

FDIC Board Meeting Statement of Vice Chairman Thomas M. Hoenig regarding 2015 Title I plans submitted by the eight domestic GSIBs

April 13, 2016

As delivered

I concur with the general conclusions of agency staff regarding the 2015 Title I plans submitted by the eight domestic global systemically important banking organizations, and I concur that individual findings be forwarded to the appropriate firm. As reflected in the letters before us, each plan has shortcomings or deficiencies, although as the letters emphasize, some firms have made more progress than others. Most importantly, no firm yet shows itself capable of being resolved in an orderly fashion through bankruptcy. Thus, the goal to end too big to fail and protect the American taxpayer by ending bailouts remains just that: only a goal.

No GSIB has yet shown how it would successfully address all phases of a successful bankruptcy if its failure were imminent. Weaknesses vary by individual firm and include, for example: how a firm determines when to enter bankruptcy; how its resolution strategy aligns with bankruptcy court processes; whether there is adequate liquidity and debtor-in-possession financing; and how it would pass capital to operating units in anticipation of bankruptcy. Having answers to these issues for each GSIB is critical to successfully move one through bankruptcy.

Moreover, the challenge of taking a GSIB through bankruptcy has only increased since the crisis of 2008. These firms are generally larger, more complicated, and more interconnected than they were then. They control assets equivalent to approximately 60 percent of GDP. They continue to rely on wholesale funding, deposit-like money market funds, and repos, all of which are major sources of volatility in uncertain times. The average notional value of derivatives for the three largest derivative dealers among these GSIBs was approximately \$50 trillion at yearend 2015, about a 30 percent increase over their level at the start of the crisis.

While having a credible living will is essential to the Title 1 process, it unfortunately is not sufficient to assure an orderly bankruptcy. The living will process assumes that individual GSIBs would be able to withstand the systemic shock arising from the failure of another GSIB. Currently this is an unrealistic assumption. As I have pointed out elsewhere, these GSIBs have excessively high leverage ratios of nearly 18 to 1 on average, while the remainder of the industry with its smaller systemic impact has an average leverage ratio of only 10 to 1. Ironically and unfortunately there is little margin of error for these most systemically important firms, and the market knows this. This factor adds enormously to the difficulty of making bankruptcy successful. If one highly leveraged GSIB were to fail, other also highly leveraged GSIBs immediately would become suspect in their ability to withstand the shock. Too easily one failure could become a systemic crisis.

Most of these plans are reliant on the single point of entry (SPOE) strategy. It requires significant dependence on the long-term debt component of TLAC, which serves as a justification for holding less equity capital and makes the system more vulnerable to financial shocks. Thus, there is a legitimate question as to whether these firms individually and thus collectively have sufficient equity capital to withstand the shock of even a single GSIB failure.

Finally, in considering debt versus equity, I am concerned that the guidance provided for the next plan submissions includes the following statement: "...the methodology is not required to produce aggregate losses that are greater than the amount of external TLAC that would be required for the firm under the Board's proposed rule." Such a statement is highly questionable since regulators cannot administratively

control future losses, and this statement appears designed to assure that losses do not undermine the on-paper success of the SPOE solution. I would remove this statement from the guidance.

The sources of too big to fail are both industry-wide in terms of leverage and GSIB-specific in terms of each firm's obstacles to bankruptcy, which is expected of every other business organization in the United States. Bankruptcy as sought under Title I, thus, remains an aspiration until both issues are addressed.