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Bankruptcy Alternatives to Title II of the Dodd-Frank Act—Part I

Paul L. Lee*

Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") is intended to be available as an alternative to and substitute for a bankruptcy proceeding because a bankruptcy proceeding was seen as inadequate to handle the failure of a systemically important financial company at the time of the financial crisis. Part I of this article focuses on the rationale for a new resolution regime in Title II of the Dodd-Frank Act, the perceived inadequacies in a Bankruptcy Code approach to the resolution of large financial institutions, the developmental work of the Federal Deposit Insurance Corporation on Title II, including the single-point-of-entry strategy, intended to make Title II an operational reality, and the role of resolution planning under Title I. Part II of the article, which will appear in an upcoming issue of The Banking Law Journal, *will analyze the recurring proposals to reform the Bankruptcy Code to make it a more viable alternative for resolving large financial companies, the contending views on such efforts, and the effects of such efforts on the resolution planning process under Title I and on the prospects for use of the Title II process.*

Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") represents a singular (if controversial) development in U.S. resolution law. It provides a new resolution regime, the so-called Orderly Liquidation Authority, for use in the event that a systemically important U.S. financial company were to encounter severe financial distress.[1] Like other provisions in the Dodd-Frank Act, Title II was designed as a response to the inadequacies in the U.S. legal and regulatory regimes evidenced during the financial crisis. Title II is intended to be available as an alternative to and substitute for a bankruptcy proceeding because a bankruptcy proceeding was seen as inadequate to handle the failure of a systemically important financial

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[1] Pub. L. No. 111-203, Title II, 124 Stat. at 1442-1520 (2010) (codified at 12 U.S.C. §§ 5381–5394).

company at the time of the financial crisis.

Since the enactment of Title II, the Federal Deposit Insurance Corporation (the "FDIC"), as the administrator of the Title II resolution process, has spent much time developing the theoretical and operational underpinnings of the new Title II resolution process. The FDIC's work to date, particularly in respect of the single-point-of-entry ("SPOE") strategy, has broken new ground in resolution planning and has taken Title II itself in directions that could not have been foreseen when Title II was enacted.[2]

Title II was nonetheless controversial at the time of its enactment and it remains controversial today. There are pending legislative proposals to revise the Bankruptcy Code to make it a more viable alternative to Title II for resolving large financial institutions. These legislative proposals would revise certain Bankruptcy Code provisions (such as those relating to derivatives) that are thought to present special problems in a bankruptcy process for a financial company. They would also add to the Bankruptcy Code certain provisions that parallel those in Title II, such as a bridge company provision that would facilitate an SPOE strategy in bankruptcy akin to the strategy proposed by the FDIC for use in Title II. These revisions are supported by various bankruptcy practitioners and academicians.

There are reasons for financial institutions to support revisions to the Bankruptcy Code as well. As a corollary to the creation of the new resolution regime in Title II, Title I of the Dodd-Frank Act imposed heightened prudential requirements on large bank holding companies and other nonbank financial companies designated as systemically important by the Financial Stability Oversight Council ("FSOC"). One of these prudential requirements is that these companies must prepare a plan for a "rapid and orderly resolution in the event of material financial distress or failure."[3] This requirement has come to be known as the resolution plan (or more colloquially, living will) requirement.[4]

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[2] *See* FDIC, Notice and Request for Comments, Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76,614 (Dec. 18, 2013). An early critic of Title II has described the development of the SPOE strategy by the FDIC as a "rare illustration of a happy unintended consequence" of the Dodd-Frank Act. David A. Skeel, Jr., *Single Point of Entry and the Bankruptcy Alternative*, *in* ACROSS THE GREAT DIVIDE: NEW PERSPECTIVES ON THE FINANCIAL CRISIS 313 (Martin N. Baily & John B. Taylor eds., 2014). This critic had originally faulted the drafters of Title II for limiting the FDIC to a single set of resolution options, *i.e.,* liquidation. DAVID SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES 149 (2011).

[3] Dodd-Frank Act, § 165(d)(1) (codified at 12 U.S.C. § 5365(d)(1)).

[4] The more sepulchrally minded initially referred to the resolution plan requirement as a "funeral plan" requirement, but that phrase quickly gave way to the more vibrant phrase, "living

Embedded in this Title I provision is the requirement that the resolution plan must be evaluated against the Bankruptcy Code, not Title II. The language of the Title I provision requires the FDIC and the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") to determine whether the plan is credible and would facilitate an orderly resolution of the company under the Bankruptcy Code.[5] The resolution plan requirement has proven to be one of the most demanding provisions in the maw of Dodd-Frank Act requirements. It is a provision fraught with structural and operational implications for large financial companies.

In addition to changes in the structure and operations of individual companies, changes to the Bankruptcy Code would assist the process of designing plans that would more readily facilitate the orderly resolution of a large financial company in bankruptcy. Thus, there are reasons for both bankruptcy practitioners and financial institutions to promote enhancements to the Bankruptcy Code, although there are still differences in opinion as to the breadth of the changes required. The debate over changes to the Bankruptcy Code is further complicated by the concern in some quarters that any proposal to enhance the Bankruptcy Code for handling the failure of a large financial institution will be used as a screen for seeking a repeal of Title II.

This article discusses the shifting contours of this debate and the contending approaches underlying the debate. Part I of this article focuses on the rationale for a new resolution regime in Title II, the perceived inadequacies in a Bankruptcy Code approach to the resolution of large financial institutions, the developmental work of the FDIC on Title II, including the SPOE strategy, intended to make Title II an operational reality, and the role of resolution planning under Title I. Part II will analyze the recurring proposals to reform the Bankruptcy Code to make it a more viable alternative for resolving large financial companies, the contending views on such efforts, and the effects of such efforts on the resolution planning process under Title I and on the prospects for use of the Title II process.

THE BACKGROUND AND RATIONALE FOR A NEW RESOLUTION REGIME

The proposal for a new resolution regime for systemically important financial institutions emerged as a key topic early in the discussion of comprehensive

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will". *See, e.g.,* U.S. Senate, Brief Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act, USA, 2010, http://www.banking.senate.gov/public/_files/070110_Dodd_Frank_Wall_Street_Reform_comprehensive_summary_Final.pdf.

[5] Dodd-Frank Act § 165(d)(4) (codified at 12 U.S.C. § 5365(d)(4)).

financial reform legislation in 2009. The U.S. Treasury Department released a detailed legislative proposal for a new resolution authority in March 2009 well in advance of the release of drafts for other parts of its comprehensive financial reform package that would ultimately be enacted as the Dodd-Frank Act, signaling the importance that the Treasury Department attached to the proposal. In a March 2009 press release proposing the new resolution regime, the Treasury Department stated that its proposal would fill a significant void in the existing financial regulatory structure for dealing with large nonbank financial companies, a void that had been highlighted during the financial crisis.[6] The Treasury Department said that the events of the financial crisis had demonstrated that when a large, interconnected nonbank financial company encountered severe financial distress, there were only two options for the company: (1) obtain outside capital or funding from the federal government as in the case of AIG; or (2) file for bankruptcy and undergo a "disorderly" failure that threatened the stability of the U.S. financial system as in the case of Lehman Brothers Holdings Inc. ("Lehman").[7] Faced with the choice between these two "untenable" options, the federal government in September 2008 chose to use the Federal Reserve Board's lending authority under section 13(3) of the Federal Reserve Act to provide assistance to AIG and so avoid a disorderly failure of AIG, much as it had in March 2008 for Bear Stearns.[8]

In light of these experiences, the Treasury Department concluded that the federal government needed another option for dealing with the resolution of a systemically significant nonbank financial firm. The Treasury Department said that this option should take the form of a resolution authority that replicated the speed and flexibility of the resolution authority for insured depository institutions under the Federal Deposit Insurance Act (the "FDIA"). The Treasury press release asserted that if the government had had the authority provided for in the proposed resolution authority, it could have resolved AIG in an orderly manner that would have shared losses among equity and debt holders in a way that maintained confidence in AIG's ability to fulfill its obligations to its insurance policyholders and other systemically important

[6] Press Release, U.S. Dep't of the Treasury, Treasury Proposes Legislation for Resolution Authority (Mar. 25, 2009), *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg70.aspx. *See also* Paul L. Lee, *The Dodd-Frank Act Orderly Liquidation Authority: A Preliminary Analysis and Critique—Part I*, 128 Banking L. J. 771 (2011). Sections of this article draw upon that earlier article.

[7] *Id.*

[8] *Id. See also* U.S. Dep't of the Treasury, Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation 76 (June 2009).

customers.[9] According to the Treasury press release, the new resolution authority would have allowed the FDIC to sell or transfer assets and liabilities of the company without court order or counterparty consent, to renegotiate or repudiate contracts, and to address the AIG derivatives portfolio.[10] The Treasury Department's initial draft of the new resolution authority legislation envisioned a new resolution authority that would allow the FDIC to act as a conservator or receiver for a nonbank financial firm deemed to be systemically important, with powers comparable to those available to the FDIC for insured depository institutions under the FDIA and with the authority to provide various forms of financial assistance, including equity, to stabilize the financial firm.[11]

In testimony in support of the legislative proposal, a senior Treasury official explained the advantages that the new resolution authority would have over the options that were available to the government during the financial crisis in 2008.[12] The first advantage derived from a different focus between the new resolution authority and the Bankruptcy Code. The focus of the Bankruptcy Code is to reorganize or liquidate a failing firm for the benefit of its creditors. The focus of the new resolution authority would be to manage the failure of a systemically important financial company in a way that protects taxpayers, the broader economy, and the stability of the financial system. Given the special focus of the new resolution authority (which might be seen to be in some derogation of the creditor protections provided by the Bankruptcy Code), the senior Treasury official stated that the new resolution authority was to be used very sparingly and was not intended "to replace bankruptcy in any but the rarest circumstances."[13] In addition to this broader objective of protecting the stability of the financial system, the Treasury official noted four specific advantages that the new resolution authority would have over a Bankruptcy Code approach:

(1) the new resolution authority would be essentially an administrative process rather than a judicial process and so would provide the

[9] Treasury Press Release, *supra* note 6.

[10] *Id.*

[11] *Id.*

[12] *See Too Big to Fail: The Role for Bankruptcy and Antitrust Law in Financial Regulatory Reform: Hearing before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. 6 (Oct. 22, 2009) [hereinafter *House Subcommittee Hearing on Regulatory Reform*] (testimony of Michael S. Barr, Ass't Sec'y of the Treasury), *available at* http://judiciary.house.gov/_files/hearings/pdf/Barr091022.pdf.

[13] *Id.* at 4.

necessary speed to deal with a failing financial firm;

(2) the new authority would provide for a temporary stay of counterparty termination and netting rights on derivative contracts to mitigate the adverse consequences of a company's failure;

(3) the new authority would allow the federal government to provide the failing company with financing to fund its liquidity needs during the resolution process and thus mitigate the "knock on" effects of its failure such as the fire-sale of assets; and

(4) the new authority would provide for the use of one or more "bridge" financial companies to preserve the business franchise, deal with counterparty claims, and protect viable assets of stronger subsidiaries pending their sale.[14]

The federal regulatory agencies enthusiastically supported the Treasury proposal for a new resolution authority for systemically important financial companies. Chairman Ben Bernanke of the Federal Reserve Board testified in favor of the proposal for a new resolution authority, noting that after the Lehman and AIG experiences, there could be little doubt that the federal government needed a "third option between the choices of bankruptcy or bailout."[15] Chairman Mary Shapiro of the Securities and Exchange Commission likewise testified in favor of the proposal, noting the Hobson's choice that confronted the government when a large, interconnected financial company was teetering on the brink of failure, and thus the need for another real option.[16] Comptroller of the Currency John Dugan also added his voice in support of the new resolution authority.[17]

The most vocal advocate for the new resolution authority among the federal regulators was Chairman Sheila Bair of the FDIC. As she would throughout her

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[14] *Id.* at 6.

[15] *See Regulatory Perspectives on the Obama Administration's Financial Regulatory Reform Proposals: Hearing before the H. Comm. on Financial Services*, 111th Cong. 12 (July 12, 2009) (testimony of Ben S. Bernanke, Chairman, Federal Reserve Board), *available at* http://financialservices.house.gov/media/file/hearings/111/testimony_of_chairman_bernanke.pdf.

[16] *See Establishing a Framework for Systemic Risk Regulation: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs,* 111th Cong. 7 (July 23, 2009) (testimony of Mary L. Schapiro, Chairman, SEC), *available at* https://www.sec.gov/news/testimony/2009/ts072309mls.htm.

[17] *See Systemic Regulation, Prudential Matters, Resolution Authority and Securitization: Hearing before the House Comm. on Financial Services*, 111th Cong. (Oct. 29, 2009) (testimony of John C. Dugan, Comptroller of the Currency), *available at* http://financialservices.house.gov/media/file/hearings/111/dugan.pdf.

tenure at the FDIC, Chairman Bair called for an end of the too-big-to-fail policy through the establishment of a credible mechanism for the orderly resolution of financial companies presenting systemic risk.[18] In support of the new resolution regime, she pointed to the severe market disruption resulting from the Lehman bankruptcy filing and offered two explanations for the severity of the market reaction.[19] The first explanation was that investors thought that the government would not let Lehman declare bankruptcy because "the protracted proceedings of a Chapter 11 bankruptcy were not viewed as credible prior to the [Lehman] bankruptcy filing" and hence investors were willing to make "moral hazard" investments in high-yielding commercial paper of companies like Lehman.[20] The second explanation was that the legal features of the bankruptcy process itself triggered the fire sale of assets and destroyed the liquidity of a large share of the claims against Lehman. In respect of the fire sale of assets, Chairman Bair focused in particular on the risk posed by derivatives. Noting that under the Bankruptcy Code, counterparties on derivatives can terminate and net out positions and sell any pledged collateral to pay off the net claims, she observed that the exercise of these rights during periods of general market instability could increase systemic risk. This legal regime makes financial firms more prone to "market runs" with a cycle of increasing collateral demands before a firm fails and collateral dumping after it fails. Chairman Bair said that under either of the above explanations for the fall-out of the Lehman failure, the answer must be the establishment of a new resolution process.[21]

Another senior official of the FDIC expanded on the reasons why a bankruptcy process was not well suited to the resolution of large financial firms.[22] He noted a fundamental difference between large financial firms and large commercial firms, namely, that large financial firms perform critical

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[18] *See, e.g., Regulatory Perspectives on the Obama Administration's Financial Regulatory Reform Proposals: Hearing Before the H. Comm. on Financial Services*, 111th Cong. 1 (July 24, 2009) (testimony of Sheila C. Bair, Chairman, FDIC), *available at* http://financialservices.house.gov/media/file/hearings/111/sheila_bair_-_fdic_(resubmitted).pdf.

[19] *See Regulating and Resolving Institutions Considered "Too Big To Fail": Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 111th Cong. 12 (May 6, 2009) [hereinafter "*Too Big To Fail" Hearing*] (testimony of Sheila C. Bair, Chairman, FDIC), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=4deb17aa-b8b8-4bc1-82ef-4c57388acf90.

[20] *Id.* at 12.

[21] *Id.* at 13–16.

