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Regulatory Reform 10 Years After the Financial Crisis: Systemic Risk Regulation of Non-Bank Financial Institutions

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Summary

When large, interconnected financial institutions become distressed, policymakers have historically faced a choice between (1) a taxpayer-funded bailout, and (2) the destabilization of the financial system—a dilemma that commentators have labeled the "too-big-to-fail" (TBTF) problem. The 2007-2009 financial crisis highlighted the significance of the TBTF problem. During the crisis, a number of large financial institutions experienced severe distress, and the federal government committed hundreds of billions of dollars in an effort to rescue the financial system. According to some commentators, the crisis underscored the inadequacy of existing prudential regulation of large financial institutions, and of the bankruptcy system for resolving the failure of such institutions.

In response to the crisis, Congress passed and President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) in 2010. Titles I and II of Dodd-Frank are specifically directed at minimizing the systemic risk created by TBTF financial institutions. In order to minimize the risks that large financial institutions will fail, Title I of Dodd-Frank establishes an enhanced prudential regulatory regime for certain large bank holding companies and non-bank financial companies. In order to "resolve" (i.e., reorganize or liquidate) systemically important financial institutions, Title II establishes a new resolution regime available for such institutions outside of the Bankruptcy Code.

The Title I regime applies to (1) all bank holding companies with total consolidated assets of $50 billion or more, and (2) any non-bank financial companies that the Financial Stability Oversight Council (FSOC) designates as systemically important. To date, FSOC has designated four non-bank financial companies for enhanced supervision: AIG, GE Capital, Prudential, and MetLife. However, FSOC has rescinded its designations of AIG and GE Capital as a result of changes to those companies, and MetLife successfully challenged its designation in federal court, leaving Prudential as the sole remaining designee as of the publication of this report.

Legislation that would repeal FSOC's authority to designate non-banks for enhanced supervision has passed the House of Representatives (H.R. 10), and a bill that would alter FSOC's designation process and standards in more limited ways has also been introduced in the House (H.R. 4061).

Title II of Dodd-Frank creates an "Orderly Liquidation Authority" (OLA) pursuant to which the Federal Deposit Insurance Corporation (FDIC) can serve as the receiver for failing financial companies that pose a significant risk to the financial stability of the United States. The OLA, which was developed as an alternative to the Bankruptcy Code, is similar to the mechanisms the FDIC uses to resolve failed commercial banks. The OLA grants the FDIC broad powers to manage the liquidation or sale of a failed financial company, and Title II includes provisions that offer financial institutions more robust protections against "runs" by their derivatives counterparties than they would have under the Bankruptcy Code. The FDIC, Federal Reserve, and Office of the Comptroller of the Currency have promulgated a number of rules that have important consequences for the OLA concerning the FDIC's powers as receiver, its general strategy for resolving failed institutions, "loss-absorbing capacity" requirements for certain bank holding companies, and derivatives contracts.

There have also been a number of proposals to reform Title II. A bill that would (among other things) repeal Title II passed the House in June 2017, and bills to amend the Bankruptcy Code to allow it to deal more effectively with the failure of large financial institutions have been introduced in the House and the Senate (H.R. 10 (115th Cong.), H.R. 1667 (115th Cong.), S. 1840 (114th Cong.)).

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The prospect of a large financial institution's failure often presents policymakers with a stark choice. Regulators can "bailout" a distressed institution, risking taxpayer money and arguably creating incentives for management, shareholders, and creditors of similar institutions to take excessive risks. Alternatively, the government can allow the institution to fail, running the risk of financial destabilization.[1] Before the 2007-2009 financial crisis, regulators relied on a variety of prudential regulations, federal deposit insurance, and the Federal Reserve's emergency lending power to limit the risk of commercial bank failures.[2] Commercial banks are also subject to a special insolvency regime administered by the Federal Deposit Insurance Corporation (FDIC), in which the FDIC has robust authorities to rapidly resolve failed banks outside of the Bankruptcy Code.[3]

However, many non-bank financial institutions fall outside the ambit of these regulations despite facing risks similar to those confronting commercial banks. Many commentators viewed the distress and failure of a number of these institutions during the 2007-2009 crisis as highlighting the inadequacy of existing prudential regulations for such firms, and of the Bankruptcy Code for resolving their failure.[4] The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) adopted two general solutions to these perceived problems.[5] First, Title I of the Act created the Financial Stability Oversight Council (FSOC) and granted it the authority to designate systemically important non-bank financial companies for enhanced prudential regulation by the Federal Reserve.[6] Second, Title II of Dodd-Frank established the Orderly Liquidation Authority (OLA), a special resolution regime outside of the Bankruptcy Code that can be invoked for systemically important financial institutions.[7]

As discussed in more detail below, federal regulatory agencies have pursued a number of measures to implement Titles I and II of Dodd-Frank.[8] And 10 years after the crisis, legal commentators continue to debate whether these provisions have improved the resiliency of the financial system.[9] This report provides an overview of how regulatory agencies have implemented Dodd-Frank's systemic risk provisions concerning non-bank financial institutions, and the legal debates surrounding proposals to repeal or change those provisions. In order to provide necessary background, the first two sections of the report discuss the nature of the "too-big-to-fail" problem and the 2007-2009 financial crisis.[10] The report then provides an overview of Titles I and II,[11] their implementation by the relevant federal agencies,[12] criticisms of those

[1] *See* "The "Too-Big-To-Fail" Problem" *infra*.

[2] *See* "Title I: Enhanced Prudential Standards for Systemically Important Financial Institutions" *infra*.

[3] *See* "Pre-Dodd-Frank Resolution Mechanisms: Bankruptcy vs. FDIC Resolution" *infra*.

[4] *See* Ben S. Bernanke, *Why Dodd-Frank's Orderly Liquidation Authority Should be Preserved*, THE BROOKINGS INST. (Feb. 28, 2017), https://www.brookings.edu/blog/ben-bernanke/2017/02/28/why-dodd-franks-orderly-liquidation-authority-should-be-preserved/; FINANCIAL REGULATORY REFORM: A NEW FOUNDATION, U.S. DEP'T OF THE TREASURY 20 (Oct. 8, 2009), https://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

[5] P.L. 111-203, 124 Stat. 1376 (2010).

[6] *See* "Designation of Non-Banks for Enhanced Prudential Regulation" *infra*.

[7] *See* "Title II and the Orderly Liquidation Authority" *infra*.

[8] *See* "Dodd-Frank Section 113 and FSOC Guidance" and "Administrative Rules" *infra*.

[9] *See* "Criticisms of Title I and Responses" and "Criticisms of Title II and Responses" *infra*.

[10] *See* "The "Too-Big-To-Fail" Problem" and "TBTF Financial Institutions During the 2007-2009 Financial Crisis" *infra*.

[11] *See* "Designation of Non-Banks for Enhanced Prudential Regulation" and "Title II and the Orderly Liquidation Authority" *infra*.

[12] *See* "Non-Bank Designations to Date" and "Administrative Rules" *infra*.

provisions and responses,[13] and legislative proposals to change them.[14] An **Appendix** to this report contains a glossary that defines certain key terms in the report.[15]

The "Too-Big-To-Fail" Problem

When large, interconnected financial institutions become distressed, policymakers often face a choice between (1) a taxpayer-funded bailout, and (2) the destabilization of the financial system—a dilemma that commentators have labeled the "too-big-to-fail" (TBTF) problem.[16] Two features of the financial system help explain the origin of the TBTF problem. First, banks and certain other financial institutions are almost always highly leveraged, meaning that their shareholder equity is a small fraction of their total assets, and that they accordingly fund their assets with large amounts of borrowing.[17] Second, banks and certain other financial institutions often fund themselves with large amounts of short-term debt, while investing in longer-term loans and other illiquid assets—a practice called "maturity transformation."[18] While commentators generally agree that maturity transformation is socially valuable,[19] the process makes financial

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[13] *See* "Criticisms of Title I and Responses" and "Criticisms of Title II and Responses" *infra*.

[14] *See* "Proposals to Alter Title I" and "Proposals to Alter Title II" *infra*.

[15] *See* **Appendix**.

[16] Randall D. Guynn, *Framing the TBTF Problem: The Path to a Solution*, *in* ACROSS THE GREAT DIVIDE: NEW PERSPECTIVES ON THE FINANCIAL CRISIS 281, 291 (Martin Neil Baily & John B. Taylor eds., 2014). *See also* RICHARD SCOTT CARNELL, JONATHAN R. MACEY & GEOFFREY P. MILLER, THE LAW OF FINANCIAL INSTITUTIONS 38 (6th ed. 2017); CRS Report R42150, *Systemically Important or "Too Big to Fail" Financial Institutions*, by Marc Labonte; *Too Big to Fail: The Path to a Solution*, BIPARTISAN POLICY CENTER (May 2013), http://bipartisanpolicy.org/wp-content/uploads/sites/default/files/TooBigToFail.pdf [hereinafter "Bipartisan Policy Center Report"].

[17] *See* Harry DeAngelo & René Stulz, *Why High Leverage is Optimal for Banks*, HARV. L. SCH. FORUM ON CORP. GOV. AND FIN. REG. (June 27, 2013), https://corpgov.law.harvard.edu/2013/06/27/why-high-leverage-is-optimal-for-banks/.

[18] *See* Guynn, *supra* note 16 at 291; Lawrence J. White, *The Basics of Too Big to Fail*, *in* PERSPECTIVES ON DODD-FRANK AND FINANCE 25, 26 (Paul H. Schultz ed., 2014); Daniel R. Fischel, Andrew M. Rosenfield & Robert S. Stillman, *The Regulation of Banks and Bank Holding Companies*, 73 VA. L. REV. 301, 306-07 (1987); Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 91 J. POL. ECON. 401, 403 (1983).

Customer deposits, many of which are payable on demand (as in most checking accounts), represent major liabilities of commercial banks, which make loans to businesses and individuals. *See* CARNELL, ET AL., *supra* note 16 at 67-78. And many large investment banks that deal in securities and derivatives obtain short-term financing from commercial paper and repurchase agreements (repos). White, *supra* note 18 at 26; DARRELL DUFFIE, HOW BIG BANKS FAIL AND WHAT TO DO ABOUT IT 29 (2011).

Commercial paper is a short-term, unsecured corporate IOU. CARNELL, ET AL., *supra* note 16 at 152. By contrast, repos are transactions pursuant to which one party sells securities to another party for cash, while simultaneously agreeing to repurchase the same or similar securities at some time in the future at a premium. *See* Jeanne L. Schroeder, *Repo Madness: The Characterization of Repurchase Agreements under the Bankruptcy Code and the U.C.C.*, 46 SYRACUSE L. REV. 999, 1004-1006 (1996). The economic function of a repo is accordingly similar to that of a secured loan. *Id*. at 1006. Large investment banks often make heavy use of "overnight repos" with a term of one day in order to benefit from their flexibility and low financing rates. DUFFIE, *supra* note 18 at 29-30; FINAL REPORT OF THE NAT'L COMM'N ON THE CAUSES OF THE FIN. AND ECON. CRISIS IN THE U.S. 296-97 (2011) [hereinafter "FINANCIAL CRISIS REPORT"].

