A2. The RLAP estimates for U.S. non-branch material entities should take into account how cash flows and the stand-alone liquidity profile may be affected by all inter-affiliate transactions, which may include the impact on the U.S. non-branch material entities from flows transacted with U.S. branches and agencies.

LIQ 16. Material Service Entity Liquidity

Q. Is a standalone liquidity position estimate needed for material service entities?

A. For material service entities with no other operations other than providing services only to their affiliates and having no third-party debt obligations, a standalone liquidity position estimate is not required.

Operational: Shared Services

OPS SS 1. Contingency Strategies and Arrangements for Critical Shared Services

Q. What did the Agencies mean by "develop documented strategies and contingency arrangements for the continuity or replacement of the shared and outsourced services that are necessary to maintain critical operations"?

A. By strategies and contingency arrangements, the Agencies are referring to the arrangements the firm has in place in order to ensure operational continuity. Components of a strategy and contingency arrangement may include, but are not limited to, maintaining service level agreements (SLAs), strengthening contractual agreements, re-alignment of critical shared services within the corporate structure, and plans to substitute critical shared services during resolution.

OPS SS 2. Working Capital

Q1. Must working capital be maintained for third-party and internal shared service costs?

A1. Where a firm maintains shared service companies to provide services to affiliates, working capital should be maintained in those entities sufficient to permit those entities to continue to provide services for six months or through the period of stabilization as required in the firm's U.S. resolution strategy.

Costs related to third-party vendors and inter-affiliate services should be captured through the working capital element of the MOL estimate (RLEN).

Q2. When does the six month working capital requirement period begin?

A2. The measurement of the six month working capital expectation begins upon the bankruptcy filing of the U.S. IHC. The expectation for maintaining the working capital is effective upon the July 2018 submission.

OPS SS 3. Critical Services Mapping/Legal Entity Rationalization Criteria

Q. How should we think about incorporating our critical services mapping into our legal entity rationalization criteria?

A. The critical services identification and mapping exercise should help the firm identify potential risk(s) to operational continuity in resolution. The firm's legal entity rationalization criteria should then address identified risk(s) to resolvability. See page 23 of the 2018 Guidance.

OPS SS 4. Third-Party Vendor Contract Terms

Q. Can we wait until our critical third-party vendor contracts are up for renewal to add resolution-friendly terms? What if we are unable to revise these contracts by July 2018 because negotiations are still in process or the vendors will not agree to the terms?

A. The Guidance states, “The firm should…update contracts to incorporate appropriate terms and conditions to prevent automatic termination and facilitate continued provision of such services during resolution,” which is expected to be addressed by July 1, 2018. Footnote two of the Guidance states, “in the event impediments arise that are outside of the firm’s control (e.g., regulatory approvals) and a firm believes a different schedule for completion is necessary for one or more current or planned future actions, the firm should provide detailed support for that schedule, and the Agencies will determine on a case-by-case basis whether a different schedule is consistent with the requirements of the implementing rules.” If the firm is facing an impediment in meeting the Guidance or believes it will be unable to meet the Guidance by July 1, 2018, the firm should present detailed support to the Agencies as soon as possible as opposed to waiting until submission of the resolution plan on July 1, 2018

Operational: Payments, Clearing, and Settlement

OPS PCS 1. FMU Contingency Arrangements

Q1. Would the Agencies prefer that firms limit FMU contingency arrangements to only the three examples provided in the Guidance (i.e., pre-positioning of additional liquidity at FMUs, limiting intraday credit provisions to clients, and requiring clients to pre-fund settlement activity), or may firms propose additional or alternative arrangements?

A1. The 2018 Guidance indicates that contingency arrangements should "not be limited to" the examples noted and firms may propose additional solutions.

Q2. Please clarify the Agencies' expectations regarding providing clients with transparency into contingency arrangements.

A2. The 2018 Guidance indicates that firms should provide clients with transparency into potential impacts from implementation of contingency arrangements and consider whether additional actions are appropriate. Where applicable, firms should, on an ex-ante basis (i.e., prior to any stress period), inform wholesale clients of contingency arrangements, such as limiting intraday credit provisions and requiring prefunding of settlement activity, so that the firm and its clients may better understand the potential operational and financial impacts from implementation of such arrangements.

