

October 16, 2022

## Federal Reserve Invites Public Comment on Potential Resolution-Related Standards for “Large” Banking Organizations

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**The ANPR, issued concurrently with the Federal Reserve’s approval of U.S. Bancorp’s application to acquire MUFG Union Bank, focuses on whether and how certain GSIB resolution-related standards, such as a long-term debt requirement, could be adapted to enhance the resolvability of other large banking organizations**

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### SUMMARY

On October 14, 2022, the Board of Governors of the Federal Reserve System published an advance notice of proposed rulemaking (the “ANPR,” available [here](#)) soliciting public comment on potential changes to the resolution-related standards applicable to certain large banking organizations (*i.e.*, generally domestic bank or savings and loan holding companies with \$250 billion or more in total consolidated assets that are not GSIBs) (“LBOs”). The Federal Reserve and the Federal Deposit Insurance Corporation (the “agencies”) jointly developed the ANPR. The FDIC is scheduled to consider the ANPR on October 18, 2022.

The ANPR suggests two central conclusions. First, there is a significant difference in the resolution-related standards applicable to global systemically important banks (“GSIBs”) and LBOs. Second, the large size of LBOs, combined with the extent of their uninsured deposit funding, may narrow the resolution options in the event of their material financial distress or failure. Framed in light of these conclusions, the ANPR broadly solicits comment and poses numerous specific questions on how adapted elements of the GSIB resolution-related standards could be applied to strengthen the resolvability of LBOs and address financial stability risks posed by the material financial distress or failure of an LBO. The imposition of a long-term debt requirement, potentially at the insured depository institution (“IDI”) and/or holding company level, is

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the main focus of the ANPR. The ANPR also seeks comment on whether other GSIB resolution-related standards, such as clean holding company requirements and guidance on separability, would enhance the resolvability of LBOs. In addition, the ANPR notes that a long-term debt requirement “could impact the cost and availability of credit” and seeks comment on the costs associated with resolution-related standards for LBOs and their customers.

In the same press release for the ANPR, the Federal Reserve also announced its approval of the application by U.S. Bancorp (“USB”) to acquire MUFG Union Bank, N.A. (“MUFG Union Bank”), a national bank subsidiary of Mitsubishi UFJ Financial Group, Inc. (“MUFG”).<sup>1</sup> The press release notes that, in connection with the Federal Reserve’s approval, USB has committed to provide the agencies with an interim update to its resolution plan reflecting the combined organization and implementation plans related to heightened prudential standards.

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### OVERVIEW OF THE ANPR

In the ANPR, the agencies state that they are focused on LBOs in Categories II and III.<sup>2</sup> The ANPR provides a high-level overview of the agencies’ existing rules and guidance supporting the orderly resolution of GSIBs and LBOs, including their joint resolution planning rule and the Federal Reserve’s enhanced prudential standards rule. The ANPR notes that existing rules and guidance are “tiered based on the complexity and risks of different banking organizations,” with the most stringent standards applying only to GSIBs and their IDI subsidiaries. The ANPR also explains the differences in resolution strategies between GSIBs and LBOs. All eight GSIBs follow a “single-point-of-entry” strategy (“SPOE”), in which only the top-tier holding company would enter resolution proceedings with losses at the subsidiaries borne by the holding company and ultimately the holding company’s security holders, while most LBOs follow a “multiple-point-of-entry” strategy (“MPOE”), in which both the parent holding company and the IDI subsidiary would enter resolution proceedings.

The agencies observed that, in the period following the issuance of the existing resolution-related rules and guidance, the size of LBOs has grown and, in particular, the average total consolidated assets of Category III firms reached \$554 billion in December 2021, up from \$413 billion in December 2019. Although the agencies acknowledge that “most of these firms’ overall business remains concentrated in traditional banking activities” and that “their proportion of total banking sector assets has remained relatively constant,” the agencies note that “their larger size heightens the potential impact of a disorderly resolution.”