Although commentators generally agree that insurance companies "are less likely to pose systemic risk than similar-sized banks" because they are "less vulnerable to runs or other liquidity problems," CARNELL, ET AL., *supra* note 16 at 671, insurance companies may pose systemic risk when they offer products that allow customers to withdraw assets with minimal penalties, engage in securities lending and certain other capital markets activities, or when they have significant financial-guarantee businesses. *See* Daniel Schwarcz & Steven L. Schwarcz, *Regulating Systemic Risk in Insurance*, 81 U. CHI. L. REV. 1569, 1571 (2014); Robert P. Bartlett III, *Inefficiencies in the Information Thicket: A Case Study of Derivatives Disclosures during the Financial Crisis*, 36 J. CORP. L. 1, 1-42 (2010).

[19] *See* Edward Simpson Prescott, *Introduction to the Special Issue on the Diamond-Dybvig Model*, 96 FED. RES. BANK RICHMOND ECON. Q. 1, 1-2 (2010).

institutions vulnerable to liquidity "runs."[20] That is, when a financial institution's short-term creditors become concerned about its solvency or liquidity, they have incentives to demand immediate conversion of their claims into cash,[21] or to reduce their exposure in other ways that force the institution to sell its illiquid assets at significantly discounted prices.[22]

A "run" on one financial institution can spread to other institutions that do business with it.[23] Small banks typically hold deposit balances at larger banks, and large banks, securities firms, and insurance companies often face significant exposure to one another through their over-the-counter derivatives portfolios.[24] Accordingly, troubles at one financial institution can spread to others, resulting in additional "runs" and a "contagious panic throughout the financial system that causes otherwise solvent financial institutions to become insolvent."[25] This type of financial "contagion" can cause asset price implosions as institutions liquidate assets in order to meet creditor demands, further impairing their ability to lend and the ability of businesses to raise capital.[26] Faced with a choice between bailouts and economic collapse, policymakers have generally opted for bailouts,[27]

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[20] *See* Guynn, *supra* note 16 at 291; Jonathan R. Macey & Geoffrey P. Miller, *Bank Failures, Risk Monitoring, and the Market for Bank Control*, 88 COLUM. L. REV. 1153, 1156-59 (1988); Fischel, et al., *supra* note 18 at 307-10; Diamond & Dybvig, *supra* note 18 at 401-02.

[21] Guynn, *supra* note 16 at 291; Bipartisan Policy Center Report, *supra* note 16 at 38-39; ROBERT E. LITAN & JONATHAN RAUCH, AMERICAN FINANCE FOR THE 21ST CENTURY 98-112 (1997); Fischel, et al., *supra* note 18 at 307-10.

Commentators have argued that short-term creditors face a classic "prisoner's dilemma" in which creditors as a group are often harmed by mass withdrawals that force a financial institution to take value-reducing actions, such as liquidating loans or securities at distressed prices. Macey & Miller, *supra* note 20 at 1156-57; Fischel, et al., *supra* note 18 at 307-10. However, individual creditors have incentives to withdraw their assets from a troubled institution to avoid being left with nothing. Fischel, et al., *supra* note 18 at 307-10. Fearing that other creditors will withdraw funds from a troubled institution, creditors "may rationally adopt a 'me-first' attitude and demand payment as soon as possible," precipitating a "run." *Id*. at 308.

[22] In the case of a large investment bank, these exposure-mitigating activities may include, among other things: (1) repo lenders demanding increased collateral or declining to renew their positions altogether, (2) derivatives counterparties requesting that other investment banks assume the obligations of a troubled bank (an act referred to as a "novation"), resulting in the transfer of cash collateral out of the troubled bank, and (3) hedge funds and other prime-brokerage clients of a troubled bank withdrawing cash from their free credit balances at the bank. *See* DUFFIE, *supra* note 18 at 23-42.

[23] White, *supra* note 18 at 27; LITAN & RAUCH, *supra* note 21 at 98-112; Helen A. Garten, *Banking on the Market: Relying on Depositors to Control Bank Risks*, 4 YALE J. ON REG. 129, 160-63 (1986).

[24] LITAN & RAUCH, *supra* note 21 at 98-112. A "derivative" is a financial instrument whose value depends on the value of some other asset, such as a commodity, interest rate, currency, bond, or stock. CARNELL, ET AL., *supra* note 16 at 871-72. An "over-the-counter" (OTC) derivative is a derivative contract that is "individually negotiated by parties dealing directly with one another," as opposed to a derivative contract that is traded on an organized exchange. *Id*. at 871.

Commentators have observed that the OTC derivatives market is highly concentrated, generating high levels of systemic risk. *See* Sheri M. Markose, *Systemic Risk from Global Financial Derivatives: A Network Analysis of Contagion and Its Mitigation with Super-Spreader Tax*, INTERNATIONAL MONETARY FUND 8 (2012), https://www.imf.org/external/pubs/ft/wp/2012/wp12282.pdf (noting that according to a 2009 survey conducted by Fitch Ratings, "the top 12 counterparties [in the OTC derivatives market] comprised 78 percent of total exposure," and that "dependence on a limited number of counterparties looks to be a permanent feature of the market").

Moreover, as discussed in greater detail in "QFCs" *infra*, OTC derivatives often provide counterparties with "cross-default rights"—that is, rights to terminate the contract, set-off obligations, or liquidate collateral based on the bankruptcy of a party's parent, subsidiary, or affiliate. The bankruptcy of a financial holding company can accordingly trigger "runs" on its subsidiaries, and vice versa.

[25] Guynn, *supra* note 16 at 291. *See also* White, *supra* note 18 at 27; Bipartisan Policy Center Report, *supra* note 16 at 39; LITAN & RAUCH, *supra* note 21 at 98-112.

[26] *See* LITAN & RAUCH, *supra* note 21 at 98-112.

arguably creating incentives for financial institutions to take excessive risks and grow larger than is socially optimal.[28]

TBTF Financial Institutions During the 2007-2009 Financial Crisis

The 2007-2009 financial crisis highlighted the significance of the TBTF problem. During that time, the United States experienced what many commentators believe was the worst financial crisis since the Great Depression, triggering a severe recession.[29] According to many observers, a principal cause of the crisis was the collapse of a bubble in the housing market that had developed in the early and mid-2000s.[30] As this bubble popped over the course of 2007 and 2008, many financial institutions experienced large losses related to the real estate market.[31]

In March 2008, Bear Stearns—the fifth largest American investment bank at the time—informed the Federal Reserve that it was unable to refinance its short-term debt as a result of a "run" by its

(...continued)

[27] Guynn, *supra* note 16 at 291 ("All indications from history suggest that when public policymakers, and even the public, are faced with the choice between bailout and collapse or destabilization, they typically choose bailouts rather than risk a collapse of the system."); Bipartisan Policy Center Report, *supra* note 16 at 19 ("Faced with a choice between bailout and fire-sale liquidations or value-destroying reorganizations that can result in a contagious panic and a collapse of the financial system, ... policymakers typically choose bailout as the lesser of two evils."). *See also* Michael M. Phillips, *Government Bailouts: A U.S. Tradition Dating to Hamilton*, WALL ST. J. (Sept. 20, 2008), https://www.wsj.com/articles/SB122186662036058787.

[28] *See* DUFFIE, *supra* note 18 at 5 (arguing that knowledge that TBTF institutions will receive government support when distressed "provides an additional incentive to large financial institutions to take inefficient risks, a well-understood moral hazard," and that "[t]he creditors of systemically important financial institutions may offer financing at terms that reflect the likelihood of a government bailout, thus further encouraging these financial institutions to increase leverage."); Bipartisan Policy Center Report, *supra* note 16 at 43-44 (arguing that if shareholders expect a TBTF institution to be bailed out, they "will encourage the institutions to engage in excessive risk-taking," and that bailouts result in market distortions in the form of "an *implicit government subsidy* of funding costs," because "shareholders, long-term unsecured debt holders and the holders of other capital structure liabilities might accept below-market returns if they expect the institutions or their claims to be bailed out by the government.").

[29] *See* Jeff Madrick, *The Real Lesson of Lehman*, THE N.Y. REVIEW OF BOOKS (Oct. 4, 2014), http://www.nybooks.com/daily/2014/10/04/real-lesson-lehman-bankruptcy/; Jon Hilsenrath, Serena Ng & Damian Paletta, *Worst Crisis Since '30s, With No End Yet in Sight*, WALL ST. J. (Sept. 18, 2008), https://www.wsj.com/articles/SB122169431617549947; Heather Stewart, *We Are in the Worst Financial Crisis Since Depression, Says IMF*, THE GUARDIAN (Apr. 9, 2008), https://www.theguardian.com/business/2008/apr/10/useconomy.subprimecrisis.

[30] FINANCIAL CRISIS REPORT, *supra* note 18 at 1-4. *See also* CARNELL, ET AL., *supra* note 16 at 32; White, *supra* note 18 at 31; Christopher L. Foote, Kristopher S. Gerardi & Paul S. Willen, *Why Did So Many People Make So Many Ex Post Bad Decisions?: The Causes of the Foreclosure Crisis*, *in* RETHINKING THE FINANCIAL CRISIS 136, 136-40 (Alan S. Blinder, Andrew W. Lo & Robert M. Solow, eds. 2012).

Commentators have debated the ultimate and proximate causes of the 2007-2009 financial crisis. In analyzing the crisis, observers have contested the relative roles of financial deregulation, easy monetary policy, government housing policy, the complexity and opacity of newly-popular financial products, predatory mortgage lending, the concentration of risk in institutions outside the ambit of traditional banking regulations (the so-called "shadow banking system"), and government bailout policy, among other things. *See* Robert E. Litan, *The Political Economy of Financial Regulation after the Crisis*, *in* RETHINKING THE FINANCIAL CRISIS 269, 270 ("There are so many alleged 'causes' of the great financial crisis of 2007 to 2008 that it is easy to lose count."); FINANCIAL CRISIS REPORT, *supra* note 18 at 125-26, 187, 230, 255; *Dissenting Statement of Keith Hennessy, Douglas Holtz-Eakin & Bill Thomas*, *in* FINANCIAL CRISIS REPORT, *supra* note 18 at 413-37; *Dissenting Statement of Peter Wallison*, in FINANCIAL CRISIS REPORT, *supra* note 18 at 443-553.