Q3. Please clarify the Agencies' expectations regarding loss of FMU access scenarios.

A3. The 2018 Guidance is additive to previous guidance. Footnote 3 of the 2018 Guidance indicates that the "2013 Guidance, the 2014 Letter, and the 2015 Communication, as described in the letters to the firms, continue to be applicable […], except to the extent superseded or supplemented by the provisions of this document." Firms are not expected to incorporate loss of FMU access scenarios into their U.S. resolution strategy. Firms should continue to provide analysis regarding the impact associated with the loss of FMU access, but this does not need to be incorporated into the RLEN/RCEN estimates.

Legal Entity Rationalization and Separability

LER 1. Data Room

Q. What information should be in the data room?

A. The 2018 Guidance addresses the data room on page 24. The data room should contain the necessary information on discrete sales options to facilitate buyer due diligence. Including only a table of contents of information that could be provided when needed would not be sufficient.

Q2. Are firms expected to include in a data room described on p. 24 of the 2018 Guidance lists of individual employee names and compensation levels?

A2. The firm should include the necessary information to facilitate buyer due diligence. In the circumstance where employee information would be important to buyer due diligence the firm should demonstrate the capability to provide such information in a timely manner. For individual employee names and compensation, the data room may include a representative sample and may have personally identifiable information redacted.

LER 2. Legal Entity Rationalization Criteria

Q. Is it acceptable to take into account business-related criteria, in addition to the resolution requirements, so that the LER Criteria can be used for both resolution planning and business operations purposes?

A. Yes, LER criteria may incorporate both business and resolution considerations. In determining the best alignment of legal entities and business lines to improve the firm's resolvability under different market conditions, business considerations should not be prioritized over resolution needs.

LER 3. Creation of Additional Legal Entities

Q. Is the addition of legal entities acceptable, so long as it is consistent with the LER criteria?

A. Yes.

LER 4. Clean Funding Pathways

Q1. Can you provide additional context around what is meant by clean lines of ownership and clean funding pathways in the legal entity rationalization criteria? Additionally, what types of funding are covered by the requirements?

A1. The funding pathways between the foreign parent, U.S. IHC, and U.S. IHC subsidiaries should minimize uncertainty in the provision of funds and facilitate recapitalization. Also, the complexity of ownership should not impede the flow of funding to a U.S. non-branch material entity under the firm's U.S. resolution strategy. Potential sources of additional complexity could include, for example, multiple intermediate holding companies, tenor mismatches, or complicated ownership structures (including those involving multiple jurisdictions or fractional ownerships). Ownership should be as clean and simple as practicable, supporting the

U.S. strategy and actionable sales, transfers, or wind-downs under varying market conditions. The clean funding pathways expectation applies to all funding provided to a U.S. non-branch material entity regardless of type and should not be viewed solely to apply to internal TLAC.

Q2. The 2018 Guidance regarding legal entity rationalization criteria discusses "clean lines of ownership" and "clean funding pathways." Does this statement mean that firms' legal entity rationalization criteria should require funding pathways and recapitalization to always follow lines of ownership?

A2. No. However, the firm should identify and address or mitigate any legal, regulatory, financial, operational, and other factors that could complicate the recapitalization and/or liquidity support of U.S. non-branch material entities.

LER 5. Separability Options Information

Q. How should a firm approach inclusion of legal risk assessments and other buyer due diligence information into separability options?

A. The legal assessment should consider both buyer and seller legal aspects that could impede the timely or successful execution of the divestiture option. Where impediments are identified, mitigation strategies should be developed.

LER 6. Market Conditions

Q. What is meant by the phrase "under different market conditions" in the Legal Entity Rationalization and Separability section of the 2018 Guidance?

A. The phrase "under different market conditions" is meant to ensure that a firm has a menu of divestiture options from which at least some could be executed under different market stresses.

LER 7. Application of Legal Entity Rationalization Criteria

Q1. Which legal entities should be covered under the LER framework?

A1. The scope of a firm's LER criteria should apply to the entire U.S. operations.