The ANPR focuses on the presumed risk that the growth of LBOs could potentially increase the likelihood of a costly resolution in the event of material financial distress or failure. Specifically, the ANPR maintains that the increased size of LBOs could present a challenge to the FDIC in resolving these institutions in light of the FDIC’s typical approach of “selling the failed IDI to another depository institution” as the “course of action which [is] least costly to the Deposit Insurance Fund.” The agencies also observe that some LBOs

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“have increased their reliance on large uninsured deposits,” which could lead to contagion risk if uninsured depositors suffer losses, or “have heightened cross-jurisdictional activity or significant non-bank operations” that could pose additional challenges in distress scenarios, particularly relating “to the feasibility of creating and stabilizing a viable bridge depository institution.”

In view of these developments, the ANPR solicits comment on “whether additional measures are warranted to address financial stability impacts,” including “whether an extra layer of loss-absorbing capacity could increase the FDIC’s optionality in resolving the insured depository institution.” The ANPR suggests that the absence of sufficient loss absorbing resources at an IDI could limit the FDIC’s options for resolving an LBO under an MPOE strategy, and, in particular, suggests that the options could be reduced to a sale of the institution to a GSIB or another LBO. Notably, however, the agencies acknowledge that an MPOE strategy “may be appropriate” for an LBO and that a long-term debt requirement for an LBO could potentially be at the IDI and/or holding company levels. The eight GSIBs, with encouragement from the agencies, have adopted SPOE as their preferred resolution strategy, and only long-term debt issued by the holding company can satisfy the regulatory requirements relating to total loss-absorbing capacity (“TLAC”) and long-term debt. The agencies also note that, in order to provide the capacity to absorb losses in resolution, long-term debt must include “an appropriate form of subordination.” For GSIBs, debt issued at the parent holding company level “is considered structurally subordinated” to the liabilities of the IDI and other subsidiaries. The agencies provide that debt issued by an IDI, to either its parent holding company or third parties, “would generally need to benefit from contractual or statutory subordination features in order to reliably serve as loss-absorbing capacity in resolution.”

The agencies solicit public comment on all aspects of the ANPR, including “how appropriately-adapted elements of the GSIB resolution-related standards – including a long-term debt requirement potentially at the insured depository institution and/or the holding company level, a clean holding company requirement, or recovery planning guidance – could be applied to large banking organizations,” and specifically requests comment on a number of enumerated questions and sub-questions, which are excerpted, in part, below:

1. “The agencies invite comment on whether and how a requirement to maintain a minimum amount of long-term debt could enhance a large banking organization’s resolvability. . . . Which entity in a banking organization’s corporate structure would be the ideal issuer of long-term debt externally to the market? What would be the costs of a long-term debt requirement for large banking organizations or their customers? . . .”
2. “The agencies invite comment on alternative approaches for determining the appropriate scope of application of a potential long-term debt requirement to the population of large banking organizations. . . . Should all Category II and, Category III firms (including [savings and loan holding companies], which are not subject to resolution planning requirements) be subject to a long-term debt requirement? . . . How should IDIs that are not part of a group under a BHC be considered?”
3. “The agencies invite comment on how any new requirements should be applied to the U.S. subsidiaries of foreign banking organizations. Top-tier U.S. intermediate holding company (IHC)

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subsidiaries of foreign GSIBs are currently subject to long-term debt requirements. To what extent should those top-tier U.S. holding companies of foreign firms or their insured depository institutions that have a similar risk profile to the domestic large banking organizations that might be subject to any long-term debt requirement considered in this ANPR, be subject to any new requirements in line with those applied to domestic large banking organizations?”