[31] FINANCIAL CRISIS REPORT, *supra* note 18 at 279-91.

short-term creditors.[32] Believing that the bankruptcy of Bear Stearns raised "the potential for contagion to similarly situated firms," and the possibility of "serious[] disrupt[ions]" to the stability of financial markets, the Federal Reserve exercised its authority to lend to non-banks in "unusual and exigent circumstances" under Section 13(3) of the Federal Reserve Act.[33] According to then-Chairman of the Federal Reserve Ben Bernanke, policymakers "were reasonably sure that [Bear Stearns's] unexpected bankruptcy filing would ignite ... panic."[34] A bankruptcy proceeding, Bernanke explained, could seriously damage the money market funds that lent to Bear Stearns and other corporations, and "lock up the cash of many other creditors, potentially for years."[35] Likewise, according to Bernanke, unwinding Bear Stearns's derivatives portfolio would have "prove[n] chaotic" because of its size and complexity.[36] Moreover, a decision by JP Morgan, the "clearing bank" for Bear Stearns's repurchase agreements (repos),[37] to liquidate collateral on behalf of Bear Stearns's creditors could drive securities prices down even further, "leading to a new wave of losses and write-downs" and possible "runs" on other investment banks.[38]

Accordingly, on March 14, the Federal Reserve Bank of New York (New York Fed) extended a bridge loan of $12.9 billion to Bear Stearns as it worked to orchestrate a deal to save the investment bank.[39] On March 17, the Federal Reserve shepherded an acquisition of Bear Stearns by JP Morgan.[40] In order to facilitate the acquisition, the Federal Reserve again exercised its

[32] *Bear Stearns, JP Morgan Chase, and Maiden Lane LLC*, BD. OF GOV. OF THE FED. RES. SYS., https://www.federalreserve.gov/regreform/reform-bearstearns.htm.

[33] *See id*.; 12 U.S.C. § 343(3) (2006).

[34] BEN BERNANKE, THE COURAGE TO ACT: A MEMOIR OF A CRISIS AND ITS AFTERMATH 215 (2015).

[35] *Id*. Money market funds are funds that generally invest in high-quality, liquid, short-term securities and give their investors the right to withdraw their share of the fund's assets on demand. CARNELL, ET AL., *supra* note 16 at 32. However, unlike commercial banks, money market funds are not required to obtain deposit insurance and do not enjoy access to the Federal Reserve's "discount window." William A. Birdthistle, *Breaking Bucks in Money Market Funds*, 2010 WISC. L. REV. 1155, 1160-62 (2010). Before the financial crisis, money market funds had become a major source of short-term financing for major financial institutions and non-financial corporations, accumulating more than $3 trillion in assets. *Id*. at 1157.

[36] BERNANKE, *supra* note 34 at 215-16.

[37] For an explanation of repos, see note 18 *supra*. Bear Stearns borrowed heavily in the "tri-party" repo market, in which a clearing bank intermediates between repo lenders and borrowers. *Id*. at 216. *See also* Adam Copeland, Darrell Duffie, Antoine Martin & Susan McLaughlin, *Key Mechanics of the U.S. Tri-Party Repo Market*, FED. RES. BANK OF NEW YORK ECON. POL. REV. 17 (Nov. 2012), https://www.newyorkfed.org/medialibrary/media/research/epr/12v18n3/1210cope.pdf.

The role of clearing banks in the tri-party repo market consists primarily in shifting cash and securities back and forth between borrowers and lenders. *Id*. at 6. However, before and during the financial crisis, the two principal clearing banks (JP Morgan and Bank of New York Mellon) provided borrowers with several hours of "intraday" credit while arranging their transactions. *Id*. at 6. Commentators have observed that the large exposure of clearing banks to troubled repo dealers and to the possibility of sharp declines in the value of the securities that collateralize repos were major contributors to systemic risk. *Id*. at 6-7.

[38] BERNANKE, *supra* note 34 at 216. *See also* TIMOTHY F. GEITHNER, STRESS TEST: REFLECTIONS ON FINANCIAL CRISES 150 (2014) ("[Bear Stearns] was completely unmeshed in the fabric of the system. It had nearly four hundred subsidiaries. It had trading positions with five thousand counterparties around the world. And it had borrowed about $80 billion in the tri-party repo market, presenting ... risks of runs on money markets and investment banks.").

[39] *See* BD. OF GOV. OF THE FED. RES. SYS., *supra* note 32. This bridge loan was extended to Bear Stearns through JP Morgan, the clearing bank between Bear Stearns and its repo lenders. *Id*.; BERNANKE, *supra* note 34 at 214. The loan was secured by Bear Stearns assets valued at $13.8 billion and was repaid on March 17, 2008. BD. OF GOV. OF THE FED. RES. SYS., *supra* note 32.

[40] *Id*.

Section 13(3) authority, creating an entity called Maiden Lane LLC and lending it roughly $29 billion to purchase certain mortgage assets from Bear Stearns.[41]

Although the Bear Stearns rescue temporarily calmed markets,[42] similar troubles surfaced later in 2008 at Lehman Brothers (Lehman), the nation's fourth largest investment bank at the time.[43] Over the weekend of September 12, the New York Fed attempted to coordinate a private-sector solution that would avert a Lehman bankruptcy.[44] During these negotiations, regulators took the position that no government money would be committed to rescuing Lehman, unlike the case of Bear Stearns six months earlier.[45]

The government's attempts to broker an acquisition of Lehman ultimately failed. Bank of America, one of the potential acquirers, purchased the also-troubled investment bank Merrill Lynch instead.[46] British regulators of Barclays, another potential purchaser, refused to approve a proposed deal without a shareholder vote.[47] Unable to secure government support or find a private buyer, Lehman declared bankruptcy on September 15, 2008.[48]

Lehman's bankruptcy reverberated throughout financial markets. On September 15, the Dow Jones Industrial Average dropped more than 500 points, its worst single-day decline in seven years.[49] Shares of Goldman Sachs and Morgan Stanley, two of the largest remaining investment banks, lost an eighth of their value.[50] Lehman's bankruptcy also precipitated a "run" on money

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[41] *Id*.; BERNANKE, *supra* note 34 at 219 (explaining that JP Morgan CEO Jamie Dimon "had made clear" that without government assistance, "the deal would be too big and too risky for JP Morgan"); GEITHNER, *supra* note 38 at 153 (explaining that JP Morgan had refused to acquire Bear Stearns without government assistance).

The Maiden Lane transaction was formally structured as a loan to comply with Section 13(3) of the Federal Reserve Act. However, some commentators have argued that the transaction exceeded the scope of the Federal Reserve's Section 13(3) authority because "the primary goal of the transaction was to remove ... assets from Bear Stearns's balance sheet," meaning that it functioned more like an asset purchase (which is not allowed under Section 13(3)) than a loan. *See* Alexander Mehra, *Legal Authority in Unusual and Exigent Circumstances: The Federal Reserve and the Financial Crisis*, 13 U. PA. J. BUS. L. 221, 238 (2010).

JP Morgan also extended a loan of roughly $1 billion to Maiden Lane LLC, which was subordinated to the loan made by the Federal Reserve. BD. OF GOV. OF THE FED. RES. SYS., *supra* note 32. Maiden Lane LLC fully repaid its loans from the Federal Reserve on June 14, 2012. *See Maiden Lane Transactions*, FED. RES. BANK OF NEW YORK, https://www.newyorkfed.org/markets/maidenlane.html#tabs-1.

[42] BERNANKE, *supra* note 34 at 226; FINANCIAL CRISIS REPORT, *supra* note 18 at 292.

[43] FINANCIAL CRISIS REPORT, *supra* note 18 at 327-31; David Teather, Andrew Clark & Jill Treanor, *Barclays Agrees $1.75bn Deal for Core Lehman Brothers Business*, THE GUARDIAN (Sept. 16, 2008), https://www.theguardian.com/business/2008/sep/17/barclay.lehmanbrothers1.

While troubles at Lehman did not boil over until September 2008, policymakers reportedly "had been pressing [it] to raise more capital for at least a year." BERNANKE, *supra* note 34 at 252. However, because Lehman was an investment bank, neither the Federal Reserve nor the FDIC had the authority to compel it to raise capital. *Id*. ("If Lehman had been a midsize commercial bank, forcing [it] to raise more capital would have been straightforward: Either the company met the supervisor's expectations or the FDIC would have taken it over and paid off the depositors as necessary. But neither the Fed nor the FDIC had the authority to take over Lehman ... Legally, the government's only alternative, if Lehman couldn't find new capital, would have been trying to force the firm into bankruptcy.").

[44] CARNELL, ET AL., *supra* note 16 at 35.

[45] CARNELL, ET AL., *supra* note 16 at 35; GEITHNER, *supra* note 38 at 178; FINANCIAL CRISIS REPORT, *supra* note 18 at 334.

[46] FINANCIAL CRISIS REPORT, *supra* note 18 at 337.

[47] *Id*. at 335-37.

[48] CARNELL, ET AL., *supra* note 16 at 35.

[49] BERNANKE, *supra* note 34 at 270.

[50] *Id*.

market funds.[51] The Reserve Primary Fund, a large fund that had invested in Lehman's commercial paper, "broke the buck," meaning that its asset value per share fell below $1.[52] Because money market investors had come to expect that fund shares would always be worth $1, the troubles at the Reserve Primary Fund precipitated a $300 billion "run" on other funds, threatening a key source of short-term financing for large and medium-sized companies.[53]

Also in September 2008, American International Group (AIG)—the nation's largest insurance company at the time—came under heavy financial pressure.[54] During the real estate boom, one of AIG's affiliates had accumulated significant exposure to the housing market by selling "credit default swaps" (CDSs) on mortgage bonds, which provided their purchasers with credit protection in the event that the bonds defaulted.[55] On September 15, the day Lehman declared bankruptcy, AIG suffered a credit rating downgrade that required it to post margin on its CDS obligations.[56] Later that day, AIG informed the New York Fed that it was unable to access the commercial paper market in order to meet the margin call.[57] As it had done with Bear Stearns, the Federal Reserve invoked its Section 13(3) authority to rescue AIG, reasoning that an AIG bankruptcy would have devastating effects on the financial system.[58] On September 16, the Federal Reserve announced that it would provide AIG with an $85 billion credit line in exchange for a 79.9 percent stake in the firm.[59]

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[51] CARNELL, ET AL., *supra* note 16 at 35.

[52] *Id*.

[53] *Id*.; GEITHNER, *supra* note 38 at 195.

[54] CARNELL, ET AL., *supra* note 16 at 35; FINANCIAL CRISIS REPORT, *supra* note 18 at 344-52.

[55] CARNELL, ET AL., *supra* note 16 at 35, 50. As an insurance company, AIG's operations were primarily overseen by state regulators—specifically, the New York State Insurance Department. FINANCIAL CRISIS REPORT, *supra* note 18 at 345. However, AIG's holding company (including its foreign operations and non-insurance businesses) was not subject to oversight by insurance regulators. BERNANKE, *supra* note 34 at 271-72. Rather, because AIG's holding company owned a small savings-and-loan company, it fell within the regulatory purview of the federal Office of Thrift Supervision (OTS). *Id*. Dodd-Frank eliminated the OTS, 12 U.S.C. § 5413, and transferred its functions and powers to the Office of the Comptroller of the Currency, the FDIC, and the Federal Reserve, *id*. § 5412.