Q2. To the extent a firm has a large number of similar U.S. non-material entities (such as single-purpose entities formed for Community Reinvestment Act purposes), may a firm apply its legal entity rationalization criteria to these entities as a group, rather than at the individual entity level?

A2. Yes.

LER 8. Application of LER Criteria

Q. Under the 2018 Guidance, is there an expectation that the LER criteria be applied to the legal structure outside of the U.S. operations (e.g. outside of the U.S. IHC or U.S. branch)?

A. The LER criteria serve to govern the corporate structure and arrangements between U.S. subsidiaries and U.S. branches in a manner that facilitates the resolvability of U.S. operations.

The Guidance is not intended to govern the corporate structure in jurisdictions outside the U.S. The application of the LER criteria should, among other things, ensure that the allocation of activities across the firm's U.S. branches and U.S. non-branch material entities support the firm's US resolution strategy and minimize risk to US financial stability in the event of resolution.

Moreover, LER works with other components to improve resolvability. For example, with regard to shared services the firm should identify all shared services that support critical operations, maintain a mapping of how/where these services support core business lines and critical operations, and include this mapping into the legal rationalization criteria and implementation efforts.

Derivatives and Trading Activities

DER 1. U.S. Resolution Strategy and Wind-Down Scenarios; Applicability

Q. What is the relationship between a firm's U.S. resolution strategy and the passive and active wind-down analyses required under Section IX of the 2018 Guidance?

A. Section IX of the 2018 Guidance provides that a foreign based covered company (a "covered FBO") should conduct, in the manner specified, a passive wind-down analysis and an active wind-down analysis for each surviving U.S. IHC subsidiary[4] with derivatives positions. The passive wind-down analysis and active wind-down analysis are intended to provide a baseline view of the risk profile of the derivatives positions at the firm's surviving U.S. IHC subsidiaries and a reference point to compare those analyses to the same entities under the firm's U.S. resolution strategy. The two wind-down analyses under Section IX are standalone analyses, separate from the firm's U.S. resolution strategy; the results of such analyses are generally not required to be incorporated into the U.S. resolution strategy's financial forecasts. However, the firm's analyses supporting the passive and active wind-down should include alternative estimates of RLEN and RCEN for the relevant surviving entities (passive and active RLEN/RCEN) as well as a discussion of the factors driving differences between the passive and active RLEN/RCEN estimates and the RLEN and RCEN estimates for the same entities under the firm's U.S. resolution strategy (see Question 1 at "LIQ 4. RLEN and MOL" in the Liquidity section). In doing so, the wind-down analyses will help inform an assessment of the U.S. resolution strategy's flexibility and resiliency to unanticipated conditions.

A firm's U.S. resolution strategy may incorporate a scenario that adopts the constraints of one of the prescribed wind-down analyses or an alternative, third scenario. For example, a firm may choose a going concern scenario (e.g., U.S. trading entities reestablish investment grade rating and do not enter a wind-down) as its U.S. resolution strategy, so long as the firm's resolution plan adequately supports the execution of that scenario and includes the required alternative wind-down analyses. Likewise, a firm may choose to adopt a combination of wind-down and going concern scenarios as its U.S. resolution strategy. For example, the U.S. resolution strategy could be a stabilization scenario for the U.S. bank entity and an active wind-down scenario for the U.S. broker-dealer entities.

DER 2. Hedging and Inter-Affiliate transactions

Q. What types of risk-reducing bilateral OTC trades, if any, are allowable under the two prescribed wind-down analyses required under Section IX of the 2018 Guidance?

A. Under the Active Wind-Down analysis required in Section IX of the 2018 Guidance, a firm should assume that entities generally cannot access bilateral OTC derivatives markets and may only hedge positions with exchange-traded and centrally cleared instruments. A firm may engage in certain risk reducing trades such as:

1. To effect the novation of the firm's side of a derivatives contract to a new counterparty, bilateral OTC trades with the acquiring counterparty
2. Bilateral trades with inter-affiliate counterparties that meet the following conditions:

[4] "Surviving U.S. IHC subsidiary" means a U.S. IHC subsidiary that does not enter an insolvency proceeding contemporaneous with the U.S. IHC's entry into a bankruptcy proceeding.