[22] *House Subcommittee Hearing on Regulatory Reform*, *supra* note 12 (testimony of Michael H. Krimminger, Special Advisor for Policy, FDIC), *available at* http://judiciary.house.gov/_files/hearings/pdf/Krimminger091022.pdf.

functions in settling payments and intermediating liquidity for individuals and markets. The freezing of these functions at a large interconnected financial firm would lead to cascading consequences for counterparties, customers, and even whole markets. The critical role of a large financial company's settlement and liquidity intermediation function for customers and markets effects the speed (and hence the process) with which such a company must be resolved.[23] The resolution of such a firm would have to be handled virtually overnight or at least over a "resolution weekend." This time constraint limits the process (and the participants in the process) as has long been the case with the resolution of banking entities under the FDIA. The resolution process for a large financial institution cannot depend upon administration by a debtor in possession, a recently appointed trustee or a set of creditors' committees. The resolution process instead requires pre-planning by the resolving authority, using a staff that is experienced in the financial operations of large financial firms.[24] The resolution of a large financial firm requires the resolver to act decisively to take over the business, preserve systematically significant operations, and provide continuity of critical financial functions. This process in turn requires special tools like a bridge institution mechanism to which financial market contracts (*e.g.*, derivatives) can be transferred without triggering netting and close-out rights and without the consent of the counterparties.[25] This bridge institution must also be in a position to continue to perform systemically significant functions, such as payment processing, securities lending, and settlement of ongoing government securities transactions.[26] As a result, a new resolution regime must be in a position to provide the liquidity necessary to continue these systemically important functions through a secure government-funding mechanism.[27] These factors were prominently cited by FDIC officials and other government officials in support of a special resolution regime for large interconnected financial firms.

CONTENDING VIEWS OF THE NEW RESOLUTION REGIME

The federal regulators provided strong support for the new resolution authority. Other commentators, including industry commentators, provided qualified support for the new resolution authority. Still other parties, including

[23] *Id.* at 2–4.

[24] *Id.* at 6–7.

[25] *Id.* at 8–9.

[26] *Id.* at 9.

[27] *Id.*

certain bankruptcy practitioners, academicians, and legislators, voiced strong opposition to the idea of the new resolution authority. The major financial industry trade groups voiced general support for the concept of a new resolution authority for systemically important financial firms, but expressed significant concerns about certain of the specific terms of the new resolution authority contained in the Treasury draft legislation. One area of particular concern related to the possible difference in treatment of creditors under the Bankruptcy Code and the new resolution authority. The major financial industry trade groups expressed the view that it was important that there be clarity of treatment of creditors and that, to the maximum extent possible, the new resolution authority should be aligned with the rights and procedures under the Bankruptcy Code. The Financial Services Roundtable, for example, noted that while certain special procedures under the FDIA might be needed in a bank insolvency to protect the interests of insured depositors, these procedures would not be appropriate in the case of a failure of a holding company.[28] The American Bankers Association echoed the concern for the treatment of creditors, saying that rules for creditors should be based on existing bankruptcy principles to provide clarity and predictability to financial markets.[29]

The Securities Industry and Financial Markets Association ("SIFMA") supported the idea of a resolution authority for systemically important financial companies, but objected to various provisions in the Treasury legislative proposal. The testimony from a SIFMA representative acknowledged the tensions that would likely arise between the government's objective of resolving large financial firms to avoid systemic risk and the market's desire for clarity, predictability, and equality of treatment.[30] The SIFMA representative pointed to one of the fundamental tensions:

> [The] core resolution powers [in the Treasury draft legislation] are designed to overcome the weaknesses in the bankruptcy process by providing a way for the systemically critical parts of a non-bank financial company's assets and liabilities to be preserved in the most

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[28] *See Systemic Regulation, Prudential Matters, Resolution Authority and Securitization: Hearing before the H. Comm. on Financial Services*, 111th Cong. 21 (Oct. 29, 2009) [hereinafter *Systemic Regulation Hearing*] (testimony of Scott Talbott, Senior Vice President for Gov. Affairs, Fin. Serv. Roundtable).

[29] *See Systemic Regulation Hearing*, *supra* note 28, at 8 (testimony of Edward L. Yingling, President and Chief Executive Officer, Am. Bankers Ass'n).

[30] *See Systemic Regulation Hearing*, *supra* note 28, at 10-22 (testimony of T. Timothy Ryan, President and Chief Executive Officer, SIFMA).

> cost-effective way, regardless of whether creditors within the same class are treated equally. This cherry-picking of assets and liabilities in the interest of systemic stability would normally be antithetical to established bankruptcy policies, which favor equality of treatment for similarly situated creditors. It is justified, however, in the case of systemically important non-bank financial companies because of the supervening policy goals of preserving the value of these entities and minimizing public costs.[31]

In its testimony, SIFMA appeared to accept the need for a new core resolution process. It nonetheless objected to the fact that the Treasury proposal went beyond the creation of the core resolution function to replace "the Bankruptcy Code's transparent judicial claims process and neutral rules for left-behind assets and liabilities with the opaque administrative claims process and creditor-unfriendly rules" taken from the bank insolvency model in the FDIA.[32]

Academicians offered a variety of views on the proposed resolution regime for large financial companies. A number of academicians and commentators supported the idea of a new regime on the grounds that the bankruptcy process was not suitable for handling a large, troubled financial company, although these commentators differed among themselves on the precise shape that the new resolution regime should take. There appeared, however, to be general agreement on several basic points relating to the need for a new resolution regime. Various commentators observed that a bankruptcy process would take too long—the financial business would "evaporate" while the company was in the proceeding—leading to a piecemeal liquidation with attendant loss of value.[33] These commentators specifically called for a new resolution authority similar to the authority that the FDIC has for banks. An equally important concern for some commentators related to the inherent risk that the bankruptcy process for a large financial company posed to the financial system as a whole:

> By definition, troubled systemically important financial institutions cannot be resolved in bankruptcy without threatening the stability of the financial system. The bankruptcy process stays payment of unsecured creditors, while inducing secured creditors to seize and then possibly sell their collateral. Either or both outcomes could lead to a

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[31] *Id.* at 11–12.

[32] *Id.* at 12–13.

[33] *See, e.g.,* "*Too Big To Fail*" *Hearing*, *supra* note 19, at 6 (testimony of Raghuram S. Rajan, Professor, University of Chicago Booth School of Business); *House Subcommittee Hearings on Regulatory Reform*, *supra* note 12, at 1 (testimony of David Moss, Professor, Harvard Business School).

> wider panic, which is why a bank-like restructuring process—which puts the troubled bank into receivership, allowing the FDIC to transfer the institution's liabilities to an acquirer or to a "bridge bank"—is necessary for non-bank SIFIs.[34]

The reference in this quote to secured creditors seizing and possibly selling collateral is presumably a reference to the special treatment accorded derivatives and other financial contracts under the safe harbor provisions in the Bankruptcy Code discussed further below. Another commentator supporting the idea of a new resolution regime was more explicit in his objection to the Bankruptcy Code's treatment of derivatives and other financial contracts. He characterized the cross-default provisions in such contracts as essentially "poison-pills that make large institutions too costly to fail."[35]

For many observers another important point working against a bankruptcy process was its inability to provide the funding that would be needed to permit an orderly wind-down of a large financial institution.[36] The Treasury proposal sought to address this problem by providing the Treasury and the FDIC with authority to supply funding to the company as part of the resolution process. As ultimately adopted, Title II provided for government debt funding to be provided to the receivership or any bridge company that the FDIC might establish as part of the resolution process.[37] Any such funding must be repaid from the proceeds of the Title II process or, if necessary, from an assessment on large financial companies.[38] While the supporters of the new resolution regime saw government funding (at least for short-term liquidity purposes) as essential to the operation of the new resolution authority, opponents of Title II saw the provision for government funding as an inherent flaw in Title II. To these opponents, such government funding was tantamount to a "bailout."

A number of other bankruptcy practitioners, academicians, and commenta-

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[34] "*Too Big To Fail*" *Hearing*, *supra* note 19, at 14 (testimony of Martin N. Baily & Robert E. Litan, Senior Fellows, Brookings Institution).

[35] "*Too Big To Fail*" *Hearing*, *supra* note 19, at 7 (testimony of Raghuram S. Rajan).

[36] *See, e.g.*, *House Subcommittee Hearing on Regulatory Reform*, *supra* note 12, at 5–6 (testimony of Harvey R. Miller, bankruptcy counsel to Lehman). This witness cited the lack of liquidity as one of the primary sources of the disorderly Lehman liquidation, but as noted *infra* he concluded that with an appropriate expansion of government authority to lend to financially distressed nonbank companies in urgent circumstances, the Bankruptcy Code could be used to provide for an orderly wind-down of a financial company rather than the new proposed resolution authority.

[37] Dodd-Frank Act, § 204(d) (codified at 12 U.S.C. § 5384(d)).

[38] Dodd-Frank Act, § 210(n) & (o) (codified at 12 U.S.C. § 5390(n) & (o)).

tors objected to the very notion of the new resolution authority. They contrasted the new resolution regime unfavorably to the bankruptcy process, which they saw as open and transparent and administered according to clear rules and settled precedent. But more fundamentally as noted above, they feared that the new resolution authority would permit the regulators to "bailout" troubled financial firms through the use of the power to provide debt funding and guarantees to the institution.[39] These commentators argued that a bankruptcy process was needed to instill discipline in the market.[40] These commentators also sought to refute the "Lehman Myth" or Myths, namely, the idea that it was the Lehman bankruptcy that precipitated the financial panic in September 2008 and the idea that the Lehman bankruptcy cast doubt on the efficacy of the bankruptcy process itself.[41] These commentators saw more fundamental problems in the regulators' handling of large financial institutions as the cause of the financial crisis.

The opponents of the new resolution authority also worried about the wide degree of discretion provided to the regulators with respect to the use of the resolution authority, *e.g.*, in deciding whether an institution would receive the treatment and in deciding which creditors and counterparties might be protected under the rubric of mitigating systemic risk.[42] In contrast to the proposed resolution authority, these commentators saw the bankruptcy process as relying on established rule of law rather than administrative discretion and as treating creditors in a way understood by lenders and investors in advance, including in particular the "absolute priority rule."[43] The more moderate

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[39] *See, e.g.*, *Systemic Risk: Are Some Institutions Too Big to Fail and If So, What Should We Do About It?: Hearing before the H. Comm. on Financial Services*, 111th Cong. 1 (July 21, 2009) (testimony of Paul G. Mahoney, Dean, University of Virginia School of Law); *Experts' Perspective on Systemic Risk and Resolution Issues: Hearing Before the H. Comm. on Financial Services*, 111th Cong. 3 (Sept. 24, 2009) (testimony of Jeffrey A. Miron, Senior Lecturer and Director of undergraduate studies, Department of Economics, Harvard University); *Systemic Regulation Hearing*, *supra* note 28 (testimony of Phillip Swagel, Visiting Professor, McDonough School of Business, Georgetown Univ.).

[40] *Id.*

[41] *See House Subcommittee Hearing on Regulatory Reform*, *supra* note 12, at 1 (testimony of John Taylor, Professor, Stanford University); *House Subcommittee Hearing on Regulatory Reform*, *supra* note 12, at 2 (testimony of David Steel, Professor, University of Pennsylvania Law School).

[42] *Id.*

[43] *See House Subcommittee Hearing on Regulatory Reform*, *supra* note 12, at 1 (testimony of John Taylor, Professor, Stanford University); *House Subcommittee Hearing on Regulatory Reform*, *supra* note 12, at 7–8 (testimony of Edwin E. Smith, partner, Bingham McCutchen LLP); *Systemic Regulation Hearing*, *supra* note 28, at 6-9 (testimony of Peter Wallison, Fellow, American Enterprise Institute).

opponents saw the new resolution authority as unnecessary. The more virulent opponents saw the new resolution authority as pernicious.

Some of the commentators who favored a bankruptcy approach over the new resolution authority nonetheless concluded that changes should be made to the Bankruptcy Code to address potential systemic concerns.[44] These commentators pointed in particular to a need to revise the "safe harbor" treatment accorded derivatives, swaps, and other financial contracts in the Bankruptcy Code. The core provisions of the Bankruptcy Code relating to the automatic stay, limitations on preferential and fraudulent transfers, and restrictions on *ipso facto* clauses are limited in their application to derivatives and other financial contracts.[45] The exclusion of these financial contracts from the automatic stay and *ipso facto* provisions of the Bankruptcy Code allows counterparties on such contracts to terminate or close out the contracts with the debtor upon a bankruptcy event and immediately liquidate any collateral.[46] The exclusion also protects the counterparty from a preference or constructive fraudulent conveyance claim on settlement payments, margin payments, and other collateral postings made during the periods specified in the relevant sections of the Bankruptcy Code.[47] In addition, a counterparty under a master netting agreement may net its exposure on a wide range of financial contracts with a debtor, thus avoiding the risk of "cherry picking" to which other creditors with executory contracts with a debtor are exposed in bankruptcy.[48] These "safe harbor" provisions in the Bankruptcy Code were the result of a series of amendments made to the Bankruptcy Code beginning in 1982 and culminating in 2006.

The Lehman bankruptcy provided a ready occasion for commentators to reevaluate the policies and consequences of the special treatment of financial

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[44] *See, e.g., House Subcommittee Hearing on Regulatory Reform*, *supra* note 12, at 9 (testimony of David Steel) & 7–9 (testimony of Harvey R. Miller).

[45] The basic categories of financial contracts that receive special treatment under the Bankruptcy Code are: commodity contracts (11 U.S.C. § 761(4)), forward contracts (11 U.S.C. § 101(25)), securities contracts (11 U.S.C. § 741(7)), repurchase agreements (11 U.S.C. § 101(47)), and swap agreements (11 U.S.C. § 101(53B)). Amendments made to the Bankruptcy Code in 2005 significantly expanded the definitions of most of these terms. *See* Edward R. Morrison & Joerg Riegel, *Financial Contracts and the New Bankruptcy Code: Insulating Markets from Bankruptcy Debtors and Bankruptcy Judges*, 13 Am. Bankr. Inst. L. Rev. 641, 645 (2005). *See also* Rhett G. Campbell, *Financial Markets Contracts and BAPCPA*, 79 Am. Bankr. L. J. 696 (2005).

[46] *See* 11 U.S.C. §§ 362(b)(6), (7), (17) & (27); 555, 556, 559, 560 & 561.

[47] *See* 11 U.S.C. §§ 546(e), (f), (g) & (j) & 548(d)(2).

[48] *See* 11 U.S.C. §§ 362(b)(27), 546(j), 548(d)(2)(E) & 561.

contracts in a bankruptcy proceeding. Harvey Miller, the late dean of the bankruptcy bar and the lead bankruptcy lawyer for Lehman, testified that the exclusion from the Bankruptcy Code's automatic stay for derivatives, swap, and other securities transactions had caused a "massive destruction" of value for Lehman.[49] In his words, the exclusions in the Bankruptcy Code exposed Lehman to the "ravages of counterparties" in respect of its securities and structured finance contracts.[50] Some experts had warned even before the Lehman bankruptcy that the special treatment for financial contracts could be a source of systemic risk in a bankruptcy proceeding of a large financial institution.[51] The irony that the special treatment of derivatives and other financial contracts was originally justified on the theory that it would protect against systemic risk was not lost on these observers.[52] The stated legislative purpose of the original exclusion from the automatic stay was to prevent the domino effect of the insolvency of a commodities or securities firm spreading to other firms and threatening the larger market. The exclusion from the automatic stay was to permit a counterparty to liquidate its contracts with the bankrupt entity immediately and minimize the ongoing market risk in the position. The Lehman experience, however, suggested to various observers that the exclusion can have the unintended effect of generating another form of systemic risk, *i.e.,* the risk of a wholesale "run" by derivative counterparties.[53]

Harvey Miller nevertheless concluded that a new resolution regime for large financial companies was not needed. Instead, he concluded that the Bankruptcy Code could be used for distressed financial companies if two changes to law were made.[54] First, the Bankruptcy Code should be amended to eliminate the

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[49] *House Subcommittee Hearings on Regulatory Reform*, *supra* note 12, at 9 (testimony of Harvey Miller).

[50] *Id*. at 4.