In addition to losses on its CDS portfolio, AIG also experienced large losses related to its securities lending business. *See* Robert McDonald & Anna Paulson, *AIG in Hindsight*, FED. RES. BANK OF CHICAGO 10-12 (Oct. 2014), https://www.chicagofed.org/~/media/publications/working-papers/2014/wp2014-07-pdf.pdf. In a securities lending transaction, one party borrows a security (often as part of a short-selling strategy, or to deliver a security to a customer) from another party and deposits collateral (typically cash) with the securities lender. *Id*. at 10. The securities lender often invests the cash collateral in short-term, highly liquid securities because lending agreements are generally callable on demand. *Id*. at 10-11. However, AIG invested a substantial portion of its cash collateral in longer-term, illiquid assets such as mortgage-backed securities, making it vulnerable to a "run." *Id*. at 11. After AIG announced a large quarterly loss in August 2008, a number of its securities lending counterparties terminated their lending agreements, forcing AIG to liquidate its longer-term assets at significantly discounted prices. *Id*. at 11-12.

[56] CARNELL, ET AL., *supra* note 16 at 35.

[57] FINANCIAL CRISIS REPORT, *supra* note 18 at 349.

[58] BERNANKE, *supra* note 34 at 283 ("[AIG's] failure would create chaos in so many ways: by raising doubts about the solvency of its creditors and derivative counterparties ... ; by imposing losses on holders of its commercial paper ... ; and by draining available cash from state funds set up to protect customers of failing insurance companies."); GEITHNER, *supra* note 38 at 191 ("The more our Fed team studied AIG and the insolvency regime for insurers, the less confidence they had in the potential for an orderly resolution ... Virtually every major financial institution in the world had some exposure to AIG."); FINANCIAL CRISIS REPORT, *supra* note 18 at 350 (quoting a press release from the Federal Reserve explaining that "a disorderly failure of AIG could add to already significant levels of financial market fragility and lead to substantially higher borrowing costs, reduced household wealth, and materially weaker economic performance.").

[59] FINANCIAL CRISIS REPORT, *supra* note 18 at 350. David S. Hilzenrath & Glenn Kessler, *U.S. Seizes Control of AIG With $85 Billion Emergency Loan*, WASH. POST. (Sept. 17, 2008), http://www.washingtonpost.com/wp-dyn/content/
(continued...)

In the fall of 2008, troubles at other large institutions rocked financial markets. Fannie Mae and Freddie Mac—government-sponsored enterprises that purchased and guaranteed mortgage loans and securities—were placed into conservatorships.[60] The FDIC took over Washington Mutual, the nation's third largest mortgage lender, and sold it to JP Morgan.[61] Goldman Sachs and Morgan Stanley, the two largest remaining investment banks, converted to bank holding companies to assure themselves continued access to the Federal Reserve's "discount window," among other reasons.[62] Numerous European financial institutions suffered "runs."[63] In October 2008, President George W. Bush signed the Emergency Economic Stabilization Act.[64] The Act established the Troubled Asset Relief Program (TARP),[65] pursuant to which the federal government would eventually disburse over $400 billion in the form of investments in financial institutions and the automotive industry, among other things.[66]

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article/2008/09/16/AR2008091602174_3.html. The Federal Reserve's loans to AIG were fully repaid in June 2012. *New York Fed Announces Full Repayment of its Loans to Maiden Lane LLC and Maiden Lane III LLC*, FED. RES. BANK OF NEW YORK (June 14, 2012), https://www.newyorkfed.org/newsevents/news/markets/2012/an120614.html.

The reasons why regulators allowed Lehman but not Bear Stearns or AIG to fail remain contested. In the weeks after Lehman filed for bankruptcy, Bernanke testified that while "[t]he failure of Lehman posed risks," the bank's difficulties "had been well known for some time," and the market was accordingly prepared to deal with its failure. FINANCIAL CRISIS REPORT, *supra* note 18 at 340. Bernanke and then-President of the New York Fed Timothy Geithner have subsequently asserted that unlike Bear Stearns and AIG, Lehman did not have sufficient collateral to allow the Federal Reserve to lend pursuant to its Section 13(3) authority. *See id.*; BERNANKE, *supra* note 34 at 226, 287-88; GEITHNER, *supra* note 38 at 185, 187, 206-07.

This claim has been the subject of much debate. *See* LAURENCE M. BALL, THE FED AND LEHMAN BROTHERS: SETTING THE RECORD STRAIGHT ON A FINANCIAL DISASTER (forthcoming, 2018); James B. Stewart & Peter Eavis, *Revisiting the Lehman Brothers Bailout That Never Was*, N.Y. TIMES (Sept. 29, 2014), https://www.nytimes.com/2014/09/30/business/revisiting-the-lehman-brothers-bailout-that-never-was.html; FINANCIAL CRISIS REPORT, *supra* note 18 at 340-41; James Surowiecki, *Explaining the Decision to Let Lehman Fail*, THE NEW YORKER (Jan. 22, 2009), https://www.newyorker.com/business/james-surowiecki/explaining-the-decision-to-let-lehman-fail.

Critics of the decision to allow Lehman to fail note that by its terms, Section 13(3) requires only that loans to non-banks be "secured to the satisfaction of the Federal Reserve," as opposed to fully secured. FINANCIAL CRISIS REPORT, *supra* note 18 at 340-41. The Financial Crisis Inquiry Commission, a ten-member commission charged with investigating the crisis by the Fraud Enforcement and Recovery Act, P.L. 111-21 (2009), concluded that regulators declined to rescue Lehman "for a variety of reasons, including the lack of a private firm willing and able to acquire it, uncertainty about Lehman's potential losses, concerns about moral hazard and political reaction, and erroneous assumptions that Lehman's failure would have a manageable impact on the financial system." FINANCIAL CRISIS REPORT, *supra* note 18 at 343.

[60] FINANCIAL CRISIS REPORT, *supra* note 18 at 309.

[61] CARNELL, ET AL., *supra* note 16 at 35.

[62] *As Goldman and Morgan Shift, a Wall St. Era Ends*, N.Y. TIMES DEALBOOK (Sept. 21, 2008), https://dealbook.nytimes.com/2008/09/21/goldman-morgan-to-become-bank-holding-companies/. The "discount window" is the program pursuant to which the Federal Reserve serves as a "lender of last resort," allowing banks to borrow in order to meet temporary liquidity needs, generally at a penalty rate of interest. *See* 12 U.S.C. § 343(2). During the crisis, the Federal Reserve opened the "discount window" to investment banks. *Id*. However, the Federal Reserve had indicated that such access was only temporary when Goldman Sachs and Morgan Stanley converted to bank holding companies. *Id*.

[63] CARNELL, ET AL., *supra* note 16 at 35-6.

[64] P.L. 110-343, 122 Stat. 3765 (2008).

[65] 12 U.S.C. § 5211.

[66] Jonathan Weisman, *U.S. Declares Bank and Auto Bailouts Over, and Profitable*, N.Y. TIMES (Dec. 19, 2014), https://www.nytimes.com/2014/12/20/business/us-signals-end-of-bailouts-of-automakers-and-wall-street.html. *See also TARP Programs*, U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/Pages/default.aspx.

The troubles in the financial system also spilled over to the real economy. U.S. households lost an estimated 26 percent of their wealth ($17 trillion) between mid-2007 and early 2009.[67] And between 2008 and December 2009, the economy lost an estimated 8.3 million jobs.[68]

In response to the crisis, Congress passed and President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank),[69] legislation that some commentators characterized as "the most ambitious overhaul of financial regulation in generations."[70] Among other things, Dodd-Frank reformed certain aspects of securities and derivatives markets,[71] imposed a variety of requirements related to mortgage standards,[72] and created a new federal agency tasked with consumer financial protection (the Consumer Financial Protection Bureau).[73] Other portions of Dodd-Frank are specifically directed at the systemic risk created by TBTF financial institutions. In order to minimize the risks that large financial institutions like Lehman and AIG fail, Title I of Dodd-Frank establishes an enhanced prudential regulatory regime for certain large bank holding companies and non-bank financial companies.[74] And in order to resolve systemically important financial institutions in the event that they nevertheless experience financial distress, Title II establishes a new resolution regime available for such institutions outside of the Bankruptcy Code.[75] The remaining sections of this report discuss the legal issues raised by Titles I and II, their implementation by federal regulatory agencies, and proposals to reform them.

Title I: Enhanced Prudential Standards for Systemically Important Financial Institutions

Regulators have traditionally relied upon a variety of tools to minimize the risks of financial institution failures. In order to reduce the risk of insolvency, regulators have imposed capital requirements on commercial and investment banks.[76] In order to reduce depositors' incentives to

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[67] William R. Emmons & Bryan J. Noeth, *Household Financial Stability: Who Suffered the Most from the Crisis?*, FED. RES. BANK OF ST. LOUIS (July 2012), https://www.stlouisfed.org/publications/regional-economist/july-2012/household-financial-stability—who-suffered-the-most-from-the-crisis#endnotes.

[68] FINANCIAL CRISIS REPORT, *supra* note 18 at 390.

[69] P.L. 111-203, 124 Stat. 1376 (2010).

[70] Brady Dennis, *Congress passes financial reform bill*, WASH. POST. (July 16, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/07/15/AR2010071500464.html.

[71] 15 U.S.C. § 78o-11; P.L. 111-203, tit. VII, XVI. *See also* CRS Legal Sidebar LSB10077, The Half Trillion Dollar Ruling: Latest Dodd-Frank Case Narrows "Skin-in-the-Game" Rule, by Jay B. Sykes.

[72] P.L. 111-203, tit. XIV.

[73] *Id*. tit., X. For a high-level overview of Dodd-Frank, *see* CRS Report R41350, The Dodd-Frank Wall Street Reform and Consumer Protection Act: Background and Summary, coordinated by Baird Webel.

[74] P.L. 111-203, tit. I.

[75] *Id*., tit. II.

[76] *See* 12 C.F.R. part 3, appendix A (imposing capital requirements on national banks), § 208.4(a) (imposing capital requirements on members of the Federal Reserve System), part 217 (imposing capital requirements on bank holding companies), parts 324-325 (imposing capital requirements on institutions insured by the Federal Deposit Insurance Corporation); 17 C.F.R. § 240.15c3-1(a) (imposing capital requirements on securities brokers and dealers). *See also* CARNELL, ET AL., *supra* note 16 at 204-14, 238-66.

Federal regulators have also imposed liquidity requirements on commercial banks. *See* 12 C.F.R. part 50 (imposing liquidity requirements on national banks), part 249 (imposing liquidity requirements on members of the Federal Reserve System), part 329 (imposing liquidity requirements on institutions insured by the Federal Deposit Insurance Corporation). Likewise, state insurance regulators have adopted capital requirements and limitations on permissible (continued...)