- Reduce the credit exposure of each participating counterparty; and
- Do not materially increase the market risk of any such counterparty on a standalone basis, after taking into account hedging with exchange-traded and centrally-cleared instruments.

The firm must demonstrate the risk-reducing nature of the trade on the basis of information that would be known to the firm at the time of the transaction.

Under the passive wind-down analysis, a firm should assume that entities cannot access bilateral OTC derivatives markets and may only hedge positions executed with exchange-traded and centrally cleared instruments. The firm should assume there are no risk-reducing, non-cleared bilateral OTC derivatives trades.

Q2. Are derivatives used to hedge risks outside of the trading book within the scope of this requirement, such as for MSRs, structural interest rates, or debt instruments?

A2. The passive wind-down analysis and the active wind-down analysis required in Section IX of the 2018 Guidance are focused on the wind-down of the derivatives positions of a firm's U.S. IHC subsidiaries (trading and hedging positions; regardless of whether they are in the banking book or trading book). Derivatives outside of the trading book of a surviving U.S. IHC subsidiary are within the scope of those analyses. Note, in the active wind-down analysis, derivatives that are used to hedge non-trading positions (e.g. MSR, structural interest rates, balance sheet management, etc.) are not themselves required to be actively wound-down and may instead be reflected in the residual portfolio (see also "DER 1. U.S. Resolution Strategy and Wind-Down Scenarios; Applicability" and Question 1 at "DER 2. Hedging and Interaffiliate transactions").

Q3. Should derivatives transactions between a surviving U.S. IHC subsidiary and all affiliates be reflected in the U.S. resolution strategy and the wind-down analyses required in Section IX of the 2018 Guidance?

A3. If a surviving U.S. IHC subsidiary has entered into derivatives transactions with a nonsurviving U.S. entity, a U.S. branch, or any other affiliate entity (including a foreign affiliate), then those transactions should be reflected in any analysis of the surviving U.S. IHC subsidiary's derivatives portfolio.

For example, where a surviving U.S. IHC subsidiary has hedged a position on its books by entering a derivatives transaction with a nonsurviving entity, the analysis should capture the effect of the nonsurviving entity's default with respect to the transaction (e.g., any uncovered exposure, cost of any replacement hedge, and increase in P&L volatility). Similarly, where a surviving U.S. IHC subsidiary has entered a transaction with an affiliate that is assumed to continue operating and performing on its inter-affiliate transactions those transactions should be reflected in the firm's active wind-down analysis, including the impact of replacing, novating, compressing or otherwise winding-down those affiliate positions.

DER 3. Stabilization/Ratings/Playbooks

Q1. How should a firm determine criteria or assumptions regarding market expectations for the sufficient capital and liquidity levels of a surviving U.S. IHC subsidiary with derivatives positions?

A1. In determining the criteria or assumptions regarding market expectations, a firm should, consistent with its U.S. strategy, consider (1) its current counterparty credit risk management approach for dealing with financial counterparties in stress, (2) its experience in dealing with stressed counterparties during the 2008 crisis, and (3) criteria utilized by the rating agencies, as applicable. At a minimum, a surviving U.S. IHC subsidiary with derivatives positions should meet any applicable regulatory capital requirements (consistent with the Q&A found at "CAP 2. Definition of 'Well-Capitalized' Status" in the Capital section) and, as applicable, meet minimum FMU membership eligibility requirements.

Q2. Which U.S. IHC subsidiaries are covered by the requirement under Section IX of the 2018 Guidance to develop rating agency playbooks?

A2. Under Section IX of the 2018 Guidance, each surviving U.S. IHC subsidiary that conducts derivatives activities should have a well-developed rating agency playbook (that includes entity-specific considerations) for maintaining, reestablishing or establishing investment-grade ratings or the equivalent level of financial soundness necessary for that entity to continue transacting (see previous question).

Q3. Should a firm assume that its trading entities are downgraded to below investment grade at the point of non-viability?