[51] *See, e.g.*, Franklin R. Edwards & Edward R. Morrison, *Derivatives and the Bankruptcy Code: Why the Special Treatment?*, 22 Yale J. on Reg. 91, 94 (2005); Robert R. Bliss & George G. Kaufman, *Derivatives and Systemic Risk: Netting, Collateral and Closeout*, 2 J. Fin. Stab. 55, 66–67 (2006); Frank Partnoy & David A. Skeel, Jr., *The Promise and Perils of Credit Derivatives*, 75 U. Cin. L. Rev. 1019 (2007).

[52] *See* Edwards & Morrison, *supra* note 51, at 93.

[53] *See id*. at 94. In the wake of the financial crisis, there were renewed calls for changes to the safe harbor provisions. *See, e.g.,* Stephen J. Lubben, *Repeal the Safe Harbors*, 18 Am. Bankr. Inst. L. Rev 319 (2010); Kenneth Ayotte & David A. Skeel, Jr., *Bankruptcy or Bailouts*, 35 J. of Corp. L. 469 (2010); Mark J. Roe, *The Derivatives Market's Payment Priorities as Financial Crisis Accelerator*, 63 Stan. L. Rev. 539 (2011).

[54] *House Subcommittee Hearings on Regulatory Reform*, *supra* note 12, at 6 (testimony of Harvey Miller).

safe harbor provisions for derivatives and other financial contacts. Second, the government's authority to extend loans to financially distressed nonbank financial companies in exigent circumstances should be expanded. The latter recommendation flowed from the observation that Lehman had suffered a liquidity failure and could not be reorganized or liquidated in an orderly fashion without an infusion of significant liquidity—which in the Lehman case was not forthcoming from the private sector.

Miller also pointed to another obstacle to the orderly bankruptcy process for Lehman that could not easily be remedied—the lack of any mechanism to achieve a coordinated international restructuring of the operations of the global enterprise.[55] He observed that the "global fragmentation that has characterized the international side of Lehman's bankruptcy is an inevitability that is not adequately addressed by the proposed resolution regime."[56] He apparently thought it unnecessary to note that it is likewise not addressed by the Bankruptcy Code regime. This is not an issue that can be addressed by changes to either the Bankruptcy Code or Title II. A new approach to resolution, such as the SPOE strategy discussed below, would be needed to deal with the prospect (or "inevitability" in the words of Harvey Miller) of international fragmentation under the Bankruptcy Code or under Title II.

CONGRESSIONAL DELIBERATIONS

The Republican members of Congress generally opposed the adoption of the new resolution authority in Title II as they did with most of the other provisions in the Dodd-Frank Act. In the House, the Republicans actually proposed an alternative financial reform bill, H.R. 3310.[57] Among its various provisions, H.R. 3310 would have created a new Chapter 14 to the Bankruptcy Code for nonbank financial companies. The idea for a new Chapter 14 appears to have originated among Republican legislators around the same time that scholars at the Hoover Institution were also considering the merits of creating a new chapter in the Bankruptcy Code for nonbank financial companies.[58] The proposed Chapter 14 was intended by the Republican legislators as a substitute for the new resolution authority proposed by the Treasury. The drafters of the

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[55] *Id*. at 9–10.

[56] *Id*. at 11.

[57] Consumer Protection and Regulatory Enhancement Act, H.R. 3310, 111th Cong. (2009).

[58] *See* Thomas H. Jackson, *Chapter 11 F: A Proposal for the Use of Bankruptcy to Resolve Financial Institutions*, *in* ENDING GOVERNMENT BAILOUTS AS WE KNOW THEM (Kenneth E. Scott et al. eds., Hoover Institution Press 2010).

proposed Chapter 14 attempted to respond to certain specific concerns about the Bankruptcy Code that had been identified in testimony on the financial reform legislation. The principal provision in Chapter 14 was directed at the safe harbor treatment provided to derivatives and other financial contracts. Under the proposed Chapter 14, the safe harbor provisions for derivatives and other financial contracts would not have automatically applied upon filing of a bankruptcy case.[59] Instead, the bankruptcy court would make a specific determination upon a motion by the debtor whether the debtor and the estate should be subject to any or all of the special provisions in the Bankruptcy Code for derivatives and other financial contracts.[60] In making the determination, the bankruptcy court would be directed to "balance the interests of both debtor and creditors while attempting to preserve the debtor's assets for repayment and reorganization of the debtor's obligations, or to provide for a more orderly liquidation."[61]

More significantly, H.R. 3310 also included a specific prohibition on a trustee in bankruptcy obtaining credit if the source of the credit either directly or indirectly was the United States.[62] This prohibition ran counter to the suggestion of various observers, including the lead bankruptcy counsel for Lehman and the scholars at the Hoover Institution, that an interim source of government funding would be necessary to make a bankruptcy process practicable for a large financial firm.[63] This prohibition was presumably intended to address the concern among Republican legislators that the federal government might "bailout" a company in a Chapter 14 case by providing financing to the company. No action was taken on H.R. 3310 in the House. Instead, the House ultimately adopted a version of the new resolution regime based on the Treasury proposal.[64] The House-adopted version of the new resolution authority removed the authority of the FDIC and the Treasury to provide equity financing to a company as part of the resolution process. It provided for only debt funding or guarantees to a company in resolution. It also

[59] H.R. 3310 § 102(f).

[60] H.R. 3310, § 102(f). The drafting of these provisions in H.R. 3310 was at best inartful. *See* Thomas H. Jackson, *supra* note 58, at 236 ("HR 3310 is doing something with respect to QFCs and the automatic stay, but, with deference, it is almost impossible to figure out quite what.").

[61] H.R. 3310, § 102(f).

[62] H.R. 3310, § 102(e).

[63] *See* Thomas H. Jackson, *supra* note 58, at 239–241.

[64] Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. (as passed by House, Dec. 11, 2009).

required that any debt funding provided by the government to a company in resolution be repaid from *ex ante* assessments on certain large financial companies.[65]

The Senate adopted its own version of a financial reform package, which included the new resolution authority in the form of Title II.[66] The Senate version of Title II included a number of revisions to the Treasury draft of the new resolution authority, for example, by incorporating certain creditor protection provisions that are more closely aligned to those in the Bankruptcy Code.[67] The Senate version of Title II also included a general provision (the so-called "no-creditor-worse-off" provision) that a creditor in a Title II proceeding would in no event receive less than the amount the creditor would have been entitled to in a Chapter 7 bankruptcy proceeding.[68] Various critics of Title II maintained that the changes made in the Senate version were merely palliatives and did not address the basic problem that Title II would be a non-transparent process and would not be administered according to a clear set of rules and settled precedents in sharp contrast to the Bankruptcy Code.[69] These critics maintained that the changes did not alter the fact that the federal government would be choosing which entities to resolve under Title II and which creditors to protect—with funding that would come from the government.[70]

The differences between the House- and Senate-passed versions of the financial reform legislation were resolved by a Conference Committee. The lucubrations of the Conference Committee produced further revisions to the new resolution authority, principally relating to an *ex post facto* assessment process on large financial firms to repay any government funding provided as part of the resolution process.[71] But even as the House and Senate voted to

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[65] *Id.* §§ 1604(d) & 1609(n).

[66] Restoring American Financial Stability Act of 2010, H.R. 4173, 111th Cong. (as passed by Senate, May 20, 2010).

[67] *Id.* §§ 201(a)(4) (contingent claims), 210(a)(11) (voidable transfers), & 210(a)(12) (set-offs).

[68] *Id.* § 210(a)(7)(B).

[69] *See, e.g.*, David Steel, The New Financial Deal: Understanding The Dodd-Frank Act and Its (Unintended) Consequences 150–152 (2011).

[70] *See, e.g.*, Peter J. Wallison, *The error at the heart of the Dodd-Frank Act* (Sept. 6, 2011), http://www.aei.org/publication/the-error-at-the-heart-of-the-dodd-frank-act/.

[71] H.R. Rep. No. 111-517, § 210(n)(9) (2010) (Conf. Rep.). Section 210(n) provides for the establishment of an Orderly Liquidation Fund in the Treasury to be available to the FDIC to carry out its authority under Title II. The FDIC is authorized (subject to certain limits in section

approve the Conference Committee Report, Republican legislators in a fighting retreat continued to assail Title II. They asserted that Title II would perpetuate bailouts and urged that an improved form of bankruptcy process for large financial institutions be adopted instead of Title II.[72] The passage of the Dodd-Frank Act may have ended the legislative battle over Title II, but it did not end the policy battle.

A LEHMAN POSTMORTEM

Much of the narrative supporting the Dodd-Frank Act reform effort centered on the cases of AIG and Lehman. AIG was "bailed out" by a government commitment of $182.3 billion, but AIG subsequently repaid all the government assistance with a positive return to the government of $22.7 billion.[73]

210(n)(5) & (6)) to borrow from the Treasury to provide funds to the receivership or to a bridge financial company established under Title II. Section 210(b) provides a priority for the repayment of any amounts borrowed by the FDIC from the Treasury. Section 210(o) further provides for the repayment of any borrowing by the FDIC from the Treasury, if necessary, through an assessment process on bank holding companies with consolidated assets of $50 billion or more, any nonbank financial company supervised by the Federal Reserve Board, and other financial companies with consolidated assets of $50 billion or more. This assessment process is intended to assure that all Treasury funds used in a Title II process are repaid from the proceeds of the Title II process and, if necessary, from an assessment on the financial industry and hence that no taxpayer money is ultimately spent to support a Title II resolution. This repayment mechanism, including the assessment process, is designed to satisfy the requirement in Title II that "taxpayers shall bear no losses from the exercise of any authority under [Title II]." Dodd-Frank Act, § 214(c) (codified at 12 U.S.C. § 5394(c)).

[72] *See* Statement of Republican Policy on H.R. 4173, the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (June 30, 2010), http://repcloakroom.house.gov/news/documentsingle.aspx?Document ID=193034. Among other things, the Statement of Republican Policy asserted that the borrowing authority in section 210(n) of Title II provided the FDIC with the ability to bail out creditors and counterparties. The Statement of Republican Policy attached no weight to the requirement in section 210(o) of Title II that any assistance provided under Title II must be repaid from the proceeds of the Title II process on a priority basis or, if necessary, from an assessment on certain large financial institutions.

[73] *See* Press Release, U.S. Dep't of the Treasury, Treasury Sells Final Shares of AIG Common Stock, Positive Return on Overall AIG Comment Reaches $22.7 Billion (Dec. 12, 2012), *available at* http://www.treasury.gov/press-center/press-releases/pages/tg1796.aspx. The Court of Federal Claims recently ruled that the Federal Reserve Board exceeded its authority under the Federal Reserve Act in conditioning its lending on AIG's agreement to convey equity, but that AIG's shareholders were not owed any damages as a result. *See Starr Int'l Co. v. United States,* 121 Fed. Cl. 428 (Fed. Cl. 2015), *appeal docketed,* no. 15-5103 (Fed. Cir. June 26, 2015). Another federal court, however, recognized the broad scope of the Federal Reserve's statutory authority in the course of dismissing a separate action similarly challenging the terms of the lending support provided to AIG. *See Starr Int'l Co. v. Fed. Reserve Bank of New York,* 906 F. Supp. 2d 202

Lehman was forced into bankruptcy a day before the government provided its initial assistance to AIG. The bankruptcy process for Lehman quickly expanded into bankruptcy or liquidation proceedings for Lehman and its affiliates in more than 80 other countries. The professional fees, expenses and other administrative costs of the bankruptcy proceedings for Lehman and its affiliates are estimated to have exceeded $11 billion as of July 2013. The senior unsecured creditors of Lehman have received to date approximately a 34.7 percent recovery on their claims. The senior unsecured creditors of other Lehman affiliates in bankruptcy have received recoveries in varying percentages, some greater and some lesser than 34.7 percent. There are still approximately 2,400 disputed and unresolved claims against Lehman and its affiliates, seeking more than $68 billion from the bankruptcy estates.[74]

The saga of the Lehman bankruptcy has provided observers with ample opportunity to consider its implications for the next failure of a large financial company. Postmortems on the Lehman bankruptcy have been performed by many sources both official and unofficial. One of the earliest official postmortems was performed by the examiner appointed by the Bankruptcy Court administering the Lehman Chapter 11 case (the "Examiner's Report").[75] The Examiner's Report was released in March 2010 as the financial reform legislation ultimately adopted as the Dodd-Frank Act in July 2010 was being debated in the Senate. Of its nature, the Examiner's Report focused on the events leading up the Lehman bankruptcy filing rather than on the effects of the bankruptcy filing, *i.e.,* it focused more on the causes of the filing than the consequences. The Examiner's Report discussed in detail the frenzied events in the early days of September 2008 preceding the bankruptcy filing by Lehman at 1:45 a.m. in the morning on September 15.[76] In a section entitled (perhaps infelicitously) "Lehman's Bankruptcy Planning," the Examiner's Report actually

(S.D.N.Y. 2012), *aff'd,* 742 F.3d 379 (2d Cir. 2014), *cert. denied*, 134 S. Ct. 2884 (2014).

[74] The figures for Lehman included in this paragraph are derived from the following sources: Michael J. Fleming & Asani Sarkar, *The Failure Resolution of Lehman Brothers,* FRBNY Economic Policy Review 175 (Dec. 2014); Michael J. Fleming & Asani Sarkar, Where was value destroyed in the Lehman Bankruptcy? (2014) (unpublished paper, Federal Reserve Bank of New York); Notice Regarding Seventh Distribution Pursuant to the Modified Third Amended Joint Chapter 11 Plan of Lehman Brothers Holdings Inc. and its Affiliated Debtors, *In re Lehman Brothers Holdings Inc., et al.,* Chapter 11 Case No. 08-13555 (Bankr. S.D.N.Y. March 26, 2015); Lehman Brothers Holdings Inc., et al. Plan Administration Update, *In re Lehman Brothers Holdings Inc., et al.*, Chapter 11 Case No. 08-13555 (Bankr. S.D.N.Y. June 9, 2015).

[75] Anton R. Valukas, Report of Examiner, *In re Lehman Brothers Holdings Inc., et al.*, Chapter 11 Case No. 08-13555 (JMP) (Bankr. S.D.N.Y.), (March 11, 2010).

[76] *Id.* vol. 2 at 718–725 & App. 15.

describes the lack of planning for Lehman's bankruptcy filing.[77] The first call by Lehman to bankruptcy counsel at Weil Gotshal came on September 10, 2008 although even this call was apparently not authorized by the senior legal officer at Lehman.[78] The senior legal officer was concerned that word of the preparation for a bankruptcy filing would leak and become self-fulfilling.[79] In any event, the preparation work by the bankruptcy counsel at Weil Gotshal during the next few days consisted only of collecting public information on Lehman. The bankruptcy lawyers at Weil Gotshal told government officials on September 13 that they had not undertaken any serious bankruptcy preparation because the Lehman financial personnel were consumed with potential deals to sell Lehman and hence were unavailable to them.[80] The hope that a sale would be consummated with government assistance was apparently foremost in the minds of Lehman's management and its advisers. According to the bankruptcy lawyers at Weil Gotshal, reflecting the prevailing sentiment at the time, "Weil was 'on watch' *just as they had been with Bear Stearns*."[81]

The Examiner's Report does not draw its own conclusion about the effects of the lack of planning for the bankruptcy filing. It notes that the lead bankruptcy counsel at Weil Gotshal did not think that the rushed filing had an adverse impact on the estate.[82] At the same time, Examiner's Report also cites a *Wall Street Journal* article for the proposition that as much as $75 billion in value was destroyed by the unplanned and chaotic form of Lehman's bankruptcy filing.[83]

Other postmortem analyses suggested that it was not the bankruptcy proceeding in Lehman that was so disorderly, but rather the process leading up to the bankruptcy proceeding. One prominent analysis concluded that the actions of the government, particularly in assisting Bear Stearns, gave Lehman's management every incentive to deliberately fail to plan for bankruptcy and to make the prospect of a bankruptcy filing as unattractive as possible.[84] This analysis asserted that by then refusing to provide assistance to Lehman as it had to Bear Stearns, the government essentially "dumped" Lehman into bankruptcy. At the same time, this analysis concluded that after the unplanned bankruptcy

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77 *Id.* vol. 2 at 718.