"run," regulators require all commercial banks to obtain minimum levels of deposit insurance from the Federal Deposit Insurance Corporation (FDIC).[77] In order to address liquidity problems, the Federal Reserve has the authority to serve as a "lender of last resort" by making "discount window" loans to commercial banks.[78] Moreover, the Federal Reserve can lend to non-banks in "unusual and exigent circumstances" pursuant to its authority under Section 13(3) of the Federal Reserve Act.[79] However, as the 2007-2009 financial crisis arguably demonstrated, sometimes these measures have proven insufficient to prevent financial institution failures.

In response to these concerns, Title I of Dodd-Frank establishes an enhanced prudential regulatory regime for certain large financial institutions.[80] Specifically, the Title I regime applies to (1) all bank holding companies with total consolidated assets of $50 billion or more, and (2) any non-bank financial companies[81] that the Financial Stability Oversight Council (FSOC)[82]

(...continued)

investments for insurance companies. *See* CARNELL, ET AL., *supra* note 16 at 658-59.

[77] *See* 12 C.F.R. § 5.20(e)(3); MICHAEL S. BARR, HOWELL E. JACKSON & MARGARET E. TAHYAR, FINANCIAL REGULATION: LAW AND POLICY 166 (2016).

[78] *See* 12 U.S.C. § 343(2). Ordinarily, the volume of "discount window" lending is low because (1) the Federal Reserve generally charges a "penalty" interest rate, and (2) obtaining "discount window" loans from the Federal Reserve may be stigmatizing. *See* CARNELL, ET AL., *supra* note 16 at 221. However, during a crisis, the Federal Reserve often lowers the penalty rate of interest and accepts collateral that it might reject in normal times. *Id*.

[79] *See* 12 U.S.C. § 343(3) (2006). While not the focus of this report, the Federal Reserve's use of its emergency lending power to lend to non-banks during the 2007-2009 financial crisis generated controversy, leading to certain changes to Section 13(3) of the Federal Reserve Act. *See generally* CRS Report R44185, Federal Reserve: Emergency Lending, by Marc Labonte; Mehra, *supra* note 41. Specifically, Dodd-Frank provides that (1) the Treasury Secretary must approve any loans made by the Federal Reserve pursuant to its Section 13(3) authority, (2) such loans may be made only as part of "a program or facility with broad-based eligibility," as opposed to only specific firms, and (3) the security for any such loans must be sufficient to protect taxpayers from losses. *See* 12 U.S.C. § 343(3).

[80] 12 U.S.C. § 5365.

[81] Title I defines a "nonbank financial company" as a "U.S. nonbank financial company" or "foreign nonbank financial company." *Id*. § 5311(a)(4)(C). A "U.S. nonbank financial company" is a company (other than a banking holding company, Farm Credit System institution, national securities exchange, clearing agency, security-based swap execution facility, security-based swap data repository, or derivatives clearing organization) that is (1) incorporated under the laws of the United States or any state, and (2) predominantly engaged in financial activities. *Id*. § 5311(a)(4)(B). A "foreign nonbank financial company" is a company (other than a bank holding company) that is (1) incorporated or organized in a country other than the United States, and (2) predominantly engaged in financial activities. *Id*. § 5311(a)(4)(A).

A company is "predominantly engaged" in financial activities if (1) the annual gross revenues derived by the company and all of its subsidiaries related to activities that are "financial in nature" represents 85 percent or more of the consolidated gross revenues of the company, or (2) the consolidated assets of the company and all of its subsidiaries related to activities that are "financial in nature" represent 85 percent or more of the consolidated gross revenues of the company. *Id*. § 5311(a)(6).

For purposes of this definition, the following activities (among others) are considered "financial in nature": (1) lending, exchanging, transferring, investing for others, or safeguarding money or securities, (2) insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing, (3) providing financial, investment, or economic advisory services, (4) issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly, (5) underwriting, dealing in, or making a market in securities. *See id*. § 1843(k)(4).

[82] FSOC is an umbrella regulatory body created by Dodd-Frank, whose voting members consist of the heads of nine federal regulatory agencies and an independent insurance expert. *Id*. § 5321(a)-(b). FSOC's voting members are the heads of the Federal Reserve Board of Governors, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Commodity Futures Trading Commission, Securities and Exchange Commission, National Credit Union Administration, Federal Housing Finance Agency, Consumer Financial Protection Bureau, and an independent insurance expert. *Id*. § 5321(b)(1). FSOC also includes five non-voting members: the director of the Office of Financial Research, the director of the Federal Insurance Office, a state banking supervisor, a state insurance commissioner, and (continued...)

designates as systemically important.[83] Section 165 of Dodd-Frank directs the Federal Reserve to impose prudential standards on these institutions that "are more stringent than" those applicable to other bank holding companies and non-bank financial companies, and that "increase in stringency" based on certain statutorily-prescribed considerations.[84] These enhanced standards include

1. risk-based capital requirements and leverage limits;[85]
2. liquidity requirements;[86]
3. overall risk management requirements;[87]
4. a requirement that the relevant companies develop resolution plans (so-called "living wills") describing how they can be rapidly resolved in the event of material distress or failure;[88] and
5. credit exposure reporting requirements.[89]

Congress is currently considering whether to change the first basis for imposition of enhanced prudential regulations on financial institutions—the automatic $50 billion threshold for bank holding companies.[90] That policy question is addressed in another recent Congressional Research Service report.[91] This section of the report accordingly provides a legal overview of (1) FSOC's process for designating non-banks as systemically important and FSOC's designations to date, (2) criticisms of FSOC's designation process and responses, and (3) proposals to reform FSOC's designation process.

Designation of Non-Banks for Enhanced Prudential Regulation

Dodd-Frank Section 113 and FSOC Guidance

As discussed, during the 2007-2009 financial crisis, troubles at certain non-bank financial firms (such as Lehman and AIG) "contributed to a broad seizing up of financial markets and stress at

(...continued)

a state securities regulator. *Id*. § 5321(b)(2).

The statutory purposes of FSOC are to (1) identify risks to the financial stability of the United States, (2) promote market discipline by eliminating expectations of government bailouts, and (3) respond to emerging threats to the stability of the United States financial system. *Id*. § 5322(a)(1). For a more detailed overview of FSOC's structure and authorities, see CRS Report R45052, Financial Stability Oversight Council (FSOC): Structure and Activities, by Jeffrey M. Stupak.

[83] *Id*. § 5365(a)(1).

[84] *Id*.

[85] *Id*. § 5365(b)(1)(A)(i).

[86] *Id*. § 5365(b)(1)(A)(ii).

[87] *Id*. § 5365(b)(1)(A)(iii).

[88] *Id*. § 5365(d)(1).

[89] *Id*. § 5365(b)(1)(A)(iv). For an overview of the Federal Reserve's implementation of these enhanced prudential standards, and legislative proposals to change Dodd-Frank's $50 billion threshold for enhanced supervision for bank holding companies, see CRS Report R45036, Bank Systemic Risk Regulation: The $50 Billion Threshold in the Dodd-Frank Act, by Marc Labonte and David W. Perkins.

[90] The Economic Growth, Regulatory Relief, and Consumer Protection Act, S. 2155, 115th Cong. (2017), which passed the Senate on March 14, 2018, would raise this threshold to $250 billion.

[91] *See* Labonte & Perkins, *supra* note 89.

other financial firms."[92] Accordingly, in the aftermath of the crisis, the Obama Administration proposed creating a council to identify non-bank financial companies whose failure could pose a threat to financial stability and subjecting them to consolidated supervision by the Federal Reserve irrespective of their legal structure.[93] Section 113 of Dodd-Frank implemented this recommendation, creating FSOC and granting it the authority to designate certain non-bank financial companies for enhanced supervision by the Federal Reserve.[94]

Section 113 provides that FSOC may, by a vote of at least two-thirds of its voting members (which must include the Treasury Secretary in the majority), designate non-bank financial companies as systemically important under either of *two standards*:

1. when "material financial distress" at a non-bank financial company "could pose a threat to the financial stability of the United States," or
2. when the "nature, scope, size, scale, concentration, interconnectedness, or mix of the [non-bank financial company's] activities" could pose that same threat.[95]

In making such a designation, FSOC must consider, among any other risk-related factors that FSOC deems appropriate, the following factors:

- the company's leverage;
- the extent and nature of its off-balance-sheet exposures;
- the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies;
- the importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities;
- the extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse;
- the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;
- the degree to which the company is already regulated by 1 or more primary financial regulatory agencies;
- the amount and nature of the financial assets of the company;
- the amount and types of the liabilities of the company, including the degree of reliance on short-term funding.[96]

Dodd-Frank requires that FSOC provide a non-bank financial company with written notice of a proposed systemic risk designation, including an explanation for the basis of the proposed

[92] Final Rule and Interpretive Guidance, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 70 Fed. Reg. 21,637, 21,637 (Apr. 11, 2012) [hereinafter "Non-Bank Designation Rule"].

[93] FINANCIAL REGULATORY REFORM: A NEW FOUNDATION, U.S. DEP'T OF THE TREASURY 20 (Oct. 8, 2009), https://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

[94] 12 U.S.C. § 5323(a)(1). Dodd-Frank does not use the term "systemically important" to describe non-banks subject to enhanced supervision. However, for purposes of brevity, this report will refer to such institutions as "systemically important."

[95] *Id*.

[96] *Id*. § 5323(a)(2).

determination.[97] A non-bank that receives a notice of a proposed determination has 30 days to request an opportunity for a written or oral hearing before FSOC to contest the proposed determination, and FSOC has 60 days after such hearing to notify the non-bank financial company of its final determination.[98] Once that determination is made, the designated non-bank is subject to the enhanced prudential regulatory regime.

A designated company can then seek judicial review of FSOC's final determination within 30 days in either the U.S. district court for the judicial district in which its home office is located, or in the U.S. District Court for the District of Columbia.[99] The court's review is limited to whether FSOC's determination was "arbitrary and capricious,"[100] a standard pursuant to which a court evaluates whether an agency:

> has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it cannot be ascribed to a difference in view of the product of agency expertise.[101]

FSOC is required to annually re-evaluate systemic risk designations for non-bank financial companies and may rescind such designations upon a vote of two-thirds of its voting members that includes the Treasury Secretary.[102]

In April 2012, FSOC issued guidance concerning the Title I designation process and standards for non-banks.[103] In the guidance, FSOC organized the 10 statutory factors guiding systemic risk designations into six "categories" of considerations:

1. interconnectedness;
2. substitutability (i.e., the extent to which other firms could timely provide similar financial services at a similar price and quantity if a non-bank financial company withdrew from a particular market);
3. size;
4. leverage;
5. liquidity risk and maturity mismatch; and
6. existing regulatory scrutiny.[104]

FSOC explained that the first three categories "seek to assess the potential for spillovers from [a] firm's distress," while the remaining three categories "seek to assess how vulnerable a company is to financial distress."[105]

The guidance further provided that FSOC intends to assess how a non-bank's financial stress could be transmitted to other firms or markets through any of three "transmission channels":

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97 *Id*. § 5323(e)(1).