A3. Under the passive wind-down analysis and the active wind-down analysis described in Section IX of the 2018 Guidance, each surviving U.S. IHC subsidiary with derivatives positions should be assumed to have failed to maintain, establish, or reestablish market confidence sufficient to continue as a transacting entity in the bilateral OTC markets.

A firm's U.S. resolution strategy should assume that, at the point of non-viability of the U.S. IHC, each surviving U.S. IHC subsidiary with derivatives positions is downgraded to below investment grade or otherwise fails to maintain, establish, or reestablish market confidence sufficient to continue as a transacting entity unless the firm provides well-supported analysis to the contrary.

DER 4. Trading Book Definitions

Q. What is the scope of activity covered in the wind down analyses required in Section IX of the 2018 Guidance, specifically with respect to non-trading derivatives and non-derivatives trading positions?

A. The wind-down analyses described in Section IX of the 2018 Guidance are focused on the wind-down of a firm's derivatives positions (trading and hedging positions; regardless of whether they are in the banking book or trading book). The Section IX wind-down analyses may also include non-derivative trading positions that are linked to specific derivatives transactions (for example, a firm might sell cash securities along with winding down the derivatives to rebalance risk positions over time). To the extent a firm includes such positions, the firm should present the analysis separately from the schedules specified in the 2018 Guidance Derivatives Appendix.

DER 5. Passive Wind-Down/Rump

Q1. Please clarify the particular approach to passive wind down expected by the Agencies.

A1. The passive wind-down analysis described in Section IX of the 2018 Guidance is intended to be a total run-off scenario whereby the wind-down of the firm's derivatives positions results from contractual maturities and limited client initiated terminations. A firm's estimates should be sensitive to the magnitude and nature of basis risks that would result from hedging with only exchange-traded and centrally-cleared instruments in a severely adverse stress environment—e.g., a portfolio comprised of short-dated, vanilla positions generally should have lower capital and liquidity impacts than a portfolio comprised of long-dated, complex positions.

The passive wind-down analysis should not include techniques such as compression and step-out, novations, risk neutral transfers of portfolios, or other discretionary client-risk reducing trades. This is a key difference between the passive wind-down analysis and active wind-down analysis.

Q2. In the wind-down analyses described in Section IX of the 2018 Guidance, do the Agencies expect projections of RWAs, liquidity, or both to determine when resource depletion occurs and with respect to the systemic risk profile analysis? Please provide more clarity around the Agencies' expectations for the systemic risk profile.

A2. For the passive wind-down analysis and the active wind-down analysis described in Section IX of the 2018 Guidance, a covered FBO should include estimated resource needs—i.e., capital and liquidity needs—over time, until the point of total run-off or when resources are depleted—e.g., when an applicable regulator would initiate proceedings for the relevant surviving U.S. IHC subsidiary. Consistent with Question 3 at "LIQ 2. Distinction between Liquidity Forecasting Periods" in the Liquidity section, resource needs can be estimated on a quarterly basis.

Bearing in mind the objectives of an orderly resolution, a covered FBO should assess the risk profile of the residual portfolio in a manner consistent with the attributes noted on page 26 of the 2018 Guidance: size, composition, complexity, and potential counterparties.

DER 6. Derivatives Sales/Active Wind Down

Q. May covered FBOs include the transfer of derivatives portfolios as part of larger line of business sales?

A. A firm's U.S. resolution strategy may include the transfer of derivative portfolios as part of broader line of business sales. In the event of such a transfer, firms should indicate whether or not the derivatives positions are linked to any securities or other positions and if such positions were included as part of the broader line of business sale. Separately, covered FBOs must also provide the passive wind-down analysis and the active wind-down analysis described in Section IX of the 2018 Guidance for each surviving U.S. IHC subsidiary with derivatives positions, which should not assume the transfer of derivatives portfolios as part of broader lines of business sales.

DER 7. Break Clauses

Q. In the wind-down analyses described under Section IX of the Guidance, is it permissible to assume that firms and clients will terminate, when able, derivatives contracts if the contracts with counterparties allow such breaks?