78 *Id.* vol. 2 at 719.

79 *Id.*

80 *Id.* App. 15 at 51.

81 *Id.* (emphasis added).

82 *Id.* vol. 2 at 725.

83 *Id.*

84 Skeel, *supra* note 69, at 28.

filing, the bankruptcy process itself worked "quite well" in the face of extreme time pressures.[85] This analysis cites the expedited process adopted by the bankruptcy court to approve the sale of Lehman's North American investment banking business to Barclays within 5 days of the bankruptcy filing and the announcement of the sale of Lehman's European, Middle East and Asian operations to Nomura within 2 days of the filing.[86] It also cites the fact that by September 29 Lehman had agreed to sell its investment management business (Neuberger Berman) to two private equity firms.[87]

This analysis likewise cited the *Wall Street Journal* article for the proposition that Lehman squandered as much as $75 billion in value by eschewing prebankruptcy planning. But the analysis observed that AIG and Lehman had no reason to prepare for bankruptcy because a significant part of each firm's hemorrhaging (through its derivatives, repo and securities lending book) would not have been arrested by filing for bankruptcy because of the safe harbor provisions in the Bankruptcy Code.[88] Among the conclusions drawn by this analysis was that the safe harbor provisions in the Bankruptcy Code should be revised to provide greater protection for a financial company facing bankruptcy.[89]

Other analyses cast doubt on some of the prevailing notions surrounding the Lehman bankruptcy, particularly relating to effects of the safe harbor treatment for Lehman's derivatives. One analysis prepared by a former Lehman managing

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[85] *Id.* at 31.

[86] *Id.* at 30. An opinion issued by the Lehman bankruptcy court in 2011 casts some doubt on how well the expedited process for the sale to Barclays complied with the bankruptcy court rules. *See In re Lehman Brothers Holding Inc.*, 445 B.R. 143, 150 (Bankr. S.D.N.Y. 2011) (". . . Movants have proven that some very significant information was left out of the record of the hearing on Lehman's motion to approve the sale of the Broker-Dealer to Barclays held on September 19, 2008 (the 'Sale Hearing')—facts that in a more perfect hearing the Court would have known. Despite what in retrospect appears to be a glaring problem of flawed disclosure, Movants have not carried their burden in establishing a right to relief from the Sale Order under Rule 60(b) because this new information would not have changed the outcome of the Sale Hearing or altered the form and content of the Sale Order in any material respect."). The opinion adopted a wartime analogy to describe the battle to save Lehman's brokerage operations as being waged in the "fog of resolution." 445 B.R. at 156.

[87] Skeel, *supra* note 69, at 30. The management of Neuberger Berman subsequently succeeded in submitting a bid to the bankruptcy court that was accepted over the bid from the two private equity firms. *See* Michael J. de la Merced, *Managers Win Auction for a Part of Lehman*, N.Y. Times, Dec. 3, 2008, *available at* http://www.nytimes.com/2008/12/04/business/04lehman.html?_r=0.

[88] Skeel, *supra* note 69, at 160.

[89] *Id.* at 158–163.

director noted that not a single derivative counterparty to Lehman filed for bankruptcy in the wake of Lehman's failure, suggesting that the safe harbor provisions had actually operated as originally intended to protect counterparties of the defaulting firm.[90] The analysis also concluded that the Lehman bankruptcy did not have catastrophic effects on the derivatives market. For example, while it was estimated that there might be $400 billion in payments to be made on credit default swaps referencing Lehman, an ISDA-administered auction process resulted in only $6 billion in net settlement payments having to be made.[91]

The situation of derivatives to which a Lehman entity was a party proved much more complex. At the time of its failure, Lehman and its affiliates had outstanding approximately 930,000 derivative transactions documented under approximately 6,100 ISDA Master Agreements. Approximately 80 percent of these contracts were terminated by the counterparties within five weeks of the Lehman Chapter 11 filing.[92] On the derivative contracts that were not terminated by counterparties (generally because they were out-of-the-money for the counterparties), the Lehman estate has been relatively successful in making recoveries. By November 2009, cumulative cash collections by the Lehman estate on its derivatives book amounted to more than $8 billion.[93] This analysis concluded that it was not clear that the FDIC's orderly liquidation authority would necessarily produce faster or better results. This analysis and a subsequent analysis from the same commentator nonetheless acknowledged that there was a relatively long and contentious process to settling claims on terminated derivative contracts. For example, as of January 2011, out of $45 billion in claims on derivative transactions, only $5 billion has been settled.[94]

Taking a cue perhaps from these contrarian analyses of the Lehman

[90] Kimberly Anne Summe, *Lessons Learned from Lehman Bankruptcy* 77–78, *in* Ending Government Bailouts As We Know Them (Kenneth E. Scott et al. eds., Hoover Institution Press 2010).

[91] *Id.* at 78.

[92] *Id.*

[93] *Id.* at 79. Another analysis indicates that as of June 30, 2010, cash collections on the derivatives book had risen to $11.5 billion. *See* Fleming & Sarkar, *supra* note 74, at 186.

[94] Kimberly Anne Summe, *An Examination of Lehman Brothers' Derivatives Portfolio Postbankruptcy: Would Dodd-Frank Have Made a Difference?* 94, in Bankruptcy *Not* Bailout: A Special Chapter 14 (Kenneth E. Scott & John B. Taylor eds., Hoover Institution Press 2012). A recent analysis by staff members of the Federal Reserve Bank of New York provides more details on the difficult settlement process for the terminated OTC derivative contracts. *See* Fleming & Sarkar, *The Failure Resolution of Lehman Brothers, supra* note 74, at 182–189. This analysis suggests that some of the outcomes in the Lehman bankruptcy process were not as

bankruptcy, the FDIC in April 2011 released its own version of a postmortem analysis of the Lehman bankruptcy.[95] The FDIC analysis discussed how Lehman hypothetically would have been handled in a Title II proceeding rather than in a Bankruptcy Code proceeding. The basic conclusion of the FDIC analysis was that while the orderly liquidation of Lehman under Title II would have been "incredibly complex and difficult," it would have been vastly superior to the bankruptcy process from the perspective of systemic stability and would have resulted in significantly higher recoveries for creditors than the bankruptcy process.[96] In fact, the FDIC analysis concluded that Lehman's general unsecured creditors would have received 97 cents on every $1 of claims in a Title II proceeding compared to the 21 cents recovery estimated in the then pending Lehman bankruptcy plan of reorganization.[97] The report provides only a brief explanation of the methodology used in reaching the very generous number for the projected recoveries in the hypothetical Title II process.[98] It appears that the FDIC used a *sui generis* methodology to produce a *sui generous* number.

One of the key assumptions in the FDIC analysis was that the FDIC as receiver for Lehman under Title II would be able to structure a rapid sale of Lehman's core operations to a third party while providing short-term liquidity to support the going concern value of those operations. This key assumption was supported in the FDIC's view by five important elements in the Title II resolution authority:

(i) the ability to conduct advance resolution planning for systemically

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predictable as some legal experts would have supposed and that some of the outcomes deviated from the absolute priority rule. *Id.* at 188.

[95] *See* Press Release, FDIC, FDIC Report Examines How An Orderly Resolution of Lehman Brothers Could Have Been Structured Under the Dodd-Frank Act (April 18, 2011), http://www.fdic.gov/news/news/press/2011/pr11076.html; The Orderly Liquidation of Lehman Brothers Holdings Inc. under the Dodd-Frank Act, http://www.fdic.gov/bank/analytical/quarterly/2011_vol5_2/lehman.pdf.

[96] *Id.*

[97] *Id.*

[98] The FDIC staff assumed that Lehman's losses would be limited to a pool of troubled assets with a book value of $50 to $70 billion and that the losses on that pool would have amounted to $40 billion. This $40 billion loss would have been applied against Lehman's book equity of $20 billion and its subordinate debt of $15 billion with a $5 billion loss to be allocated among its general unsecured creditors. The FDIC assumed that there would be no other losses in any of the Lehman entities. For a detailed criticism of the methodology used by the FDIC, see Joshua Mitts, *Systemic Risk and Managerial Incentives in the Dodd-Frank Orderly Liquidation Authority*, J. Fin. Reg. 51, 79–83 (2015). Similar criticisms are made in the other sources cited in note 99 *infra.*

important financial institutions through a variety of mechanisms similar to those used for problem banks (as further enhanced by the supervisory authority and the resolution plans, or living wills, required under section 165(d) of Title I of the Dodd-Frank Act);

(ii) an immediate statutory source of liquidity for an orderly liquidation, which would allow continuation of essential functions and maintain asset values;

(iii) the ability to make advance dividends and prompt distributions to creditors based upon expected recoveries;

(iv) the ability to continue key systemically important operations, including through the formation of one or more bridge financial companies; and

(v) the ability to transfer all qualified financial contracts with a given counterparty to another entity (such as a bridge financial company) and avoid their immediate termination and liquidation to preserve value and promote stability.

These were the same key advantages that the FDIC had cited in support of the new resolution authority as part of the Dodd-Frank Act legislative process.

Many observers found the underlying assumptions in the FDIC report far too facile.[99] One such assumption was that the FDIC could conduct due diligence, identify potential acquirers and troubled assets, determine a transaction structure, and conduct a sealed bidding process, all before Lehman ever failed and was put into a Title II receivership. This assumption, based on the FDIC historical experience with banks, seemed misplaced when dealing with an institution as large and complex as Lehman. The FDIC's discussion of the sales options for Lehman's operations, cast as a "whole company purchase and assumption with partial loss share" or a "modified purchase and assumption without loss share," likewise appeared firmly grounded in past FDIC experience, and failed to acknowledge the complexity of the situation that the FDIC would likely face in a future Title II case.

The FDIC report on Lehman can perhaps best be regarded as a position

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[99] *See*, *e.g.,* Stephen J. Lubben, *Resolution, Orderly and Otherwise: B of A in OLA*, 81 U. CIN. L. REV. 485, 485–486 (2013); Thomas H. Jackson & David A. Skeel, Jr., *Dynamic Resolution of Large Financial Institutions*, 2 HARV. BUS. L. REV. 435, 436–437 (2012); William F. Kroener, *Comment on Orderly Liquidation under Title II of Dodd-Frank and Chapter 14* 78–83, *in* BANKRUPTCY, NOT BAILOUT: A SPECIAL CHAPTER 14 (Kenneth E. Scott & John B. Taylor eds., Hoover Institution Press 2012). *See also* Wallison, *supra* note 70, at 10; Mitts, *supra* note 98, at 79–83.

paper on the conceptual benefits of a Title II approach and not as a real analysis of how the conceptual benefits of Title II could actually be brought to bear on the failure of a large complex company. In many ways the FDIC report on Lehman was actually a backward-looking document. Many observers concluded that the FDIC would have to expand its thinking in fundamental ways to address the challenges presented by the failure of a large financial company under Title II.[100] Barely nine months after the issuance of its report on Lehman, the FDIC would surprise observers by embracing an entirely new approach to Title II, the SPOE strategy.

A DODD-FRANK POSTPARTUM

Title II is a relatively detailed regime, but not sufficiently detailed to cover the expanse of space that it would be required to occupy if it were actually to displace the Bankruptcy Code in a specific case. As with other titles in Dodd-Frank Act, Title II calls for regulations to be issued to implement and further explicate its provisions. The principal rulemaking provision in Title II, section 209, directs the FDIC in consultation with the FSOC to issue "rules and regulations with respect to the rights, interests, and priorities of creditors, counterparties, security entitlement holders, or other persons with respect to any covered financial company or any assets or other property of or held by such covered financial company."[101] The rulemaking provision in section 209 also provides that "[t]o the extent possible, the [FDIC] shall seek to harmonize applicable rules and regulations promulgated under this section with the insolvency laws that would otherwise apply to a covered financial company."[102]

The FDIC moved with exemplary speed to commence its rulemaking process under Title II. In an initial rulemaking commenced in October 2010, the FDIC addressed several preliminary issues under Title II, including one that had been the source of much controversy during the legislative process.[103] This issue related to the authority contained in subsection 210(b)(4) and related

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[100] *See, e.g.*, Randall D. Guynn, *Are Bailouts Inevitable?*, 29 Yale J. on Reg. 121 (2012) (suggesting a recapitalization within resolution approach for use in Title II); Letter from the Securities Industry and Financial Markets Association and The Clearing House to the Federal Deposit Insurance Corporation, May 23, 2011, *available at* http://www.fdic.gov/regulations/laws/federal/2011/11c16Ad73.PDF (also suggesting a recapitalization approach). *See also* Paul L. Lee, *The Dodd-Frank Act Orderly Liquidation Authority: A Preliminary Analysis and Critique—Part II*, 128 Banking L.J. 867, 901–902 (2011).

[101] Dodd-Frank Act, § 209 (codified at 12 U.S.C. § 5389).

[102] *Id.*

[103] *See* Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Author-

subsections of Title II for the FDIC as receiver to make "additional payments" to certain creditors of a covered financial company. Under this statutory provision, the FDIC is authorized to pay certain creditors more than other "similarly situated" creditors (i.e., creditors otherwise entitled to the same priority under the priority provision in section 210 (b)(1)) if the FDIC decides such payments are necessary to maximize the value of the assets of the company, to minimize the amount of the loss on the sale of assets of the company, or to continue operations essential to the implementation of the receivership or any bridge financial company. This authority under Title II is in sharp contrast to the absolute priority rule under the Bankruptcy Code. Critics of Title II cited the authority to make such additional payments as a significant flaw in Title II.[104] The authority appeared to permit the bailout of certain creditors. The source of funding for these additional payments would be the FDIC's authority under Title II to borrow from the Treasury, enhancing in the mind of the critics the perception that these additional payments would amount to a bailout of those creditors.

The FDIC sought to defuse this criticism by circumscribing in regulation some of the authority otherwise potentially available to it under the statutory provisions of subsection 210(b)(4) and related subsections. In the preamble to the proposed rule, the FDIC described its purpose:

> To emphasize that all unsecured creditors should expect to absorb losses along with other creditors, the Proposed Rule clarifies the narrow circumstances under which creditors could receive any additional payments or credit amounts under Sections 210(b)(4), (d)(4), or (h)(5)(E).[105]

The proposed rule provided that holders of unsecured senior debt with a term of more than 360 days would not be eligible to receive "additional payments."[106] This language in the proposed rule was carried over into the final rule as adopted in January 2011. In the Supplemental Information section of the January 2011 *Federal Register* notice of the adoption of the final rule, the FDIC stated that there appeared to be a misapprehension among commenters on the proposed rule that the proposed rule made it more likely that short-term

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ity Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 64173 (Oct. 19, 2010).

[104] *See, e.g.*, Statement of Republican Policy, *supra* note 72.

[105] 75 Fed. Reg. at 64,175.