98 *Id*. § 5323(e)(2)-(3). Upon a two-thirds vote that includes the Treasury Secretary, FSOC may waive these requirements if it determines "that such waiver or modification is necessary or appropriate to prevent or mitigate threats posed by the nonbank financial company to the financial stability of the United States." *Id*. § 5323(f)(1).

99 *Id*. § 5323(h).

100 *Id*.

101 Motor Vehicles Mfrs. v. State Farm Mut. Auto. Ins., 463 U.S. 29, 43 (1983).

102 12 U.S.C. § 5323(d).

103 Non-Bank Designation Rule, *supra* note 92.

104 *Id*. at 21,641.

105 *Id*.

1. exposure (i.e., the extent to which creditors, counterparties, investors, or other market participants are exposed to the company);
2. asset liquidation (i.e., whether the company holds assets that, if liquidated quickly, would cause a fall in asset prices); and
3. critical function or service (i.e., whether the company provides a critical function or service that is relied upon by market participants and for which there are no ready substitutes).[106]

The FSOC guidance also outlined a three-stage process for systemic risk designations.[107] FSOC explained that during Stage 1, it will apply "a set of uniform quantitative metrics ... to a broad group" of non-bank financial companies in order to identify companies "for further evaluation."[108] According to the guidance, during Stage 2, FSOC will apply "a wide range of quantitative and qualitative information" about the companies identified in Stage 1, and "begin the consultation process" with the company's "primary financial regulatory agencies or home country supervisors."[109] After Stage 2 is completed, companies selected for additional review are notified that they are being considered for designation as systemically important.[110] Finally, during Stage 3, FSOC will evaluate information collected from the company under consideration, in addition to information considered during Stages 1 and 2, and will decide whether to make a proposed determination that the company be subject to enhanced supervision.[111]

Non-Bank Designations to Date

To date, FSOC has designated four non-bank financial companies for enhanced supervision: AIG, General Electric Capital Corporation (GE Capital), Prudential Financial (Prudential), and MetLife.[112] However, FSOC later rescinded the designations of two of these entities—AIG and GE Capital—based on changed circumstances at those companies.[113] Further, MetLife successfully challenged its designation by FSOC in federal district court, leaving Prudential as the only non-bank financial company subject to the enhanced prudential regulatory regime at the time

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106 *Id*.

107 *Id*. at 21,660.

108 *Id*.

109 *Id*.

110 *Id*.

111 *Id*. In February 2015, FSOC issued additional supplemental procedures relating to its designations of non-banks for enhanced supervision. *See* Fin. Stability Oversight Council Supplemental Procedures Relating to Nonbank Financial Company Determinations, U.S. DEP'T OF THE TREASURY (Feb. 4, 2015), https://www.treasury.gov/initiatives/fsoc/designations/Documents/Supplemental%20Procedures%20Related%20to%20Nonbank%20Financial%20Company%20Determinations%20-%20February%202015.pdf. FSOC indicated that pursuant to the supplemental procedures, it will notify a non-bank financial company within 30 days after it forms an analytical team to commence active review of a company in Stage 2 (as opposed to after the company is advanced to Stage 3). *Id*. at 2. A company under active review in Stage 2 may submit to FSOC any information it deems relevant, and may meet with FSOC's analytical team. *Id*. FSOC also indicated that it intends to publicly confirm a company's announcement that it is under active review in Stage 2, or that it has been advanced to Stage 3. *Id*. at 4.

112 *See Designations*, FIN. STABILITY OVERSIGHT COUNCIL, U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx (last visited Apr. 9, 2018).

113 *See* "AIG" and "GE Capital" *infra*.

of publication of this report.[114] The following subsections of the report discuss the designations of each of these institutions as illustrations of how FSOC has implemented its designation authority.

AIG

FSOC designated AIG for enhanced supervision in July 2013.[115] In designating AIG, FSOC explained that although a large number of the company's insurance products (such as life insurance and annuities) are intended to be long-term liabilities, many also contain "features that could make them vulnerable to rapid and early withdrawals by policyholders."[116] FSOC further explained that if AIG were to encounter sufficiently severe stress, "funds from products allowing for early withdrawals might be withdrawn regardless of the size of associated surrender charges or tax penalties," forcing AIG to "liquidate a substantial portion of its large portfolio of relatively illiquid corporate and foreign bonds, as well as asset-backed securities."[117] Such an asset liquidation could, in FSOC's view, have disruptive effects on financial markets and "cause financial contagion if the negative sentiment and uncertainty associated with material distress at AIG spread[] to other insurers."[118] FSOC also concluded (1) that "[a] large number of corporate and financial entities have significant exposures to AIG,"[119] (2) that because AIG was the leading commercial insurance underwriter in the U.S., its exit from the marketplace "could reduce the availability and affordability of certain insurance products,"[120] and (3) that AIG's "highly complex" interstate and cross-border structure complicated its resolvability, further aggravating the effects that its financial distress could have on financial stability.[121] AIG did not contest FSOC's designation.[122]

After an annual re-evaluation required by Dodd-Frank, FSOC voted to rescind its designation of AIG in September 2017.[123] In rescinding its designation, FSOC explained that AIG had reduced the amounts of its total debt, short-term debt, derivatives portfolio, securities lending, repos, and total assets.[124] FSOC further indicated that additional analyses conducted for the purposes of its re-evaluation, "including additional consideration of the effects of incentives and disincentives for [AIG's] policyholders to surrender their life insurance policies and annuities," indicated "that there is not a significant risk that a forced asset liquidation by AIG would disrupt market functioning."[125] FSOC also noted that AIG had sold certain businesses, "reduced its multi-

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[114] *See* "Prudential" and "MetLife" *infra*.

[115] *Basis of the Financial Stability Oversight Council's Final Determination Regarding American International Group, Inc.*, U.S. DEP'T OF THE TREASURY (July 8, 2013), https://www.treasury.gov/initiatives/fsoc/designations/Documents/Basis%20of%20Final%20Determination%20Regarding%20American%20International%20Group,%20Inc.pdf.

[116] *Id*. at 2.

[117] *Id*.

[118] *Id*. at 2-3.

[119] *Id*. at 6.

[120] *Id*. at 8.

[121] *Id*. at 10-11.

[122] *Id*. at 1.

[123] *Notice and Explanation of the Basis for the Financial Stability Oversight Council's Rescission of Its Determination Regarding American International Group, Inc. (AIG)*, U.S. DEP'T OF THE TREASURY (Sept. 29, 2017), https://www.treasury.gov/initiatives/fsoc/designations/Documents/American_International_Group,_Inc._(Rescission).pdf.

[124] *Id*. at 5.

[125] *Id*.

jurisdictional operations, simplified its legal structure, and reduced its size and global footprint," making it "notably different from the company as it existed leading up to the financial crisis."[126]

GE Capital

On the same day it designated AIG for enhanced supervision, FSOC similarly designated GE Capital, a savings-and-loan holding company and wholly owned subsidiary of the General Electric Company.[127] In designating GE Capital, FSOC explained that the company was one of the largest financial holding companies in the United States and "a significant source of credit to the U.S. economy."[128] FSOC further observed that large global banks and non-bank financial companies had significant exposure to GE Capital through their purchase of its commercial paper and long-term debt, and provision of backup lines of credit.[129] Financial distress at GE Capital, FSOC reasoned, could trigger "runs" on money market funds that would in turn "impair the ability of financial and other firms to fund their operations."[130] FSOC also concluded that GE Capital's interstate and cross-border structure, coupled with its intercompany funding and shared service agreements, complicated its resolvability.[131] GE Capital did not contest FSOC's designation.[132]

After an annual re-evaluation required by Dodd-Frank, FSOC rescinded its designation of GE Capital in June 2016, explaining that since its designation, GE Capital had "fundamentally changed its business ... [t]hrough a series of divestitures, a transformation of its funding model, and a corporate reorganization."[133] Moreover, FSOC noted that since its designation, GE Capital had decreased its total assets by more than 50 percent, shifted away from short-term debt, and reduced its interconnectedness with large financial institutions.[134] Finally, FSOC observed that as a result of divestitures and changes to its business, GE Capital no longer owned any U.S. depository institutions, nor did it provide financing to consumers or small business customers.[135]

Prudential

Slightly less than two months after designating AIG and GE Capital, FSOC designated Prudential, a large financial services company and one of the largest U.S. insurers, for enhanced supervision.[136] In designating Prudential, FSOC explained that "[c]orporations, banks, and

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[126] *Id*. at 5, 7.

[127] *Basis of the Financial Stability Oversight Council's Final Determination Regarding General Electric Capital Corporation, Inc.*, U.S. DEP'T OF THE TREASURY (July 8, 2013), https://www.treasury.gov/initiatives/fsoc/designations/Documents/
Basis%20of%20Final%20Determination%20Regarding%20General%20Electric%20Capital%20Corporation,%20Inc.pdf.

[128] *Id*. at 2.

[129] *Id*.

[130] *Id*.

[131] *Id*. at 10-11.

[132] *Id*. at 1.

[133] *Basis of the Financial Stability Oversight Council's Rescission of Its Determination Regarding GE Capital Global Holdings, LLC*, U.S. DEP'T OF THE TREASURY (June 28, 2016), https://www.treasury.gov/initiatives/fsoc/designations/Documents/GE%20Capital%20Public%20Rescission%20Basis.pdf.

[134] *Id*. at 2.

[135] *Id*.

[136] *Basis of the Financial Stability Oversight Council's Final Determination Regarding Prudential Financial, Inc.,* U.S. DEP'T OF THE TREASURY (Sept. 19, 2013), https://www.treasury.gov/initiatives/fsoc/designations/Documents/
(continued...)

pension plans have exposures to Prudential through retirement and pension products, corporate- and bank-owned life insurance, and other group insurance products."[137] Moreover, FSOC reasoned that Prudential's capital market activities—specifically, its derivatives activities, use of credit lines from large banks, securities lending, and reverse repo portfolio—further "expand[ed] its connections to other financial firms and markets."[138]As with AIG, FSOC reasoned that if Prudential faced pressure to rapidly liquidate its illiquid assets to meet withdrawals, securities markets could face significant disruptions, and other insurance companies could face "runs" of their own triggered by heightened uncertainty.[139] FSOC also concluded that because of its multi-state and cross-border operations, and because there was "no precedent for the resolution of an insurance company the size and scale of Prudential," the company would likely be difficult to resolve in an orderly fashion.[140] Prudential requested a hearing to contest FSOC's proposed determination, and FSOC made its final determination after reviewing Prudential's written submissions and holding an oral hearing.[141]

As a result of FSOC's rescission of its designations of AIG and GE Capital, and a decision by the U.S. District Court for the District of Columbia overturning MetLife's designation (discussed in "MetLife" *infra*), Prudential remains the only non-bank financial company designated for enhanced supervision as of the publication of this report. However, in February 2018, Prudential announced that FSOC was in the process of conducting its annual review of its designation, and that the company intended to make its case that it does not meet the statutory standards for designation.[142]

MetLife

Over a year after its designation of Prudential, FSOC designated MetLife, another large insurance company, for enhanced supervision.[143] MetLife's designation came after a lengthy engagement process that reportedly included 12 meetings between FSOC and the company's representatives, the submission of over 21,000 pages of materials to FSOC, and an oral hearing challenging FSOC's proposed determination.[144] In designating MetLife, FSOC reasoned that MetLife's financial distress "could lead to an impairment of financial intermediation or financial market functioning that could be sufficiently severe to inflict significant damage on the economy."[145] Specifically, FSOC reasoned that large financial intermediaries had significant exposure to MetLife because of its institutional products and capital market activities, such as funding agreements, guaranteed investment contracts, pension closeouts, and securities lending

(...continued)

Prudential%20Financial%20Inc.pdf.