A.*Client-initiated terminations.* In the passive wind-down analysis and the active wind-down analysis described under Section IX, covered FBOs should assume that counterparties will exercise any contractual termination right, consistent with any rights stayed by the ISDA protocol, (i) that is available to the counterparty following the U.S. IHC's entry into an insolvency proceeding (e.g., optional early termination right) and (ii) if exercising such right would economically benefit the counterparty ("expected client-initiated terminations").

Firm-initiated terminations. In the passive wind-down analysis, a covered FBO cannot assume that it can terminate trades on derivatives contracts except where the termination is to facilitate the close-out of an expected client initiated-termination. For example, upon a client-initiated termination the firm may close-out the external or internal leg of a mirrored, back-to-back transaction with a counterparty or affiliates if the firm has the contractual right to terminate the transaction or it would be economically beneficial for the counterparty or affiliates to mutually consent to such termination.

In the active wind-down analysis, a covered FBO can initiate the termination of trades when it has the contractual rights to do so, such as in cancellable swaps and rights in similar instruments. The firm may also seek, and consent to, the termination of trades on derivatives contracts to facilitate novations and risk reducing trades consistent with Question 1 at "DER 2. Hedging and Interaffiliate transactions."

In all instances, including the firm's U.S. resolution strategy, assumptions regarding early terminations (regardless of whether the termination is initiated by the firm or its client) should be adequately supported by the underlying contract and economic benefits to the firm and/or counterparty.

DER 8. Risk Evolution of Derivatives in Wind Down

Q. What are the Agencies' expectations with respect to modeling the evolution of risk factors associated with the derivatives portfolio through the resolution period?

A. The Agencies have not imposed an expectation that firms should model the evolution of risk factors with respect to the passive wind-down analysis and the active wind-down analysis described in Section IX of the 2018 Guidance or in the context of a wind-down of its derivatives portfolio under its U.S. resolution strategy.

DER 9. Limitation on Access to Bilateral OTC Derivatives Markets

Q. Section IX of the 2018 Guidance regarding the passive wind-down analysis and the active wind-down analysis directs the covered FBOs to "assume that entities cannot access bilateral over-the-counter (OTC) markets." Please clarify the scope of that limitation and whether the limitation extends beyond OTC derivatives instruments to include bilateral securities financing transactions used to source collateral and securities?

A. The limitation noted above applies only to derivatives. For example, a firm may use reverse repo and stock borrow transactions to source collateral and securities so long as such transactions are on terms consistent with the plan's scenario assumptions regarding counterparty/market expectations.

DER 10. Indirect Access to FMUs During Wind-Down

Q. For the passive wind-down analysis and the active wind-down analysis described in Section IX of the 2018 Guidance, please clarify under which circumstances a firm may assume continued access through an affiliate to exchanges and other FMUs?

A. A firm may assume that an entity can retain access to exchanges and other FMUs through an affiliate where this relationship is established prior to resolution, and so long as its margin arrangements with that affiliate are on third-party terms (see also "OPS PCS 1. FMU Contingency Arrangements," Question 3, in the Operational: Payments, Clearing, and Settlement section)

DER 11. General Applicability.

Q. Does Section IX apply regardless of the size of a firm's U.S. derivatives portfolio?

A. Section IX of the 2018 FBO Guidance applies to a foreign-based covered company if it conducts derivatives and trading activities within any of its U.S. IHC subsidiaries. For nonsurviving entities, firms need only provide the analysis and explanation described on pages 27–28 of the Guidance.

Legal

LEG 1. Support Within the United States

Q. Could the Agencies clarify what further legal analysis would be expected regarding the impact of potential state law and bankruptcy law challenges and mitigants to the planned provision of Support?

A. The firms should address developments from the firm's own analysis of potential legal challenges regarding the Support and should also address any additional potential legal challenges identified by the Agencies on pages 10–11 of the 2018 Guidance. A legal analysis should include a detailed discussion of the relevant facts, legal challenges, and Federal or State law and precedent. The analysis also should evaluate in detail the legal challenges identified in the 2018 Guidance under the heading "Support Within the United States," any other legal challenges identified by the firm, and the efficacy of potential mitigants to those challenges. Firms should identify each factual assumption underlying their legal analyses and discuss how the analyses and mitigants would change if the assumption were not to hold. Moreover, the analysis need not take the form of a legal opinion.