[106] 75 Fed. Reg. at 64,181 (proposed § 380.2).

debt holders *would* receive "additional payments."[107] In response, the FDIC stated that short-term debt holders (including holders of commercial paper and derivatives) are "highly unlikely to meet the criteria set forth in the statute for permitting payment of additional amounts" and that "additional payments" to any creditor would be "very rare."[108] It further stated that "[i]n virtually all cases, creditors with shorter-term claims on the covered financial company will receive the same pro rata share of their claim that is being provided to the long-term debt holders."[109] The FDIC did provide a few examples of the types of creditors who might be afforded additional payments. These were the providers of utility and other service contracts and contracts with companies that provide payment processing services.[110]

After finalizing its first Title II rulemaking process in January 2011, the FDIC in quick order commenced a second Title II rulemaking process in March 2011.[111] Cognizant of the "direct mandate" in section 209 to seek to harmonize the rules under Title II with the insolvency rules that would otherwise be applicable to the company,[112] the FDIC adopted rules for the treatment of contingent claims, the treatment of collateral for secured claims, and the treatment of fraudulent and preferential transfers that were intended by the FDIC to create parity with the treatment of creditors under the Bankruptcy Code or other normally applicable insolvency rules.[113] In the second rulemaking process, the FDIC also addressed points specific to the Title II resolution process, such as the statutory priority of claims in Title II, the effect of the transfer of assets and liabilities to a bridge financial company, and the details of the administrative claims process in a Title II proceeding.[114]

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107 Interim Final Rule, Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4,207, 4,212 (Jan. 25, 2011).

108 *Id.*

109 *Id.*

110 *Id.* at 4,211.

111 *See* Notice of Proposed Rulemaking, Orderly Liquidation Authority, 76 Fed. Reg. 16,324 (March 23, 2011).

112 *See* 76 Fed. Reg. at 4,209.

113 *See* Final Rule, Certain Orderly Liquidation Authority Provisions under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 41,626, 41,646 (July 15, 2011) (§ 380.39 (contingent claims), § 380.50 (secured claims) & § 380.9 (fraudulent and preferential claims)).

114 *See id.* at 41,642 (§ 380.21 (priorities), § 380.26 (effect of transfer to a bridge institution) & § 380.30 (administrative claims process)).

THE CONCEPTION OF SPOE

Although the FDIC rulemaking process did provide helpful clarifications to the resolution process, the clarifications were merely incremental in nature. The real breakthrough in the thinking on Title II came not in the rulemaking process, but in a parallel analytic process being pursued by the Office of Complex Financial Institutions at the FDIC. In a briefing provided to the FDIC's Systemic Resolution Advisory Committee in January 2012, the FDIC staff provided the first public discussion of the SPOE strategy, a novel strategy specifically designed for use in resolving a financial company under Title II.[115]

The SPOE approach at its most "stylized" envisions that a legal resolution under Title II would occur only at the top-tier holding company, avoiding to the greatest extent possible the need for the initiation of resolution proceedings at the level of the operating subsidiaries. This approach minimizes the complexities and conflicts that would invariably arise if multiple resolution proceedings in home and host jurisdictions had to be commenced at the level of the operating subsidiaries. It also mitigates the risk of "runs" by uninsured depositors and other short-term creditors of the operating companies.[116] This approach envisions that losses that have been incurred at the level of the operating subsidiaries would in effect be "pushed up" to the top-tier holding company.

In this resolution process, the first step would be for the FDIC after its appointment as receiver for the top-tier company to transfer virtually all the assets of the top-tier company, principally the shares of its operating subsidiaries (and loans made to its operating subsidiaries), to a new bridge financial company. Under Title II, this transfer can be effected by the FDIC as receiver without any court approval or any customer or counterparty consent, facilitating a resolution over a "resolution weekend." Virtually all liabilities of the

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[115] *See* FDIC, Office of Complex Financial Institutions, *Dodd-Frank Act Title II: Resolution Strategy Overview* (Jan. 25, 2012), *available at* http://www.fdic.gov/about/srac/2012/2012-01-25_resolution-strategy.pdf.

[116] For a succinct discussion of the benefits of the SPOE approach, *see* Shaun Kern, Bipartisan Policy Center, *Creditor Treatment and Single Point of Entry* (June 26, 2013), http://bipartisanpolicy.org/blog/2013/06/26/creditor-treatment-and-single-point-entry. For a more detailed discussion of the benefits and challenges of the SPOE approach, see Thomas C. Baxter, Jr., Executive Vice President and General Counsel of the Federal Reserve Bank of New York, Resolving the Unresolvable: The Alternative Pathways to Ending Too Big to Fail, Remarks at the International Insolvency Institute 13th Annual Conference, Columbia University Law School (June 17, 2013), *available at* http://www.newyorkfed.org/newsevents/speeches/2013/bax130618.html.

top-tier company, consisting principally of long-term debt specifically intended to be "loss absorbing," would be left behind in the receivership proceeding under Title II. Critical vendor claims and guarantees related to the operating subsidiaries would also be transferred to the bridge company. The direct effect of these actions would be to create a strongly capitalized bridge financial company. The indirect effect of these actions would be to position the bridge company to recapitalize the operating subsidiaries transferred to it (as described below). The holders of claims left behind in the receivership would receive contingent interests in the equity of the bridge company.

The second step would be for the bridge financial company to recapitalize the operating subsidiaries by contributing assets to the operating subsidiaries or converting existing debt obligations due from the operating subsidiaries to the successor bridge company into equity in the operating subsidiaries. As a result of this action, the losses at the level of the operating subsidiaries would be in effect absorbed by the subordinated and long-term senior debt holders at the top-tier holding company level. Under the SPOE model, the top-tier holding company would generally not have other business operations and would have only minimum liabilities (*e.g.*, for taxes) other than its "loss absorbing" senior long-term debt or subordinated debt. The presence of short-term debt or other operating liabilities at the top-tier holding company would complicate the resolution process because these liabilities would rank *pari passu* with the senior long-term debt and would have to be accorded the same treatment as the senior long-term debt, *i.e.*, be left behind in the receivership and not passed to the bridge company, unless the FDIC were to invoke its special power in Title II to treat these liabilities more favorably than the senior long-term debt to mitigate systemic risk.

The SPOE strategy is particularly well-suited to the topography of the U.S. financial system where the largest banking institutions are typically organized in a holding company form and typically issue large amounts of long-term debt at the holding company level. The SPOE strategy is not so well suited to the topography of certain other financial systems, such as those that generally do not rely on the use of a holding company structure or those in which long-term debt is generally raised at the operating subsidiary level and not at the holding company level. These financial systems will require a different resolution approach, a so-called "multiple-point-of-entry" ("MPOE") approach.[117] An

[117] For a discussion of the differences between an SPOE approach and an MPOE approach, see FSB, *Consultative Document*, *Recovery and Resolution Planning: Making the Key Attributes Requirements Operational* 14–15 (Nov. 2012), *available at* http://www.financialstabilityboard.org/publications/r_121102.pdf. Some commentators have taken a particularly robust view of the

MPOE strategy envisions that there would be multiple insolvency proceedings at the top-tier company level and at various intermediate holding company or operating company levels, initiated by multiple resolution authorities. The FDIC staff acknowledged that a MPOE strategy might have to be used in some cases. It was clear, however, from FDIC staff's presentation to the Advisory Committee in January 2012 that the FDIC staff saw the SPOE strategy as the more promising approach, particularly from the perspective of minimizing the potential for adverse consequences of a resolution of a large complex U.S. financial institution in a cross-border context and the potential for disruption in critical financial functions even in a domestic context.[118] If the SPOE strategy can be made operational, it would represent an "elegant" solution to many of the most vexing problems presented by the failure of a large interconnected financial company.

The SPOE strategy has garnered strong support not only in the United States, but also in other key jurisdictions. In a speech in May 2012, Chairman Gruenberg of the FDIC confirmed that from the FDIC's point of view, the SPOE strategy represented a "much more promising approach" than the prospect of initiating multiple resolution proceedings at the level of the operating subsidiaries.[119] He specifically observed that the SPOE strategy "offers the promise of overcoming many of the cross-border issues that have been identified in both theory and practice."[120] At the same time, the FDIC actively engaged with foreign authorities, such as the Bank of England, the European Commission, the Japan Financial Services Authority, and the Swiss Financial Market Supervisory Authority, to promote the SPOE concept. These

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advantages of the SPOE approach and have urged the FSB to endorse a mandatory holding company structure for global systemically important banking institutions to facilitate an SPOE approach. *See* Letter of Jeffrey N. Gordon & Wolf-Georg Ringe to FSB (Feb. 2, 2015), *available at* http://www.financialstabilityboard.org/wp-content/uploads/Jeffrey-N.-Gordon-and-W.-Georg-Ringe-on-TLAC.pdf.

[118] *See Resolution Strategy Overview*, *supra* note 115. Other regulators also saw promise in the SPOE strategy. *See*, *e.g.*, Jerome H. Powell, Governor, Federal Reserve Board, Ending "Too Big to Fail" (March 4, 2013), *available at* http://www.federalreserve.gov/newsevents/speech/powell20130304a.htm (". . . [M]y earlier experience had led me to be skeptical about the possibility of resolving one of the largest financial companies without destabilizing the financial system . . . [H]owever, I came around to the view that it is possible to resolve a large, global financial institution. What changed my mind was the FDIC's innovative 'single-point-of-entry' approach, which was just coming into focus in 2011.").

[119] *See* Martin J. Gruenberg, Acting Chairman, FDIC, Remarks to the Federal Reserve Bank of Chicago Bank Structure Conference (May 10, 2012), *available at* http://www.fdic.gov/news/news/speeches/chairman/spmay1021.html.

[120] *Id.*

efforts bore fruit. In December 2012, the FDIC and the Bank of England issued a joint paper discussing how an SPOE strategy could be used for a U.S. or a U.K. financial group to facilitate an orderly resolution.[121] In August 2013, the Swiss Financial Market Supervisory Authority ("FINMA") issued a position paper on the resolution of Swiss systemically important banks.[122] The position paper confirmed that based on consultation with the FDIC and the Bank of England, FINMA's preferred resolution approach for Swiss systemically important banks would be an SPOE bail-in approach. Although both the Bank of England paper and the FINMA paper noted that there were significant preconditions to the successful use of an SPOE strategy, the mere issuance of the papers gave increased international stature to the SPOE concept.

The Financial Stability Board (the "FSB") too has taken note of the advantages to the SPOE approach, while at the same time recognizing that the MPOE approach will need to be used in the case of certain financial systems.[123] The FSB has itself spearheaded an effort to establish a common international standard for total loss-absorbing capacity ("TLAC"), which is a critical precondition to the operation of an SPOE strategy.[124] The SPOE strategy and the related concept of TLAC constitute a new paradigm in thinking on resolution planning for systemically important financial institutions. The developmental work by the FDIC under Title II has produced what may appropriately be called a paradigm shift (or at least a tilt) in resolution thinking for financial institutions.

For all the early enthusiasm surrounding the SPOE model, it is still important to recognize, as the supervisory authorities cited above themselves have noted, that the model is premised on the number of significant assumptions or preconditions. One critical assumption is that there will be sufficient TLAC at the top company level in the form of equity, subordinated debt, and senior unsecured debt to bear the losses suffered not only at the top

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[121] *See* FDIC & the Bank of England, *Resolving Globally Active, Systemically Important, Financial Institutions* (Dec. 10, 2012), *available at* http://www.fdic.gov/about/srac/2012/gsifi.pdf. *See also* Martin Gruenberg & Paul Tucker, *Global Banks Need Global Solutions When They Fail*, Fin. Times, Dec. 10, 2012, *available at* http://www.fdic.gov/news/letters/srac.html.

[122] *See* FINMA, *Resolution of global systemically important banks* (Aug. 7, 2013), *available at* https://www.finma.ch/en/news/2013/08/mm-pos-sanierung-abwicklung-20130807.

[123] *See* FSB, *Consultative Document*, *supra* note 117. The FSB uses the abbreviations SPE and MPE in lieu of SPOE and MPOE.

[124] FSB, *Consultative Document*, *Adequacy of loss-absorbing capacity of global systemically important banks in resolution* (Nov. 10, 2014), *available at* http://www.financialstabilityboard.org/wp-content/uploads/TLAC-Condoc-6-Nov-2014-FINAL.pdf. The TLAC concept is also relevant to an MPOE strategy.

company level, but also those that have been incurred at the operating subsidiary level (where most of the losses are likely to have been incurred). This assumption encompasses at least three sub-assumptions. The first sub-assumption is that the parent company will have the sufficient "loss-absorbing" debt on the parent-only balance sheet to permit the conversion of such loss-absorbing debt into equity to recapitalize the group on a consolidated basis. The second sub-assumption is that the parent company will have sufficient assets on the parent-only balance sheet to permit the intra-group recapitalization of the principal operating subsidiaries. As noted above, the intra-group recapitalization could be accomplished through the contribution of assets by the parent company to the individual operating subsidiaries, or through conversion into equity of debt owed by the operating subsidiaries to the parent company, or through a combination of such techniques. The intra-group recapitalization of the operating subsidiaries must be sufficient to restore the capital of those subsidiaries to levels that the marketplace and the applicable supervisory authorities find adequate (after accounting for all the losses at the operating subsidiaries). Local supervisory authorities for the operating subsidiaries will want the additional assurance that the benefit of the recapitalization of the top-tier holding company will readily be extended to the operating subsidiaries through a so-called "prepositioning" of internal loss-absorbing capacity (internal TLAC). The internal prepositioning could take the form of debt issued by the operating subsidiary to the holding company that can be converted into equity at the direction of the local supervisory authority. The third sub-assumption, as discussed above, is that the holding company structure will be relatively "clean," meaning that the top-tier holding company will be relatively free of short-term liabilities and other operating liabilities, the existence of which at the holding company level would complicate the restructuring and recapitalization of the bridge company.

Another critical assumption is that the bridge company will be in a position to provide liquidity support to its operating subsidiaries. The holders of "runnable" liabilities at operating subsidiaries (and the supervisory authorities of those subsidiaries) will require strong assurances on day one that the bridge company will support the ongoing operations of the operating subsidiaries. The intra-group recapitalization envisioned above, even if effected through a prepositioning of internal loss-absorbing capacity, does not directly provide liquidity to the operating subsidiaries. Funding from, or guarantees by, the bridge company of certain liabilities of the operating subsidiaries will likely be required by the marketplace and the relevant supervisory authorities. Important questions will also arise as to the role of central banks in providing back-up liquidity to the operating subsidiaries in host jurisdictions.

Like the assumptions underlying any model, the assumptions underlying the SPOE model will need to be carefully assessed. In several instances, the predicates for the assumptions will need to be established by regulatory or supervisory requirements. The Federal Reserve Board has indicated that it intends to propose a long-term debt requirement for systemically significant bank holding companies as an essential step in establishing the TLAC predicate for use in an SPOE approach.[125] Signaling the importance that the international supervisory community attaches to these efforts, the FSB, as noted above, has already issued a proposal for a common international TLAC standard, including an internal TLAC standard. The FSB proposal has drawn significant comment, detailing a range of concerns with the approach that the FSB proposed to take to TLAC.[126] Issues concerning the design and calibration of TLAC and internal TLAC will have to be addressed in establishing a regulatory requirement. Likewise, it may be necessary as a regulatory or supervisory matter to limit the type or amount of short-term debt or other liabilities at the top-tier holding company to facilitate the rapid implementation of an SPOE strategy.[127] In addition to establishing these critical predicates to the use of an SPOE strategy, there are many other important operational elements to the implementation of an SPOE strategy, such as the valuation technique for assets and

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[125] *See* Governor Daniel K. Tarullo, *Toward Building a More Effective Resolution Regime: Progress and Challenges 3* (Oct. 18, 2013) *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20131018a.htm (stating that the Federal Reserve Board would be issuing "in the next few months" a proposal that would require the largest, most complex banking firms to hold a minimum amount of long-term, unsecured debt at the holding company level).