4. “The agencies invite comment on the appropriateness of recognizing debt issued by various legal entities within a holding company structure in determining compliance with any long-term debt requirement imposed on the top tier holding company. Specifically, to what extent should the [Federal Reserve] consider whether a large banking organization’s resolution strategy is an SPOE or MPOE strategy, whether the long-term debt is issued by the parent holding company or the insured depository institution, or other factors in determining the requirement?”
5. “The agencies invite comment on the appropriate calibration of a long-term debt requirement for large banking organizations. . . . How should the agencies consider competitive equality in calibrating any long-term debt requirements for large banking organizations relative to existing requirements for GSIBs and top-tier IHC holding companies of foreign banking organizations?”
6. “The agencies invite comment on the potential effect of a long-term debt requirement on large banking organizations in different tiering categories (for example, Category II and Category III) and on the capacity of these firms to issue such debt into the market throughout an economic cycle. What are the potential effects of a long-term debt requirement on these firms’ funding model and funding costs, including any associated effect on market discipline and overall firm resiliency? What, if any, are the potential effects of a long-term debt requirement on the cost and availability of credit?”
7. “The [Federal Reserve] invites comment on the pros and cons of permitting eligible long-term debt issued externally by a large banking organization’s principal insured depository institution subsidiary to count toward a requirement at the top-tier holding company. . . .”
8. “The agencies invite comment on whether requirements on governance mechanics should be put in place to ensure that entry into resolution will occur at a time when the eligible long-term debt will be available at the insured depository institution and/or the holding company level to absorb losses? . . .”
9. “The agencies invite comment on whether subjecting the operations of the top-tier holding company of large banking organizations to “clean holding company” limitations similar to the ones imposed on GSIBs would further enhance the resolvability of a large banking organization. . . .”
10. “Among the other requirements that must be satisfied under the existing GSIB TLAC rule in order for debt issued by the parent company to qualify as eligible long-term debt (for example, relating to “plain vanilla” characteristics, minimum remaining maturity, governing law), which requirements would remain essential in order for long-term debt instruments issued by large banking organizations to properly function as a loss-absorbing resource in resolution? What modifications of such requirements, if any, should the agencies consider in the large banking organization context with respect to loss absorbing debt at insured depository institutions and/or holding companies?”
11. “The agencies invite comment on the appropriate form and content of the disclosure large banking organizations should be required to provide to their long-term debt investors with respect to the potential treatment of such debt in resolution. . . .”

In addition, the agencies observe that the identification of executable “separability options”, such as “the sale, transfer or disposal of significant assets, portfolios, legal entities or business lines on a discrete product line or regional basis”, could provide alternatives to an acquisition of an LBO by an even larger firm, such as a GSIB, in the event of the LBO’s material financial distress or failure. Accordingly, the agencies

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are evaluating whether they should impose any separability requirements for recovery or resolution on LBOs and GSIBs, and seek public comment on the question below:

12. “Should the agencies impose any separability requirements for recovery or resolution on all large banking organizations, including GSIBs? To what extent would imposing new separability requirements add net benefits against the backdrop of other existing requirements? In what fashion can or should these requirements be harmonized to promote their effectiveness?”

Comments on the ANPR will be accepted for 60 days after the ANPR’s publication in the Federal Register.

Three Federal Reserve Board Governors issued separate statements in connection with the ANPR issuance. Vice Chair Brainard’s statement noted that she is encouraged that the Federal Reserve is seeking comment on the ANPR and, notably, “is undertaking a serious review of large bank capital requirements.”<sup>3</sup> Governor Waller stated that his support for issuing the ANPR does not mean that he supports or opposes applying the requirements discussed in the ANPR to LBOs.<sup>4</sup> Although Governor Bowman stated that she was generally supportive of issuing the ANPR and approving USB’s application (discussed below), she cited concerns about the potential impact of long-term debt requirements on “the cost and availability of credit.”<sup>5</sup> Governor Bowman also said that the ANPR should not have been expressly linked to the Federal Reserve’s approval of the USB application.

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### APPROVAL OF USB’S ACQUISITION OF MUFU UNION BANK

Concurrently with the Federal Reserve’s publication of the ANPR, on October 14, 2022, the Federal Reserve issued an order (available [here](#)) approving USB’s application to acquire 100% of the outstanding common stock of MUFU Union Bank. In connection with the Federal Reserve’s approval, USB, which currently is a Category III banking organization as defined in the Federal Reserve’s enhanced prudential standards rule, has made certain commitments to the Federal Reserve, including (i) a commitment to provide the Federal Reserve and FDIC with an interim update to its resolution plan reflecting the combined organization within six months of closing the acquisition, (ii) a commitment to meet the requirements for a Category II banking organization by the earlier of the date it is obligated to do so by regulation or, if notified by the Federal Reserve by January 1, 2024,<sup>6</sup> by December 31, 2024, and (iii) a commitment to submit quarterly implementation plans for complying with Category II requirements prior to its becoming a Category II banking organization.<sup>7</sup>