137 *Id*. at 2.

138 *Id*.

139 *Id*. at 2-3.

140 *Id*. at 12.

141 *Id*. at 1.

142 Michelle Price & Pete Schroeder, *U.S. Financial Regulatory Panel to Review Prudential Risk Designation*, REUTERS (Feb. 15, 2018), https://www.reuters.com/article/us-usa-fsoc/u-s-financial-regulatory-panel-to-review-prudential-risk-designation-idUSKCN1FZ291.

143 *Basis for the Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc.,* U.S. DEP'T OF THE TREASURY (Dec. 18, 2014), https://www.treasury.gov/initiatives/fsoc/designations/Documents/MetLife%20Public%20Basis.pdf.

144 *Id*. at 2-3.

145 *Id*. at 15.

agreements.[146] Moreover, as with AIG and Prudential, FSOC concluded that a large-scale forced liquidation of MetLife's assets could disrupt securities markets.[147] FSOC also reasoned that MetLife's interstate and cross-border operations complicated its resolvability, further exacerbating the effects its distress might have on financial stability.[148]

MetLife proceeded to challenge FSOC's decision before the U.S. District Court for the District of Columbia, which invalidated FSOC's determination in March 2016.[149] In holding that FSOC's determination was "arbitrary and capricious," the court explained that by assessing only the potential impact of MetLife's financial distress, and not MetLife's *vulnerability to* financial distress, FSOC had violated its April 2012 guidance, which indicated that FSOC would consider both issues and divided its "categories" of analysis accordingly.[150]

The court also concluded that FSOC had failed to abide by its April 2012 guidance—which provided that a non-bank financial company could threaten financial stability only "if there would be an impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy"[151]—by failing to project "*what* the losses would be, *which* financial institutions would have to actively manage their balance sheets, or *how* the market would destabilize as a result" of MetLife's distress.[152] Instead, the court observed, FSOC had only "summed gross potential market exposures" to MetLife in conducting its "transmission channel" analysis, without analyzing the extent to which MetLife's creditors were secured or other mitigating factors.[153]

In arriving at this conclusion, the court acknowledged that counterparties' gross exposure to MetLife is relevant to the second statutory standard for designation—that a company's "nature, scope, size, scale, concentration, interconnectedness, or mix of ... activities" alone "could pose a threat to" financial stability.[154] However, it interpreted FSOC's explanation for its designation as relying on only the *first* statutory standard, which allows for designation when "material financial distress" at a non-bank financial company "could pose a threat to the financial stability of the United States."[155] Because FSOC's guidance had provided that this standard requires a finding that a firm's financial distress would impair financial market functioning to a degree sufficient to inflict significant damage on the broader economy, and FSOC had not adequately supported that finding, the court held that its determination was arbitrary and capricious.[156]

Finally, the court held that FSOC's designation of MetLife was arbitrary and capricious because FSOC failed to consider the costs of its designation (which MetLife alleged ran in the "billions of dollars")—a consideration that it explained is "essential to reasoned rulemaking."[157]

[146] *Id*. at 16.

[147] *Id*.

[148] *Id*. at 29-30.

[149] MetLife, Inc. v. Financial Stability Oversight Council, 177 F. Supp. 3d 219 (2016).

[150] *Id*. at 233-36.

[151] *Id*.

[152] *MetLife, Inc.*, 177 F. Supp. 3d at 237.

[153] *Id*.

[154] *MetLife, Inc.*, 177 F. Supp. 3d at 238.

[155] *Id*.

[156] *Id*.

[157] *Id*. at 239-42.

Although FSOC initially appealed the district court's decision to the U.S. Court of Appeals for the D.C. Circuit, it filed a motion to dismiss the appeal in January 2018, which the court granted, ending the case.[158]

Criticisms of Title I and Responses

Title I and FSOC's process for designating non-banks as systemically important have attracted some criticism. Some commentators have criticized FSOC for failing to provide firms under consideration with meaningful, specific information about the criteria used in determining whether a firm is systemically important.[159] Relatedly, some observers have questioned the rigor of FSOC's analysis of companies under consideration for designation.[160] Others have raised concerns about the transparency of the designation process.[161] Finally, some commentators have criticized FSOC for not considering the costs of designations in conducting its analyses—a criticism echoed in the district court's decision overturning FSOC's designation of MetLife.[162]

In response, defenders of FSOC have argued that the "malleable standard[s]" FSOC applies in determining whether companies qualify as systemically important effectively deter companies

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[158] *See* MetLife, Inc. v. Financial Stability Oversight Council, No. 16-5086, 2018 WL 1052618 (D.C. Cir. Jan. 23, 2018).

[159] *See* Andy Winkler, *Primer: FSOC's SIFI Designation Process for Nonbank Financial Companies*, AM. ACTION FORUM (Sept. 3, 2014), https://www.americanactionforum.org/research/primer-fsocs-sifi-designation-process-for-nonbank-financial-companies/; Peter J. Wallison, *What the FSOC's Prudential Decision Tells Us About SIFI Designation*, AM. ENTER. INST. (Mar. 31, 2014), http://www.aei.org/publication/what-the-fsocs-prudential-decision-tells-us-about-sifi-designation/ (arguing that FSOC has "failed to develop or implement any intelligible standard for determining whether a particular firm is" systemically important).

Relatedly, in 2014, a group of plaintiffs challenged the constitutionality of the provisions in Title I allowing FSOC to designate non-banks as systemically important, arguing that the level of discretion afforded FSOC violated the separation of powers. *See* Second Amended Complaint for Declaratory and Injunctive Relief ¶ 8, State Nat. Bank of Big Spring v. Lew, 958 F. Supp. 127 (D.D.C. 2013). To establish standing, a plaintiff-bank contended that it was harmed by FSOC's designation of GE Capital (a competitor) for enhanced regulation because that designation allegedly conferred reputational benefits upon GE Capital. State Nat. Bank of Big Spring v. Lew, 795 F.3d 48, 55 (D.C. Cir. 2015). The U.S. Court of Appeals for the D.C. Circuit rejected that argument and affirmed an order dismissing the plaintiff's claims for lack of standing, reasoning that the doctrine of competitor standing does not apply in cases where a challenged regulation increases a competitor's regulatory burdens. *Id*.

[160] *See* Wallison, *supra* note 159 (noting that in its designation of Prudential, FSOC concluded that Prudential's failure would have "significant" effects on financial markets and counterparties, but "made no effort to support its characterizations with the kind of numerical data that would give the word some meaning"); *Resolution Approving Final Determination Regarding Prudential Financial, Inc., Views of the Council's Independent Member having Insurance Expertise*, U.S. DEP'T OF THE TREASURY at 6 (Sept. 19, 2013), https://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/September%2019%202013%20Notational%20Vote.pdf (dissenting from FSOC's designation of Prudential, and contending that FSOC's explanation of its designation "does not contain any analysis that presents any findings as to severe impairment of financial intermediation; severe impairment of the functioning of U.S. and global financial markets; or resulting significant damage to the economy. No empirical evidence is presented; no data is reviewed; no models are put forward.").

[161] *See Dodd-Frank's Missed Opportunity: A Road Map for a More Effective Regulatory Architecture*, BIPARTISAN POLICY CENTER at 41 (April 2014), https://bipartisanpolicy.org/wp-content/uploads/sites/default/files/BPC%20Dodd-Frank%20Missed%20Opportunity.pdf (concluding that "[t]he use of more open forums to discuss FSOC business would ... be helpful," and arguing that "FSOC should also consider releasing additional details about the closed-door conversations that occur during their regular meetings"); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-886, NEW COUNCIL AND RESEARCH OFFICE SHOULD STRENGTHEN THE ACCOUNTABILITY AND TRANSPARENCY OF THEIR DECISIONS 55, (Sept. 2012), https://www.gao.gov/assets/650/648064.pdf (noting that public information on FSOC's decision-making is limited, and recommending that FSOC keep detailed records of closed-door sessions and develop a strategy for improving communication with the public).

[162] *See MetLife, Inc.*, 177 F. Supp. 3d at 238; Winkler, *supra* note 159.

from seeking out systemically risky activities.[163] According to this line of argument, the adoption of precise mathematical formulas for distinguishing between safe and risky companies would encourage companies to seek out activities with risks that are not adequately reflected in such rigid standards.[164] These commentators contend that vesting FSOC with "broad discretion" to designate firms as systemically important is appropriate given the inherent difficulty of identifying systemic risks and the perils of failing to identify such risks.[165] Moreover, in responding to arguments that it should consider the costs of designations, FSOC has argued that because Dodd-Frank's statutory text does not require such analysis, it need not engage in that inquiry.[166]

Proposals to Alter Title I

Proposed Legislation

A number of bills that would alter FSOC's authority to designate non-banks for enhanced regulation have been introduced in the 115th Congress. The Financial CHOICE Act of 2017, as passed by the House of Representatives in June 2017, would repeal FSOC's authority to designate non-banks for enhanced regulation altogether.[167] H.R. 4061, the Financial Stability Oversight Council Improvement Act of 2017, which was reported out of the House Committee on Financial Services in March 2018, proposes more limited changes to FSOC's authority.[168] Specifically, H.R. 4061 would require FSOC to consider "the appropriateness of the imposition of prudential standards as opposed to other forms of regulation to mitigate the identified risks" in determining whether to designate a non-bank as systemically important.[169] The bill would further require that FSOC provide designated companies with the opportunity to submit written materials contesting their designation during FSOC's annual reevaluation process.[170] If FSOC determines during a re-evaluation that a designation should not be rescinded, the bill would require it to provide notice to the designated company "address[ing] with specificity" how it assessed the relevant statutory factors in light of the company's written submissions.[171]

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[163] Daniel Schwarcz & David Zaring, *Regulation by Threat: Dodd-Frank and the Nonbank Problem*, 84 U. CHI. L. REV. 1813, 1834 (2017); Simon Johnson & Antonio Weiss, *The Financial Stability Oversight Council: An Essential Role for the Evolving US Financial System*, PETERSON INST. FOR INT'L ECON. 10 (May 2017), https://piie.com/system/files/documents/pb17-20.pdf.