[126] The leading U.S. and international trade associations for the banking industry provided detailed comments on the FSB proposal, *See, e.g.*, Letter from Institute of International Finance and Global Financial Markets Assn. to FSB (Feb. 2, 2015), *available at* http://www.financialstabilityboard.org/wp-content/uploads/The-Institute-of-International-Finance-IIF-and-the-Global-Financial-Markets-Association-GFMA-on-TLAC.pdf; Letter from The Clearing House, SIFMA, American Bankers Assn. and Financial Services Roundtable to FSB (Feb. 2, 2015), *available at* http://www.sifma.org/comment-letters/2015/sifma,-tch,-aba,-and-fsr-submit-comments-on-fsb%E2%80%99s-proposal-relating-to-total-loss-absorbency-(tlac)-requirement-on-g-sibs/. One letter from two academicians took the particularly robust position that the FSB "should come down more firmly on the side of a mandatory holding company structure, which should be coupled with a 'single point of entry' (SPOE) approach to resolution." *See* Letter from Jeffrey N. Gordon & Wolf-Georg Ringe to FSB (Feb. 2, 2015), *available at* http://www.financialstabilityboard.org/wp-content/uploads/Jeffrey-N.-Gordon-and-W.-Georg-Ringe-on-TLAC.pdf.

[127] *See* Governor Daniel K. Tarullo, *Toward Building a More Effective Resolution Regime: Progress and Challenges*, *supra* note 125, at 3 (discussing the desirability of keeping the parent holding company "non-operational" and otherwise "clean" through limits on the issuance of short-term debt and on the conduct of material business operations in the parent holding company).

the construction process for contingent interests to be provided to long-term debt and subordinated debt holders of the failed company.

A PARADIGM'S PROGRESS

In 2012 the FDIC staff embarked on an outreach and education program on SPOE with key stakeholders, including foreign regulators, industry groups, and fixed income investors (the prospective purchasers of TLAC debt).[128] The FDIC staff conducted over 20 such outreach events during 2012. Those outreach efforts have continued. Based on their consultation with these key stakeholder communities, the FDIC staff was able to report to Congress in May 2013 that the SPOE represented the "best promise" of achieving Title II's goals of holding shareholders, creditors, and management of a failed firm accountable for the company's losses while at the same time maintaining financial stability.[129] Governor Tarullo of the Federal Reserve Board also reported that the Federal Reserve Board was making progress in developing a proposal for a regulatorily mandated long-term debt requirement for holding companies.[130] Private sector entities such as the Bipartisan Policy Center also provided strong support for the SPOE recapitalization strategy while noting a number of improvements that could be made to the SPOE model.[131] In a detailed report on the SPOE strategy, the Bipartisan Policy Center stated:

> . . . the SPOE recapitalization strategy eliminates virtually all of the material impediments to a cross-border resolution of a G-SIFI by keeping the group's domestic and foreign operating subsidiaries, including their foreign branches, out of resolution or other insolvency

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[128] *See* FDIC, Advisory Committee on Systemic Resolution, *Title II Orderly Liquidation Authority 5* (Dec. 10, 2012), *available* at https://www.fdic.gov/about/srac/2012/2012-12-10_title-ii_orderly-liquidation-authority.pdf.

[129] *See Improving Cross Border Resolution to Better Protect Taxpayers and the Economy: Hearing before S. Comm. on Banking, Housing & Urban Affairs Subcomm. on National Security and International Trade and Finance* (statement of James R. Wigand, Director, FDIC Office of Complex Financial Institutions) (May 15, 2013), *available at* http://www.fdic.gov/news/news/speeches/spmay1513_2.html?source=govdelivery.

[130] *See Dodd-Frank Implementation: Hearing before S. Comm. on Banking, Housing and Urban Affairs*, (statement of Governor Daniel Tarullo) (July 11, 2013), *available at* http://www.federalreserve.gov/newsevents/testimony/tarullo20130711a.htm.

[131] John F. Bovenzi, Randall D. Guynn & Thomas H. Jackson, *Too Big to Fail: The Path to a Solution* (Bipartisan Policy Center May 2013). Other private sector entities as well have expressed strong support for an SPOE recapitalization strategy under Title II. *See, e.g.*, THE CLEARING HOUSE, *Ending "Too-Big-to-Fail": Title II of the Dodd-Frank Act and the Approach of "Single Point of Entry" Private Sector Recapitalization of a Failed Financial Company* (Jan. 2013).

> proceedings. The remaining impediments appear relatively minor and reasonably manageable with advanced planning by the FDIC or SIFIs themselves.[132]

Not quite a hymn to a calm sea and prosperous voyage, but close.

Even as the FDIC staff forged ahead with establishing the regulatory and operational preconditions for the use of the SPOE model, some discordant notes were being sounded both from within the regulatory community and from without. Some private sector commentators in fact mounted a frontal assault on the SPOE concept.[133] These commentators challenged both the legal and policy legitimacy of the SPOE approach. These commentators asserted that Title II explicitly requires a liquidation and that there is no language in Title II to suggest that it can be used to recapitalize a depository institution subsidiary of the holding company.[134] They further asserted that the SPOE strategy institutionalizes "too big to fail" by providing assurances that all the creditors of a bank subsidiary of a holding company will be protected from loss.[135] They noted as well the irony of regulators requiring a bank holding company to have more debt (as part of a TLAC component) and hence more leverage than the

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[132] Bovenzi, Guynn & Jackson, *supra* note 131. at 2.

[133] *See, e.g.*, Paul H. Kupiec & Peter J. Wallison, *Can the "single point of entry" strategy be used to recapitalize a failing bank?* (America Enterprise Institute Economic Working Paper 2014-08, Nov. 4, 2014).

[134] *Id*. at 4. There is a hint of inconsistency in the position of one of these co-authors. In an earlier analysis of Title II, this co-author actually criticized the fact that Title II called for a liquidation and offered no opportunity for a reorganization. He ascribed this legislative intent behind Title II to a mistaken idea:

> The reason for this provision [requiring liquidation], which can only be described as punitive, seems to flow from the mistaken idea that unless a firm is liquidated its shareholders will be bailed out.

Wallison, *supra* note 70, at 18. His positions in these two papers can perhaps be reconciled by positing the proposition that the "original intent" of a statute must always be honored even when it is the wrong intent.

Wallison's position on SPOE may be contrasted with the position of David Skeel, who in an initial analysis of Title II also criticized the fact that Title II appeared to limit the options of the FDIC to liquidation. *See* Skeel, *supra* note 69, at 148–149. Section 214(a), for example, provides that "[a]ll financial companies put into receivership under this title shall be liquidated." 12 U.S.C. § 5394(a). Skeel nonetheless concluded that through the use of a bridge financial company the FDIC could achieve a *de facto* reorganization. *See* Skeel, *supra* note 69, at 148–149. In a subsequent analysis, Skeel concluded that the FDIC's development of the SPOE strategy was a positive development. *See* Skeel, *Single Point of Entry and the Bankruptcy Alternative*, *supra* note 2, at 313.

[135] Kupiec & Wallison, *supra* note 133, at 5.

business needs of the company might otherwise require.[136]

Other voices of skepticism came—from of all places—the FDIC, in the person of Vice Chairman Thomas Hoenig and Jeremiah Norton, another member of the FDIC board. In a speech delivered in October 2013, Director Norton described the SPOE strategy being formulated "by the FDIC staff" as "not contemplated in Dodd-Frank."[137] While conceding the "conceptual advantages" of the SPOE, he voiced concerns about the design and effects of the long-term debt requirement, including the competitive effects of such a requirement on the funding costs of the operating subsidiaries of large bank holding companies.[138]

Vice Chairman Hoenig, who joined the FDIC board in April 2012 and was confirmed as Vice Chairman in November 2012, *i.e.,* after the FDIC staff had already announced the SPOE strategy, brought an even broader sense of skepticism to the SPOE project. His skepticism was based on his belief that the Title I resolution planning process must take precedence over FDIC planning for a Title II resolution process.[139] In his view, the more feasible a Title II resolution is made, the less incentive there would be for all the relevant constituencies to make resolution feasible under the Bankruptcy Code. Vice Chairman Hoenig was particularly concerned that under the SPOE strategy for Title II, "public" funding for the bridge company and its operating subsidiaries would likely be necessary.[140] His strong preference was for the use of a Bankruptcy Code process with funding provided from private sources. Like Director Norton, he was also concerned with the implicit funding advantage that the operating subsidiaries of a large bank holding company would derive from the prospect of any financial difficulty being resolved through an SPOE strategy. This Menshevik faction (in the literal and not any pejorative sense of the term) on the FDIC board pressed for a public comment process on the

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[136] *Id*. at 6. Other commentators have raised similar questions about the SPOE strategy. *See, e.g.*, Stephen Lubben, *OLA After Single Point of Entry—Has Anything Changed?, in* An Unfinished Mission: Making Wall Street Work for Us 13, 16 (Roosevelt Inst. 2013), http://rooseveltinstitute.org/sites/all/files/Unfinished_Mission_2013.pdf; John Crawford, *"Single Point of Entry": The Promise and Limits of the Latest Cure for Bailouts,* 109 Nw. U.L. Rev. 103 (2014).

[137] Jeremiah O. Norton, Remarks to the American Bankers Association, Discussion on the Current State of Resolution Planning 2 (Oct. 21, 2013), *available at* https://www.fdic.gov/news/news/speeches/archives/2013/spoct2113.html.

[138] *Id*. at 3–4.

[139] *See* Vice Chairman Thomas M. Hoenig, Can We End Financial Bailouts? (May 7, 2014), *available at* https://www.fdic.gov/news/news/speeches/spmay0714.html.

[140] *Id.*

SPOE strategy to augment the private consultation process that the FDIC had already pursued.

In December 2013, the FDIC issued a request for public comment on the SPOE strategy.[141] The request for comment provided a relatively detailed explanation of how an SPOE strategy would be implemented and a discussion of issues that the FDIC had identified during the development of the SPOE strategy. This notice came exactly a year to the day after the FDIC and the Bank of England had publicly endorsed the SPOE strategy in their joint paper and in an editorial article in the *Financial Times*.[142] The FDIC rang in the anniversary of the joint paper by issuing a request for public comment that raised some questions—at least nominally—about the SPOE strategy.

Vice Chairman Hoenig and Director Norton each released individual statements on the issues that they saw in the SPOE strategy.[143] The comments of Vice Chairman Hoenig and Director Norton largely mirrored each other, covering concerns with the calibration of TLAC and internal TLAC, the competitive and moral hazard effects of protecting all the creditors of the operating subsidiaries, the potentially destabilizing effects of cross-default provisions in derivative contracts, and the risk of non-cooperative action, including ring-fencing, by host country regulators.[144]

The initial reaction to the request for comment from one consulting firm was instructive. The consulting firm observed that "[w]hile the FDIC deserves credit for making progress, SPOE as the way forward on resolving G-SIFIs remains far from the goal line."[145] It further observed (in something of a mixed metaphor) that "the proposal shines a light, even if only by its silence" on various key issues, such as funding, moral hazard, and international cooperation

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[141] Press Release, FDIC Board Releases Resolution Strategy for Public Comment (Dec. 10, 2013), *available at* https://www.fdic.gov/news/news/press/2013/pr13112.html; Notice and Request for Comments, Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76, 614 (Dec. 18, 2013).

[142] *See supra* note 121 and accompanying text.

[143] *See* Statement of FDIC Vice Chairman Thomas M. Hoenig on the Single Point of Entry Strategy (Dec. 10, 2013), *available at* https://www.fdic.gov/about/learn/board/hoenig/statement20131210b.html; Statement of FDIC Director Jeremiah Norton on the Single Point of Entry Strategy (Dec. 10, 2013), *available at* https://www.fdic.gov/about/learn/board/norton/statement12-10-2013.html.

[144] *Id.*

[145] PwC, Regulatory brief, *Resolution planning: FDIC's single point of entry 1* (Dec. 2013), *available at* http://www.pwc.com/en_US/us/financial-services/regulatory-services/publications/assets/fs-reg-brief-dodd-frank-act-resolution-planning-spoe.pdf.

in implementing an SPOE strategy.[146] Comments filed by banking industry groups, on the other hand, were more positive, generally supporting the SPOE strategy though requesting more detail on various elements of the strategy.[147] Comments filed by groups not affiliated with the banking industry were generally more quizzical of the tenets and operation of the SPOE model.[148]

There was an important subtext to the request for comment on SPOE. This subtext was provided in the comments of the Vice Chairman Hoenig. Not only did his comments appear skeptical of the SPOE strategy, but equally telling they pointed away from the importance of Title II and instead to the importance of pending developments under the Title I resolution planning process. In his comments, he emphasized that bankruptcy was the preferred means for resolving the failure of large financial institutions as provided in Title I and that Title II and SPOE would represent only a last-resort approach.[149] Developments under the Title I resolution planning process would increasingly preoccupy the attention of the large banking institutions.

THE RELEVANCE OF RESOLUTION PLANNING

One of the lessons learned from the financial crisis was the need for advance planning for the failure of a large financial institution, particularly in a context where not one but multiple institutions might be under severe stress at the same time. Section 165(d) of the Dodd-Frank Act was designed to respond to this lesson. It requires all systemically important financial institutions designated by FSOC and all bank holding companies with $50 billion or more in consolidated assets (formulaically treated as systemically important under section 165) to produce a plan "for rapid and orderly resolution in the event of material financial distress or failure."[150] Pursuant to regulations adopted by the Federal

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[146] *Id*. at 2. In a more recent analysis, this consulting firm has seen rising hopes for an SPOE strategy. *See* PwC, Regulatory brief, *Resolution: Single Point of Entry Strategy Ascends* (July 2015), *available at* http://www.pwc.com/en_US/us/financial-services/regulatory-services/publications/assets/resolution-planning-2015-wave-1.pdf.

[147] *See, e.g.,* Letter from The Clearing House, SIFMA, American Bankers Assn., Financial Services Roundtable and Global Financial Markets Assn. to the FDIC (Feb. 18, 2014), *available at* http://www.aba.com/Advocacy/commentletters/Documents/Joint%20Trades%20Single%20Point%20of%20Entry%20Comment%20Letter%20(Feb%2018,%202014).pdf.

[148] *See, e.g.,* Letter from The Systemic Risk Council to the FDIC (Feb. 18, 2014), *available at* http://www.systemicriskcouncil.org/wp-content/uploads/2014/02/SRC-Comment-Ltr-to-FDIC-re-SPOE-2-18-14.pdf.

[149] *See* Statement of FDIC Vice Chairman Thomas M. Hoenig, *supra* note 143.

[150] Dodd Frank Act, § 165(d)(1) (codified at 12 U.S.C. § 5365(d)(1)).

Reserve Board and the FDIC, the resolution planning process has emerged as one of the most extensive and demanding exercises under the Dodd-Frank Act.[151]

There is a seeming paradox in the Dodd-Frank Act approach to resolution. Title II is based on the conviction that in the event of severe financial stress, a systemically important financial institution can only be resolved through a disorderly bankruptcy or a government bailout. As witnesses who testified in favor of the Orderly Liquidation Authority said, "[b]y definition, troubled systemically important financial institutions cannot be resolved in bankruptcy without threatening the stability of the financial system."[152] Title II is intended as a substitute for the Bankruptcy Code process because the special provisions of Title II are thought to better address the issues of financial stability than the Bankruptcy Code. But in seeming conflict with this foundational belief behind Title II, the resolution plan provision in section 165(d)(4) provides that the Title I resolution plan will be tested against the Bankruptcy Code, *i.e.,* the plan must demonstrate that it would facilitate an orderly resolution of the company under the Bankruptcy Code. How does one reconcile the seemingly different premises underlying Title I and Title II? One explanation is that the drafters of section 165(d)(4) (which was added in the Senate-adopted version of the financial reform legislation) simply wanted to confirm that bankruptcy remained the preferred resolution framework notwithstanding the addition of Title II.