LEG 2. Contractually Binding Mechanisms

The 2018 Guidance states that the legal analysis described under the heading "Support Within the United States" should include mitigants to the potential challenges to the planned Support and that the plan should identify the mitigant(s) to such challenges that the firm considers most effective. The 2018 Guidance does not specifically reference consideration of a contractually binding mechanism. However, the following questions and answers may be useful to a firm that chooses to consider a contractually binding mechanism as a mitigant to the potential challenges to the planned Support.

Q1. Do the Agencies have any preference as to whether capital is down-streamed to key subsidiaries (including an IDI subsidiary) in the form of capital contributions vs. forgiveness of debt?

A1. No. The Agencies do not have a preference as to the form of capital contribution or liquidity support.

Q2. Should a contractually binding mechanism relate to the provision of capital or liquidity? What classes of assets would be deemed to provide capital vs. liquidity?

A2. Contractually binding mechanism is a generic term and includes the down-streaming of capital and/or liquidity as contemplated by the U.S. resolution strategy. Furthermore, it is up to the firm, as informed by any relevant guidance of the Agencies, to identify what assets would satisfy an U.S. affiliate's need for capital and/or liquidity.

Q3. Is there a minimum acceptable duration for a contractually binding mechanism? Would an "evergreen" arrangement, renewable on a periodic basis (and with notice to the Agencies), be acceptable?

A3. To the extent a firm utilizes a contractually binding mechanism, such mechanism, including its duration, should be appropriate for the firm's U.S. resolution strategy, including adequately addressing relevant financial, operational, and legal requirements and challenges.

Q4. Are there any particular related actions or agreements that the Agencies have observed or believe may enhance the effectiveness of a contractually binding mechanism which the firm should consider?

A4. Firms may consider the appropriate tool(s) that best enhances the likelihood of the enforceability and effectiveness of any contractually binding mechanism.

Q5. Have the Agencies developed (or do they intend to develop) a prototype of a contractually binding mechanism that would address their concerns?

A5. No.

Q6. The firm may need to amend its contractually binding mechanism from time to time resulting potentially from changes in relevant law, new or different regulatory expectations, etc. Is a firm able to do this as long as there is no undue risk to the enforceability (e.g., no signs of financial stress sufficient to unduly threaten the agreement's enforceability as a result of fraudulent transfer)?

A6. Yes, however the Agencies should be informed of the proposed duration of the agreement, as well as any terms and conditions on renewal and/or amendment. Any amendments should be identified and discussed as part of the firm's next U.S. resolution plan submission.

Q7. If a firm intends to use a contractually binding mechanism (CBM) to mitigate potential legal challenges to the provision of capital and liquidity to subsidiaries prior to bankruptcy, do the Agencies expect the firm to execute the CBM by July 1, 2018?

A7. No. The Agencies are focused on reviewing firms' analyses of how CBMs would mitigate legal challenges and support the successful recapitalization and funding of U.S. affiliates prior to bankruptcy.

Q8. Should firms include a formal regulatory trigger by which the Agencies can directly trigger a contractually binding mechanism?

A8. No.

General

GEN 1. Sufficiency of Remediation

Q. Can the Agencies confirm that the action steps we have outlined will meet 2018 Guidance expectations?

A. Agency staff cannot confirm whether the actions of the firm are adequate to satisfy the 2018 Guidance. Authority and decision-making relative to resolution plan determinations rest with the respective Boards of the FDIC and Federal Reserve.

GEN 2. Stabilization

Q. What is the required frequency of balance sheets and income statements throughout the stabilization period?

A. Your 2018 Plan must include the actual balance sheet for each Material Entity and the consolidating balance sheet adjustments between Material Entities as of December 31, 2017. Your 2018 Plan also should include pro forma balance sheets for each Material Entity at the beginning and end of the runway period and at key junctures in the execution of the resolution strategy. The pro forma financial statements and accompanying notes in your 2018 Plan should clearly evidence the failure trigger event, the Plan's assumptions, and any transactions that are critical to the execution of the Plan's post-runway strategy, such as recapitalizations, the creation of new legal entities, transfers of assets, and asset sales and unwinds.

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