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Rep. Brad Miller Urges the Fed, FDIC
to Use Living Wills Authority to Break Up Banks

Washington, D.C. – **U.S. Rep. Brad Miller (D-NC)** sent a letter today to Federal Reserve Chairman Ben Bernanke and Chairman of the Federal Deposit Insurance Corporation *Martin J. Gruenberg* calling for both agencies to exercise the authority provided under the "living will" provision of the Dodd-Frank Act to require the biggest banks divest or independently capitalize their subsidiaries.

The living will provision requires the largest institutions to submit resolution plans, or "living wills" to outline organizational structure and identify critical operations and known risks. Regulators use living wills to spot impediments to quick, orderly resolution in bankruptcy. If the plans do not show a credible way to avoid severe disruption, regulators can require tougher supervision or restructuring.

"'Ultimately' is an unacceptable deadline for structural changes required for credible resolution plan," said **Rep. Miller**. "The uncertainties in the financial system may not allow for year after year of polite suggestions by regulators and modest tweaks by institutions."

In the letter, **Rep. Miller** writes that the Federal Reserve and the FDIC must act with increased urgency to prevent another financial collapse and asks them to "assume that the financial system faces an exigent threat."

The full text of the letter follows:

December 13, 2012

Chairmen Bernanke and Gruenberg:

I am writing to urge that the Federal Reserve and the FDIC exercise your authority under the "living wills" provision of the Dodd Frank Act with more energy, ambition and urgency.

William Dudley, the president of the Federal Reserve Bank of New York, recently conceded that the living wills submitted by systemically significant banks this summer "confirmed that we are a long way from the desired situation in which large complex firms could be allowed to go bankrupt without major disruptions to the financial system and large costs to society. Significant changes in structure and organization will ultimately be required for this to happen." The "initial exercise," Dudley said, provided regulators a "better understanding of the impediments to an orderly bankruptcy," and was the beginning of an "iterative process."

"Ultimately" is an unacceptable deadline for structural changes required for credible resolution plans. The uncertainties in the financial system may not allow for year after year of polite suggestions by regulators and modest tweaks by institutions.

I agree with Dudley that too big to fail is "an unacceptable regime," a position that puts Dudley in distinguished company, including that of Federal Reserve Board Governor Daniel Tarullo. Dudley called proposals to "break up the most systemically important firms into smaller or simpler pieces" a "more direct, but less nuanced approach" to ending the regime. As an author of such a proposal, I support a direct approach, but am willing to consider nuanced approaches. Dudley makes several suggestions that merit your serious consideration.

I also urge that you consider the proposal by Sheila Bair to require that systemically important firms be "simplified and subsidiarized" into "discrete, separately managed legal entities" based on business lines. Stand-alone subsidiaries would be easier to manage and supervise and far less messy to resolve. The failure of one or more subsidiaries would result in an investment loss for the parent corporation, but would not necessarily result in the disorderly collapse of the institution. If the institution became insolvent, many subsidiaries could still operate relatively normally. Stand-alone subsidiaries could be sold or spun off without significant disruption to the institution or the financial system, even in a crisis, without damaging the franchise value of the subsidiaries.

Stand-alone subsidiaries would also provide prudential regulators an important ally in supervising systemically significant institutions: the market. Each of the systemically significant institutions has hundreds if not thousands of subsidiaries. The institutions create subsidiaries for regulatory or tax purposes, but operate the institution as a single enterprise with consolidated management and a common pool of capital and liquidity. The institution presents the subsidiaries to taxing authorities and regulators as separate entities, but assures counterparties that all of the assets of the institution stand behind each subsidiary. Prudential regulators have no realistic way to assess the risk posed in thousands of subsidiaries engaged in all manner of businesses and neither do counterparties. Counterparties assume that the institutions are still too big to fail, so they will get paid one way or another. If counterparties knew that they could only be paid from the assets of the specific subsidiary with which they did business, they would consider that subsidiary's assets and potential liabilities. The adequacy of capital would be far easier to judge if the capital was devoted to a specific subsidiary. The restoration of market discipline would go a long way to solving the too big to fail problem. If subsidiaries engaged in other business lines were small enough to fail, prudential regulators could pay closer attention to the activities that create the greatest risk of economic disruption.

Again, I urge that you not assume that the next financial crisis is decades or perhaps generations away in exercising your living wills authority. I urge that you assume that the financial system faces an exigent threat, because it may.

Sincerely,

Brad Miller
Member of Congress

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