Another more cynical explanation (assuming there is a role for cynicism in statutory analysis) is that the drafters of Title I imbedded the Bankruptcy Code test in section 165(d)(4) as a Trojan horse on the expectation that the Bankruptcy Code test would ultimately force the largest and most complex financial institutions (under threat from the FDIC and the Federal Reserve Board) to reduce their size and complexity in order to produce a credible plan for orderly resolution under the Bankruptcy Code. If so, the conceit behind

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151 *See* Resolution Plans Required, 76 Fed. Reg. 67,323 (Nov. 1, 2011) (final rule). In addition to the resolution plan requirements under section 165(d) of the Dodd-Frank Act, the FDIC in its capacity as deposit insurer has issued a separate regulation requiring insured depository institutions with $50 billion or more in total assets to prepare resolution plans under the applicable resolution provisions of the FDIA. *See* Resolution Plans Required for Insured Depository Institutions With $50 Billion or More in Total Assets, 77 Fed. Reg. 3075 (Jan. 23, 2012). Insured depository institutions are not subject to resolution under the Bankruptcy Code or Title II. For a more detailed discussion of the resolution process for an insured depository institution under the FDIA, see Paul L. Lee, *Cross-Border Resolution of Banking Groups: International Initiatives and U.S. Perspectives—Part IV*, 11 Pratt's J. of Bankr. L. 59 (2015).

152 *See* testimony of Martin N. Baily & Robert E. Litan, *supra* note 34, at 14.

section 165(d)(4) creates at least some tension with the provisions of section 121 of the Dodd-Frank Act.[153] The question whether the largest and most complex financial institutions should be broken up was openly debated in the Dodd-Frank Act legislative process. The addition of section 121 to the Dodd-Frank Act was thought to represent the legislative judgment on the question. Section 121 provides that if the Federal Reserve Board determines that a bank holding company with $50 billion or more in consolidated assets or a nonbank financial company subject to supervision under Title I poses a "grave threat" to the financial stability of the United States, the Federal Reserve Board upon an affirmative vote of no fewer than two-thirds of the voting members of the FSOC shall require the company to take various "mitigatory" actions, including if necessary action to sell assets or off-balance sheet items to unaffiliated entities.[154] Section 121 provides for notice and an opportunity for the company to contest the proposed mitigatory action.[155] The credibility analysis under section 165(d) (performed in a sense in the ordinary course of business of a large complex financial company) might be regarded as both hypothetical and antecedent to any situation qualifying for mitigatory action under section 121 and would not involve the procedural safeguards provided by section 121. In response, the supporters of robust action under section 165(d)(4) and (5) would argue that section 121 was intended as an additional power to address a grave threat that cannot otherwise be addressed by antecedent measures under section 165, including measures under subsection (d)(4) and (5). They would also argue that in any event the failure to submit a credible plan under section 165(d) itself is not hypothetical and means that a company currently poses a "grave threat" to the financial stability of the United States.

The full implications of the resolution plan requirement, and the willingness of the regulators to act upon those implications, have emerged over time. When they first proposed their joint rule for resolution plans in April 2011, the FDIC

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[153] Dodd-Frank Act, § 121 (codified at 12 U.S.C. § 5331).

[154] *Id.* § 121(a). This authority in section 121 of the Dodd-Frank Act augments other authority that already exists with respect to bank holding companies in the Bank Holding Company Act of 1956. Section 5(e) of the Bank Holding Company Act of 1956 provides that the Federal Reserve Board may require a bank holding company to terminate activities in a nonbank subsidiary or to divest its ownership or control of the nonbank subsidiary or any bank subsidiary if the Federal Reserve Board determines that the activities or the ownership of the nonbank subsidiary constitutes a "serious risk" to the financial stability, soundness or stability of the bank subsidiary. *See* 12 U.S.C. § 1844(e).

[155] *Id.* § 121(b).

and the Federal Reserve Board offered the following observation on the section 165(d) resolution planning process:

> The Dodd-Frank Act requires that certain financial companies incorporate resolution planning into their overall business planning processes. In preparing for an orderly liquidation of a financial company under Title II of the Dodd-Frank Act, the [FDIC] will have access to the information included in such company's resolution plan. Advance knowledge of and access to this information will be a vital element in the Corporation's resolution planning for such a company.[156]

This observation places resolution planning squarely within a Title II frame of reference even though the language of the proposed rule, consistent with the language of section 165(d), defined the phrase "rapid and orderly resolution" to mean a reorganization or liquidation under the Bankruptcy Code that can be accomplished within a reasonable period of time and in a manner that substantially mitigates the risk of serious adverse effects on financial stability in the United States.[157] Under a self-styled iterative process applicable to resolution planning, the FDIC and the Federal Reserve Board have increasingly placed more weight on the proposition that the companies should be taking action now to make themselves more easily resolvable in a bankruptcy process. Vice Chairman Hoenig appears to be the driving force behind this heightened emphasis on preparing for and accomplishing resolution under the Bankruptcy Code rather than under Title II. In a speech in May 2014, Vice Chairman Hoenig referred to the Title II resolution process as less preferable than a bankruptcy resolution process for large financial institutions.[158] He asserted that the government should not rely on the Title II process even though the "industry clearly prefers the Title II solution because it requires nothing fundamentally transformational to its operations."[159]

In August 2014, the FDIC announced that it had determined that the second-round resolution plans submitted by eleven of the largest banking institutions in October 2013 were not credible and would not facilitate an orderly resolution under the Bankruptcy Code.[160] The Federal Reserve Board

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[156] Resolution Plans and Credit Exposure Reports Required, 78 Fed. Reg. 22,648, 22,648–49 (April 22, 2011) (proposed rule).

[157] *Id.* at 22,649.

[158] Vice Chairman Thomas M. Hoenig, Can We End Financial Bailouts? (May 7, 2014), *available at* https://www.fdic.gov/news/news/speeches/spmay0714.html.

[159] *Id.* at 3.

[160] *See* Joint Press Release, Board of Governors of the Federal Reserve System and Federal

took the less drastic step of determining that the companies needed to take immediate steps to improve their resolvability and reflect those improvements in their 2015 resolution plans.[161] Section 165(d)(4) requires a joint determination by the FDIC and the Board of Governors that a resolution plan is not credible or would not facilitate an orderly resolution of the company under the Bankruptcy Code before action can be taken by the regulators under section 165(d)(5).[162] The Federal Reserve Board did not join the FDIC in making such a determination based on the resolution plans before them. The FDIC and the Federal Reserve Board, however, did say in their joint press release that if the companies do not submit changes responsive to the identified shortcomings in their plans to be filed on July 1, 2015, they "expect" to use their authority under section 165(d) to determine that a resolution plan does not meet the requirements of the Dodd-Frank Act.[163] The agencies said that they would require that the 2015 resolution plans demonstrate that the firms are making "significant progress" in addressing all the identified shortcomings.

In their joint press release, the FDIC and the Federal Reserve Board noted some common failures in the 2013 plans, such as (i) unrealistic assumptions

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Deposit Insurance Corporation, Agencies Provide Feedback on Second Round Resolution Plans of "First-Wave" Filers (Aug. 5, 2014), *available at* https://www.fdic.gov/news/news/press/2014/pr14067.html. The FDIC and the Federal Reserve Board have recently provided feedback on the first-round resolution plans filed in July 2014 by three nonbank financial companies designated as systemically important by the FSOC. *See* Joint Press Release, Board of Governors of the Federal Reserve System and Federal Deposit Insurance Corporation, Agencies Provide Feedback to Nonbank Firms on Resolution Plans (July 28, 2015), *available at* https://www.fdic.gov/news/news/press/2015/pr15063.html.

161 *Id. See also* Statement of the Board of Governors of the Federal Reserve System regarding the 2013 resolution plans filed by 11 large banking organizations (Aug. 5, 2014), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140805-statement.htm.

162 Under section 165(d)(4) of the Dodd-Frank Act if the FDIC and the Federal Reserve Board jointly determine that a plan is not credible or would not facilitate an orderly resolution of the company under the Bankruptcy Code, then the company is required to resubmit a resolution plan with revisions demonstrating that the plan is credible and would result in an orderly resolution under the Bankruptcy Code, including any proposed changes in the business operations and corporate structure to facilitate implementation of the plan. Under section 165(d)(5)(A) if the company fails to resubmit an acceptable plan, the FDIC and the Federal Reserve Board may jointly impose more stringent capital, leverage or liquidity requirements or restrictions on growth, activities or operations of the company until the company resubmits a plan that remedies the deficiencies in its resolution plan. Under section 165(d)(5)(B) if the company fails to resubmit a resolution plan that remedies the deficiencies within two years of the date of the imposition of the more stringent requirements or restrictions, the FDIC and the Federal Reserve Board in consultation with the FSOC may issue an order directing the company to divest assets or operations identified by the FDIC and the Federal Reserve Board.

163 Joint Press Release, *supra* note 160.

about the likely behavior of customers, counterparties, investors, central clearing facilities, and regulators, and (ii) the failure to make or even to identify the kinds of changes in firm structure or practice necessary to enhance the prospects of an orderly resolution. In a separate statement, Vice Chairman Hoenig identified other failures in the plans, such as the failure to address continued reliance on wholesale funding and the failure to demonstrate how a large financial company could access private debtor-in-possession financing.[164] Chairman Gruenberg and Director Norton also issued separate statements as did the Federal Reserve Board.[165] The multiplicity of statements provided commentators with the opportunity to speculate—in the vein of Kremlinologists—about rifts among the regulators.[166] It appears that the failure to provide earlier and individualized feedback to the large banks on their 2013 resolution plans was both a source of friction between the agencies and a source of frustration to the banks. By the time that the agencies provided their feedback on the 2013 resolution plans in August 2014, the large banks had already filed their third-round resolution plans in July 2014. Much is now riding on the enhancements that these institutions have made to their fourth-round resolution plans filed in July 2015.

In separate letters to each of the eleven companies, the agencies also detailed individual shortcomings in the 2013 plans. Among the actions to improve resolvability that the regulators expect the companies to take would be establishing a "rational and less complex" legal structure to improve resolvability, developing a holding company structure that supports resolvability,

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[164] *See* Statement of Thomas M. Hoenig, Vice Chairman, FDIC, on the Credibility of the 2013 Living Wills Submitted by First Wave Filers (Aug. 5, 2014), *available at* https://www.fdic.gov/news/news/speeches/spaug0514a.html.

[165] *See* Statement by Martin J. Gruenberg, Chairman, FDIC on the Issuance of Joint Letters to First-Wave Resolution Plan Filers (Aug. 4, 2014), *available at* https://www.fdic.gov/news/news/speeches/archives/2014/spaug0514.html; Statement of Jeremiah O. Norton on Memorandum and Resolution re: Determination Regarding 2013 Resolution Plans of Eleven First Wave Covered Companies and Memorandum and Resolution re: Authorization to Send Letters Jointly with Board of Governors of the Federal Reserve System in Response to October 2013 Resolution Plan Submission of First Wave Covered Companies (Aug. 5, 2014), *available at* https://www.fdic.gov/news/news/speeches/archives/2014/spaug0514b.html; Statement of the Board of Governors of the Federal Reserve System regarding the 2013 resolution plans filed by 11 large banking organizations (Aug. 5, 2014), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140805-statement.htm.

[166] *See, e.g.*, Cleary Gottlieb, Alert Memorandum, *Federal Reserve and FDIC Require First Wave Filers to Show "Significant Progress" on Specific Shortcomings for 2015 Resolution Plans* 4 (Aug. 11, 2014) (the multiple statements "reflect different approaches to the message being conveyed").

ensuring the continuity of shared services for critical operations during resolution, and demonstrating operational capabilities, such as the ability to produce reliable information in a timely manner, to facilitate the resolution process.[167]

In addition to these structural and operational action points, the agencies also called upon the firms to take action on an industry-wide and specific firm basis to amend their derivative and other financial contracts to provide for a stay of early termination rights triggered by insolvency proceedings.[168] This action item is in response to the widely perceived problems arising from the prospect of immediate close-out and sale of collateral underlying financial contracts in the case of a resolution. This is also a cause that the FSB has taken up as a priority matter.[169] The FDIC and several other foreign regulators in November 2013 called upon the International Swaps and Derivatives Association ("ISDA") to adopt uniform language in its model contracts to provide a temporary suspension of such early termination rights.[170] By emphasizing this particular action point in their public comments on the resolution plans, the FDIC and the Federal Reserve Board put additional pressure on ISDA through some of its largest members to implement a prompt solution to the early termination issue.

From a U.S. perspective, the contractual solution to the temporary stay issue has to solve for two problems. The first problem is that unlike the FDIA and Title II, the Bankruptcy Code contains no temporary stay provision and thus

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[167] *See* Joint Press Release, *supra* note 160.

[168] *Id.*

[169] The Key Attributes of Effective Resolution Regimes for Financial Institutions call for regulatory or statutory action to impose a temporary stay on early termination rights in financial contracts to facilitate orderly resolution. FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions* 4.3 (Oct. 2014), *available at* http://www.financialstabilityboard.org/2014/10/r_141015/. In a September 2014 consultation paper the FSB identified a contractual approach for recognition of temporary stays on early termination and cross-default rights as one of critical prerequisites for orderly resolution. *See* Press Release, FSB, FSB consults on Cross-Border Recognition of Resolution Action (Sept. 29, 2014), *available at* http://www.financialstabilityboard.org/2014/09/pr_140929/. The FSB said that a statutory approach would be the preferred longer term solution to the issue of cross-border recognition of resolution actions such as temporary stays on early termination rights, but that the time and complexity involved in making national statutory changes meant that a contractual approach would need to be used in the interim.

[170] *See* Press Release, FDIC, Federal Deposit Insurance Corporation, Bank of England, German Federal Financial Supervisory Authority and Swiss Financial Market Supervisory Authority Call for Uniform Derivatives Contracts Language (Nov. 5, 2013), *available at* http://www.fdic.gov/news/news/press/2013/pr13099.html.

permits the immediate exercise of acceleration, close-out, and netting rights under financial contracts. The second and perhaps more significant problem is that even for an institution in an FDIA or Title II proceeding, foreign choice-of-law provisions in financial contracts raise significant issues as to whether the temporary stay provisions in the FDIA or the temporary stay and cross-default provisions in Title II, as the case might be, would be recognized and enforced. Although various commentators have called for amendments to the Bankruptcy Code to deal with the safe harbor provisions for financial contracts, no consensus has emerged among the interested parties as to the appropriate amendatory approach to address this problem. In any event, as noted above, amending the Bankruptcy Code would not solve the foreign choice-of-law problem. A contractual solution appeared to be the most expedient and practical means of addressing these problems in the near term.

The pressure from the FDIC and the Federal Reserve Board worked. In October 2014, ISDA announced that 18 of its major global bank members had agreed to enter into a new ISDA Resolution Stay Protocol (the "Stay Protocol") developed in coordination with the FSB to support cross-border resolution.[171] Section 1 of the Stay Protocol provides for the adhering parties to "opt in" to the statutory stay provisions in the special resolution regimes in six initial jurisdictions. The special resolution regimes covered by Section 1 are those of the United States (including the FDIA and Title II), the United Kingdom, Germany, Switzerland, Japan, and France. The length of the stay and applicable creditor protections are in each case as specified in the individual special resolution regime. Section 2 of the Stay Protocol is designed to provide a temporary stay of termination rights for cross-defaults resulting from affiliate insolvency proceedings under U.S. resolution regimes, including the Bankruptcy Code and the FDIA. Under Section 2, parties adhering to the Stay Protocol agree to a stay on cross-default rights for the longer of one business day and 48 hours, provided that certain creditor protection provisions are satisfied.[172] Section 2 has the effect of extending by contract the stay of cross-default rights contained in Title II to companies in proceedings under the FDIA and the Bankruptcy Code. Section 1 took effect for the initial 18 adhering banks on

[171] Press Release, ISDA, Major Banks Agree to Sign ISDA Resolution Stay Protocol (Oct. 11, 2014), *available at* http://www2.isda.org/news/major-bacns-agree-to-sign-isda-resolution-stay-protocol. On November 12, 2014, ISDA published the Stay Protocol. *See* Press Release, ISDA, ISDA Publishes 2014 Resolution Stay Protocol (Nov. 12, 2014), *available at* http://www2.isda.org/news/isda-publishes-2014-resolution-stay-protocol.