Also on October 14, 2022, the Office of the Comptroller of the Currency approved the proposed merger of MUFU Union Bank with and into U.S. Bank National Association (“U.S. Bank”), USB’s wholly owned national bank subsidiary, which would be effected after the completion of USB’s acquisition of MUFU Union Bank (see the OCC’s approval order [here](#)).<sup>8</sup> The OCC’s order imposes several conditions, including the submission by U.S. Bank, within six months of the completion of the bank merger, of “a list of business lines and/or portfolios (each an ‘object of sale’) that could be sold quickly in the event of stress” and “a plan,

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including a timeline, to effectuate such separability, including through the establishment of ‘data rooms’ for each object of sale.”<sup>9</sup>

Following the publication of the approval orders by the Federal Reserve and the OCC noted above, USB and MUFG announced that they have received all required U.S. regulatory approvals to complete the USB’s acquisition of MUFG Union Bank and related transactions, including the approvals from the Federal Reserve, the OCC, and the FDIC.<sup>10</sup>

The proposed acquisition, which was announced on September 21, 2021, is one of the largest bank M&A transactions in the United States since the Great Financial Crisis, and is one of several large regional bank mergers announced since the beginning of 2021.<sup>11</sup> The approval of the transaction by the federal banking regulators (including the resolution-related commitments and conditions in the Federal Reserve and OCC approval orders), and the concurrent publication of the ANPR, reflects the federal banking regulators’ increasing focus on enhancing resolvability of large regional banks as they grow in size, including through mergers and acquisitions.

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ENDNOTES

- <sup>1</sup> See The Federal Reserve's press release announcing the ANPR and the approval order, *available at* <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20221014a.htm>. On October 14 and 15, 2022, USB and MUFG respectively announced that they have received all required U.S. regulatory approvals to complete USB's acquisition of MUFG Union Bank and related transactions, including the approvals from the Federal Reserve, the OCC and the FDIC. See MUFG's press release at: <https://www.bk.mufg.jp/global/newsroom/admin/newse1015.pdf>. The OCC's press release announcing its approval of MUFG Union Bank's merger with and into U.S. Bank National Association is available at: <https://www.occ.gov/news-issuances/news-releases/2022/nr-occ-2022-128.html>.
- <sup>2</sup> Category II banking organizations have (i) \$700 billion or more in average total consolidated assets or (ii) \$100 billion or more in average total consolidated assets and \$75 billion or more in average cross-jurisdictional activity. Category III banking organizations have (i) between \$250 billion and \$700 billion in average total consolidated assets or (ii) \$100 billion or more in average total consolidated assets and \$75 billion or more in off-balance sheet exposures, nonbank assets or short-term wholesale funding.
- <sup>3</sup> See Statement by Vice Chair Brainard on advance notice of proposed rulemaking on resolution requirements for large banks (October 14, 2022), *available at* <https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20221014.htm>.
- <sup>4</sup> See Statement by Governor Waller on advance notice of proposed rulemaking on resolution requirements for large banks (October 14, 2022), *available at* <https://www.federalreserve.gov/newsevents/pressreleases/waller-statement-20221014.htm>.
- <sup>5</sup> See Statement by Governor Bowman on advance notice of proposed rulemaking on resolution requirements for large Banks and application by U.S. Bancorp (October 14, 2022), *available at* <https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20221014.htm>.
- <sup>6</sup> The Federal Reserve noted that it "would likely provide such a notification unless the firm can demonstrate through its quarterly implementation plan a credible path to reducing its projected risk profile such that the requirements should not apply (including, for example, a path toward a material reduction in assets)". *U.S. Bancorp*, FRB Order No. 2022-22 (October 14, 2022), at 12 n. 35.
- <sup>7</sup> *U.S. Bancorp*, FRB Order No. 2022-22 (October 14, 2022), at 12 n. 35; and 38 n. 71.
- <sup>8</sup> Following the closing of its acquisition of MUFG Union Bank, USB would operate Union Bank as a separate bank subsidiary for a transitional period post-closing, after which MUFG Union Bank will be merged with and into U.S. Bank.
- <sup>9</sup> Order No. 2021-LB-Combination-323603, Approving the Application to Merge MUFG Union Bank, National Association with and into U.S. Bank National Association (October 14, 2022), at 18.
- <sup>10</sup> See *supra* n.1 for MUFG's and USB's press releases.
- <sup>11</sup> Sullivan & Cromwell LLP is advising MUFG on its sale of MUFG Union Bank to USB.

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