[172] *See* FDIC Systemic Resolution Advisory Committee Meeting, *Presentation on ISDA Protocol* (Dec. 10, 2014), *available at* https://www.fdic.gov/about/srac/2014/2014_12_10_presentation_orderly-liquidation.pdf.

January 1, 2015.[173] Section 2 will take effect on the effective date of national regulations requiring global systemically important banks to amend their over-the-counter derivatives contracts to conform to the Stay Protocol. The precise scope and content of these regulations will emerge as the individual regulatory or rulemaking processes in the national jurisdictions proceed.[174]

Even after the October 2014 announcement from ISDA, Vice Chairman Hoenig continued to press the case for changes in company structures and operations to facilitate resolution under the Bankruptcy Code. In a speech delivered in November 2014, Vice Chairman Hoenig outlined the key precepts behind his approach:

- The Dodd-Frank Act designates bankruptcy, not Title II, as the chosen resolution method for the largest U.S. financial institutions.
- For the bankruptcy resolution plans to be credible, the firms must be more realistic in their approaches to capital, liquidity, structure, and cross-border impediments to orderly bankruptcy.
- Dealing with these issues as they arise is not a solution; potential obstacles to bankruptcy must be identified and dealt with well before a company fails.
- If it is determined that a company cannot feasibly be put through bankruptcy because of its structure or operations, then the law requires changes within the company.[175]

He observed that the Title I resolution planning process had been going on since the enactment of the Dodd-Frank Act, but that it had shown "limited

[173] As of June 23, 2015, a total of 181 ISDA members (including individual affiliates) had adhered to the Stay Protocol. *See* ISDA, Adhering Parties, http://www2.isda.org/functional-areas/protocol-management/protocol-adherence/20.

[174] The Bank of England has taken a leading role in implementing the regulatory requisites for the Stay Protocol. In May 2015 the Bank of England through the Prudential Regulation Authority (the "PRA") proposed a rule requiring contractual adoption of UK resolution stays in financial contracts governed by third-country law. *See* Bank of England, Prudential Regulation Authority, Consultation Paper CP19/15, Contractual stays in financial contracts governed by third-country law (May 2015). The Consultation Paper states that the PRA anticipates that firms will take advantage of the Stay Protocol in complying with the requirements of the proposed rule. *Id.* at 6.

[175] Vice Chairman Thomas M. Hoenig, A Credible Case for Resolving Through Bankruptcy Presented to the George Washington University Law School conference on Financial Stability After Dodd-Frank: Have We Ended Too Big to Fail? (Nov. 5, 2014), *available at* https://www.fdic.gov/news/news/speeches/spnov0514.html.

success."[176] In part he attributed this to the "confusion among some firms that failure would be dealt with under Dodd-Frank's Title II Orderly Liquidation provisions, which involve government assistance, rather than liquidation through bankruptcy."[177] He sought to disabuse the banking industry of that notion.

At the same time, while he recognized the recent progress made by ISDA on the issue of temporary stays on derivatives, he cited the need to extend the progress to repos that use long-term assets to secure short-term funding. But perhaps the most critical issue from his perspective to resolve as part of Title I resolution planning is the need for sufficient debtor-in-possession financing to cover the funding needs of the enterprise in bankruptcy. This is a linchpin issue for Vice Chairman Hoenig because the inability to obtain sufficient debtor-in-possession financing would force resort by the regulators to a Title II process and a government funding source.[178] It is difficult to forecast the availability on a sufficiently rapid basis of a sufficiently large private financing to cover the needs of a very large financial company in bankruptcy. A predicate for establishing the theoretical feasibility of debtor-in-possession financing might be a substantial reduction in size of the certain banking institutions, even given the substantial increase in liquidity reserves at the largest banking institutions as a result of enhanced regulatory requirements under the Dodd-Frank Act. The feasibility of adequate debtor-in-possession financing may thus become a pivotal point in the credibility analysis of Title I resolution plans. If so, it is possible that certain of the largest banking institutions might be required to reduce their size as well as their complexity as part of the recovery phase of their resolution plan—if not sooner. Vice Chairman Hoenig wants to see it sooner. His object all sublime—to reduce the size and complexity of the largest financial institutions—he expects to achieve in time, in his own view in a relatively short time.[179]

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[176] *Id.* at 2.

[177] *Id.* (footnote omitted).

[178] Vice Chairman Hoenig noted in a May 2014 speech that a bankruptcy expert had previously advised the FDIC Systemic Resolution Advisory Committee that, given the complexity and interdependence of the largest banking firms, it was unrealistic to assume that private sector parties would provide debtor-in-possession financing in a bankruptcy proceeding of such a firm. *See* Hoenig, *supra* note 158, at 2. Other commentators have made the same point. *See, e.g.,* Stephen J. Lubben, *Resolution, Orderly or Otherwise*: *B of A in OLA*, 81 U. Cin. L. Rev 485, 517 (2012).

[179] In a recent speech Chairman Gruenberg has also referred to the need for "immediate structural changes" by institutions submitting living wills. *See* Chairman Martin J. Gruenberg, A Progress Report in the Resolution of Systemically Important Financial Institutions 2 (May 12,

Vice Chairman Hoenig also asserted that the resolution plans did not realistically assess the likelihood of the ring-fencing of foreign subsidiaries by foreign regulatory or resolution authorities.[180] Although he has expressed skepticism about the SPOE strategy under Title II, an SPOE strategy under Title II or the Bankruptcy Code offers the best hope of avoiding the ring-fencing of foreign operations. Thus, changes to the Bankruptcy Code to facilitate the use of an SPOE strategy in the bankruptcy of a large U.S. financial institution should receive encouragement from the regulators and the industry. This represents an instance where common ground exists for resolution approaches under Title II and the Bankruptcy Code. As a correlative matter, the availability of sufficient debtor-in-possession financing may also be critical to mitigating the risk of ring-fencing of the foreign subsidiaries under an SPOE strategy in bankruptcy. From Vice Chairman Hoenig's perspective, it appears that the two greatest challenges to the Title I resolution planning process are concerns relating to the availability of private financing and the prospect of cooperation from foreign regulatory and resolution authorities.

RESOLUTION *EX MACHINA*

In the realm of resolution, there are many possibilities, but few certainties. The initial objective of a resolution planning process should actually be to expand the range of possibilities and then refine those possibilities with the hope that at least certain of the possibilities can approach the point of a higher probability. The initial FDIC work has increased the range of possibilities by at least two—SPOE and TLAC. The conception of these possibilities is a singular achievement in itself. The ongoing work of the FDIC is now aimed at increasing the probabilities surrounding SPOE and ultimately achieving a high level of confidence that an SPOE strategy can actually be implemented.

As with any planning process, however, a measure of skepticism should be applied. It may be recalled, for example, that *Monsieur* Maginot had a plan too. Not only did he have a plan, but in fact the plan was fully implemented. At the time of its initial implementations the plan was widely regarded as state-of-the art. But, at least in contrast to the Maginot plan, the resolution planning process under section 165(d) cannot be said to have the banking firms fighting the last war. Otherwise, the FDIC and Federal Reserve Board would have

2015), *available at* https://www.fdic.gov/news/news/speeches/spmay1215.html. The emphasis in this speech on resolution through bankruptcy under Title I may be contrasted with the emphasis in Chairman Gruenberg's comments in May 2012 on resolution under Title II. *See supra* note 119.

[180] Hoenig, *supra* note 175, at 3.

required the banking firms to prepare their resolution plans on an assumption of a financial system collapse akin to the one experienced in September 2008. Instead, the FDIC and Federal Reserve Board have allowed the firms to prepare their plans on the assumption of an idiosyncratic failure by an individual firm. In that sense, the resolution plan requirement has the firms fighting the second-to-last war. To be fair to the FDIC and the Federal Reserve Board, however, it is not the purpose of a living will to address a systemic crisis.[181] The purpose of a living will is to address the failure of an individual institution that could potentially cause systemic consequences through interconnectedness or general contagion.[182] The solution to a systemic crisis will not be found in Title II or the Bankruptcy Code, but instead in a broad-based government liquidity program to support the financial system.

Resolution plans will to a greater or lesser extent be flawed, as all human mechanisms must be. Resolution cannot be achieved *ex machina,* at least not in the near term.[183] The realistic expectation of the resolution planning process should be to achieve plans that are flawed to a lesser extent.[184] At the same time, it must be an objective of resolution planning to preserve the flexibility to

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[181] One of the early regulatory proponents of the living will exercise recognized that the living will exercise could not address systemic problems, affecting all banks, such as sudden changes in interest or exchange rates or sovereign defaults. *See* Thomas F. Huertas, Director, Banking Sector, Financial Services Authority, Living Wills: How Can the Concept be Implemented? 1 (Feb. 12, 2010) *available at* www.fsa.gov.uk/Pages/Library/Communication/Speeches/2010/0212_Th.shtml. *See also* Hoenig, *supra* 175, at 2 ("Congress in the Dodd-Frank Act requires that each SIFI show how, in the event of an idiosyncratic failure, it could be resolved in bankruptcy without precipitating a crisis.").

[182] *See id.*

[183] This observation is not intended to diminish in any way the importance of robust systems, including systems *ex machinis*, to support the resolution process. For a forward-looking reflection on the role that advanced systems can play in resolution planning, see Paul Lippe et al., *How Smart Resolution Planning Can Help Banks Improve Transparency, Increase Profitability and Reduce Risk*, The Clearing House Banking Perspective Quarter 2 (2015). This paper discusses how the advances made in cognitive computering can be harnessed for use in resolution planning. It also discusses the work being done in developing the computational representation of financial agreements as a future aid to resolution planning. *See* Mark D. Flood & Oliver R. Goodenough, Treasury Department—Office of Financial Research, *Contract as Automation—The Computational Representation of Financial Agreements*, *available at* http://financialresearch.gov/working-papers/files/OFRwp-2015-04_Contract-as-Automaton-The-Computational-Representation-of-Financial-Agreements.pdf.

[184] For a general discussion of some of the challenges that are presented, for example, in the forecasting and modelling exercise for a resolution plan, see Nizan Pakin, *The Case Against Dodd-Frank Act's Living Wills: Contingency Planning Following the Financial Crises*, 9 Berkeley Bus. L. J. 29, 59–72 (2013).

respond to the exigencies of the "fog of resolution." This flexibility should apply both to the options to be executed initially by the individual firm and to the options to be executed ultimately by the regulatory authorities. On the latter score, this flexibility must include multiple options for intervening in the firm, including an option that currently dares not speak its name—lender of last resort. The *illuminati* understand the importance of the lender-of-last-resort function, but it is feared that the general populace does not.[185] The Dodd-Frank Act has placed significant restrictions on the emergency lending power in section 13(3) of the Federal Reserve Act.[186] The potential role of the Federal Reserve System in providing emergency financing to the operating subsidies of a bridge company under an SPOE strategy is yet to be established.[187] These issues will be explored in greater detail in Part II of this article. For the moment, it will suffice to note that Title II must be retained as an option if resolution under the Bankruptcy Code cannot be accomplished on an orderly basis because of the lack of an adequate private financing source or the lack of coordination among foreign resolution authorities.[188]

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[185] Even among the financial *cognoscenti*, questions have recently been raised about the continuing validity of some traditional lender-of-last-resort principles. *See, e.g.,* Kathryn Judge, *A Different Take on the AIG Case: The Dangers of Invoking 19th Century Principles to solve 21st Century Problems* (June 23, 2015), *available at* http://clsbluesky.law.columbia.edu/2015/06/23/another-take-on-aig-the-dangers-of-invoking-19th-century-principles-to-solve-21st-century-problems/. Other experts have called for a strengthening of the lender-of-last-resort function. *See, e.g.* Glenn Hubbard & Hal Scott, *A Financial System Still Dangerously Vulnerable to a Panic: The Federal Reserve's powers to act as lender of last resort need to be restored and strengthened*, WALL ST. J., March 1, 2015, *available at* http://www.wsj.com/articles/glenn-hubbard-and-hal-scott-a-financial-system-still-dangerously-vulnerable-to-a-panic-1425249064.

[186] The Dodd-Frank Act revised section 13(3) to limit the power to lend to nonbank financial companies in unusual and exigent circumstances to programs of "broad-based eligibility." *See* 12 U.S.C. § 343(3)(A) (as amended by section 1101(a) of the Dodd-Frank Act). As amended, section 13(3) further provides that any emergency lending program is to be for the purpose of providing liquidity to the financial system and not to aid a failing financial company. A company in a bankruptcy proceeding, in resolution under Title II, or in any other federal or state insolvency proceeding would not be eligible to borrow under section 13(3) nor may a program under section 13(3) be established for the purpose of assisting a single and specific company to avoid bankruptcy, resolution under Title II, or any other federal or state insolvency proceeding. Even as restricted by the Dodd-Frank Act, section 13(3) remains an indispensable tool for support to the U.S. financial system in the event of a systemic crisis.

[187] The Federal Reserve Board has published a proposed rule to implement the changes made by the Dodd-Frank Act to its emergency lending power. *See* Notice of Proposed Rulemaking and Request for Public Comment, Extensions of Credit by Federal Reserve Banks, 79 Fed. Reg. 615 (Jan. 6, 2014). The proposed rule essentially incorporates the language changes made to section 13(3) by the Dodd-Frank Act into the rule.

[188] *See, e.g.,* Michael S. Helfer, *We Need Chapter 14*—And *We Need Title II, in* ACROSS THE

CONCLUSION

Title II remains both the source of hope and the object of criticism. The hope comes from various professional, political and regulatory quarters. The criticism comes from other professional, political, and even regulatory quarters.[189] Notwithstanding the criticism, the progress made by the FDIC and other international bodies such as the FSB on the SPOE and TLAC strategy offers the best hope of mitigating many of the problems that would be presented by the failure of a large U.S. financial company. Whether the government authorities and the firms are fighting an old war or, as is much more likely, a new war, they will—with SPOE and TLAC—at least be fighting with new weapons. But it will still be important to marshal old weapons as well, such as a lender-of-last-resort power. The progress that is being made under a Title II model in these respects should to the extent possible be replicated under a Bankruptcy Code model. Part II of this article will explore the possibilities for orderly resolution under the Bankruptcy Code and the changes proposed to be made to the Bankruptcy Code to facilitate an orderly resolution of a systemically important financial institution.

Great Divide: New Perspectives on the Financial Crisis (Martin N. Baily & John B. Taylor eds., Hoover Institution Press 2014) (providing a high-level but compelling statement of the reasons to retain Title II even if changes are made to the Bankruptcy Code, noting as an important consideration that foreign regulators will not be able to develop the kinds of advance agreements on resolution with bankruptcy judges that the foreign regulators can develop with the FDIC). For a particularly literate discussion of the need for Title II not merely as a backstop but also as a frontstop to a bankruptcy process, see Joseph H. Sommer, *Why Bail-In? And How!,* FRBNY Economic Policy Review 207 (Dec. 2014).

[189] *See, e.g.,* Failing to End "Too Big to Fail": An Assessment of the Dodd-Frank Act Four Years Later, Report Prepared by the Republican Staff of the Committee on Financial Services, U.S. House of Representatives (July 2014). This report challenges the proposition that Title II is effective in ending "too-big-to-fail" or bailouts. It specifically criticizes the SPOE strategy as promoting a bailout similar to the bailout provided to the creditors and counterparties of AIG. *Id.* at 69–72.