[164] Schwarcz & Zaring, *supra* note 163 at 1856. *See also* Johnson & Weiss, *supra* note 163 at 10 ("[F]irms considered for designation are, by definition, large multifaceted financial institutions, and only a holistic approach to assessing risk can be effective. Any fixed list of criteria would be easy to game, and there are not likely to be one or two easy 'fixes' for avoiding designation.").

[165] Schwarcz & Zaring, *supra* note 163 at 1817. *See also Written Testimony of Adam J. Levitin, Hearing on The Administrative State v. The Constitution: Dodd-Frank at Five Years Before the Subcomm. on the Constitution of the S. Comm. on the Judiciary*, 114th Cong. 8 (July 23, 2015) (statement of Adam. J. Levitin, Professor of Law, Georgetown University Law Center), https://www.judiciary.senate.gov/imo/media/doc/07-23-15%20Levitin%20Testimony.pdf. ("SIFI designation is not an unfettered exercise of discretion. Instead, it requires consideration of no less than eleven detailed factors, as well as an ultimate finding about the nature of risks posed by a firm to the economy.").

[166] *See MetLife, Inc.*, 177 F. Supp. 3d at 238.

[167] H.R. 10, 115th Cong. § 151 (2017).

[168] H.R. 4061, 115th Cong. (2017).

[169] *Id*. § 2.

[170] *Id*.

[171] *Id*.

The Trump Administration's Views

In November 2017, the Trump Administration's Treasury Department released a report outlining four general recommendations for reforming FSOC's process for designating non-banks as systemically important.[172] First, the report recommended that FSOC adopt an "activities-based" or "industry-wide" approach to assessing potential risks posed by non-banks.[173] Under this approach, FSOC would prioritize identifying specific financial activities and products that could pose risks to financial stability, work with the primary financial regulatory agencies to address those specific risks, and consider individual firms for designation as systemically important only as a matter of last resort if more limited actions aimed at mitigating discrete risks are insufficient to safeguard financial stability.[174]

Second, the Treasury Department recommended that FSOC "increas[e] the analytical rigor" of its designation analyses.[175] Specifically, the Report recommended that FSOC: (1) consider any factors that might mitigate the exposure of a firm's creditors and counterparties to its financial distress; (2) focus on "plausible" (and not merely "possible") asset liquidation risks; (3) evaluate the likelihood that a firm will experience financial distress before evaluating how that distress could be transmitted to other firms; (4) consider the benefits *and* costs of designations; and (5) collapse its three-stage review process into two steps, notifying companies that they are under active review during Stage 1 and voting on proposed designations after the completion of Stage 2.[176]

Third, the Treasury Department recommended enhancing engagement between FSOC and companies under review, and improving the designation process's transparency.[177] Specifically, the report recommended that FSOC: (1) engage earlier with companies under review and "explain ... the key risks" that FSOC has identified, (2) "undertake greater engagement" with companies' primary financial regulators, and (3) publicly release explanations of its designation decisions.[178]

Fourth, the Treasury Department recommended that FSOC provide "a clear off-ramp" for non-banks designated as systemically important.[179] The report recommended that FSOC: (1) highlight the key risks that led to a company's designation, (2) "adopt a more robust and transparent process for its annual reevaluations" that "make[s] clear how companies can engage with FSOC ... and what information companies should submit during a reevaluation," (3) "develop a process to enable a designated company to discuss potential changes it could make to address the risks it could pose to financial stability," and (4) "make clear that the standard it applies in its annual reevaluations is the same as the standard for an initial designation of a nonbank financial company."[180] FSOC has yet to act on these recommendations.

[172] FIN. STABILITY OVERSIGHT COUNCIL DESIGNATIONS, U.S. DEP'T OF THE TREASURY (Nov. 17, 2017), https://www.treasury.gov/press-center/press-releases/Documents/PM-FSOC-Designations-Memo-11-17.pdf.

[173] *Id*. at 10.

[174] *Id*. at 19-21.

[175] *Id*. at 22.

[176] *Id*. at 22-29.

[177] *Id*. at 29.

[178] *Id*. at 29-34.

[179] *Id*. at 34.

[180] *Id*. at 34-36.

Title II: Orderly Liquidation Authority

While Title I of Dodd-Frank is aimed at minimizing the likelihood that systemically important financial institutions experience financial distress, Title II is directed at resolving such institutions in a rapid and orderly fashion in the event that they nevertheless become distressed. To accomplish this goal, Title II establishes a new resolution regime available for systemically important financial institutions outside of the Bankruptcy Code.[181] The following sections of the report discuss Title II and proposals for its reform. First, the report provides an overview of the resolution mechanisms available for financial institutions before Dodd-Frank. Second, the report discusses Title II's legislative history and the new resolution authority that it establishes. Third, the report canvasses a variety of administrative rules with important implications for Title II. Fourth, the report discusses certain criticisms of Title II, and responses to those criticisms. Finally, the report discusses proposals to repeal or change Title II.

Pre-Dodd-Frank Resolution Mechanisms: Bankruptcy vs. FDIC Resolution

Commercial banks, broker-dealers, and insurance companies are subject to different insolvency regimes. Commercial banks must utilize a special resolution regime administered by the FDIC.[182] Before Dodd-Frank, broker-dealers and bank holding companies were limited to the Bankruptcy Code.[183] Finally, before Dodd-Frank, insurance companies were limited to state law insolvency proceedings.[184]

The purpose and mechanics of bankruptcy and the FDIC's resolution regime differ in important respects.[185] A non-bank corporation may generally file a voluntary bankruptcy petition with the clerk of a federal bankruptcy court,[186] or the company's creditors can file a petition for involuntary bankruptcy if certain conditions are met.[187] By contrast, a bank's chartering agency, primary federal regulator, or the FDIC initiates the bank resolution process based upon one or

[181] P.L. 111-203, 124 Stat. 1376, tit. II. (2010).

[182] 12 U.S.C. § 1821(c)-(d). *See also* 11 U.S.C. § 109 (specifying which entities are eligible to declare bankruptcy under the Bankruptcy Code); CARNELL, ET AL., *supra* note 16 at 397-446.

Commentators have adduced a number of considerations favoring a special insolvency regime for commercial banks, including, among other things: (1) banks' importance to the nation's money supply, payments system, and macroeconomy, (2) banks' vulnerability to "runs," and (3) the fact that bank assets can be transferred quickly and cheaply. *See* Robert R. Bliss & George G. Kaufman, *U.S. Corporate and Bank Insolvency Regimes: A Comparison and Evaluation*, 2 VA. L. & BUS. REV. 143, 147-48 (2007).

[183] *See* 11 U.S.C. §§ 741-753; Wolkowitz v. FDIC (*In re* Imperial Credit Indus., Inc.), 527 F.3d 959, 962 (9th Cir. 2008). Broker-dealers are not eligible for Chapter 11 reorganizations and may only be liquidated pursuant to Chapter 7. *Id*. § 109(d). Under the Securities Investor Protection Act of 1970, the Securities Investor Protection Corporation (SIPC) may file an application to stay bankruptcy proceedings of a broker that is an SIPC member to allow the SIPC liquidate the broker. 15 U.S.C. § 78eee. For an overview of differences between Chapter 7 liquidations and Chapter 11 reorganizations, see CRS Report R45137, *Bankruptcy Basics: A Primer*, by Kevin M. Lewis, at 9-14.

[184] *See* CARNELL, ET AL., *supra* note 16 at 659-71.

[185] *See* Lewis, *supra* note 183; Richard M. Hynes & Steven D. Walt, *Why Banks are Not Allowed in Bankruptcy*, 67 WASH. & LEE L. REV. 985, 987 (2010); Bliss & Kaufman, *supra* note 182 at 153-54.

[186] *See* 11 U.S.C. § 301; FED. R. BANKR. P. 1002(a). *But see* 11 U.S.C. § 109 (limiting which entities are eligible to be a debtor under the Bankruptcy Code).

[187] *See* 11 U.S.C. § 303; FED. R. BANKR. P. 1003.

more statutorily-established grounds, including a bank's undercapitalization.[188] Accordingly, a bank need not have defaulted on any outstanding obligations or be deemed insolvent for an involuntary resolution to begin.[189]

Corporate bankruptcies are usually resolved in special federal bankruptcy courts.[190] In a Chapter 7 bankruptcy, a court appoints an agent such as a trustee to coordinate the insolvency process.[191] In a bankruptcy reorganization, the insolvent corporation's management is generally allowed to continue operating the company[192] and has exclusive rights to develop a reorganization plan for a period of 120 days after the petition is filed, which may be extended under certain circumstances.[193] Many of the trustee or management's decisions—for example, to release collateral to secured creditors, pay employees, and obtain debtor-in-possession financing (i.e., financing used to keep the company operating as a going concern)—are subject to court approval.[194] Moreover, any reorganization plan is subject to the unanimous agreement of a company's creditors unless the court determines that certain conditions are met.[195] These and other decisions by the bankruptcy court are reviewable by higher courts.[196]

By contrast, bank resolutions are handled in administrative proceedings conducted by the FDIC.[197] When the FDIC commences administrative resolution proceedings, it generally removes

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[188] *See* 12 U.S.C. §§ 203(a), 1821(c). The Office of the Comptroller of the Currency serves as the chartering agency for national banks, while state banking agencies serve as the chartering agencies for state-chartered banks. *See* Bliss & Kaufman, *supra* note 182 at 156 n.44. State-chartered banks are required to obtain deposit insurance from the FDIC and can become members of the Federal Reserve System. *See* BARR ET AL., *supra* note 77 at 166; 12 U.S.C. § 321. Accordingly, the FDIC serves as the primary federal regulator for state-chartered banks that are not members of the Federal Reserve System. For a discussion of the architecture of bank regulation in the United States, see CRS Report R44918, *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework*, by Marc Labonte.

The statutorily-established grounds for appointment of a receiver or conservator are: (1) the insufficiency of a bank's assets to service its obligations, (2) the "substantial dissipation" of assets due to a violation of law or "any unsafe or unsound practice," (3) "[a]n unsafe or unsound condition to transact business," (4) the willful violation of a final cease-and-desist order, (5) concealment of the bank's books or records from its regulators, (6) likelihood that a bank will be unable to pay its obligations or meet its depositors' demands, (7) the incurring or likelihood that a bank will incur losses that will deplete all or substantially all of its capital, (8) any violation of law that is likely to cause insolvency or a substantial dissipation of assets, weaken the bank's condition, or otherwise seriously prejudice the bank's depositors or the Deposit Insurance Fund, (9) consent to the appointment of a conservator or receiver, (10) failure to maintain deposit insurance, (11) undercapitalization, with no reasonable prospect of becoming adequately capitalized, failure to become adequately capitalized when required to do so, failure to submit a required capital restoration plan, or material failure to implement a capital restoration plan, (12) "critical[]" undercapitalization or otherwise having "substantially insufficient capital," or (13) notification from the Attorney General that the bank has been found guilty of certain criminal money laundering offenses. 12 U.S.C. § 1821(c)(5).

[189] *See* Stanley V. Ragalevsky & Sarah J. Ricardi, *Anatomy of a Bank Failure*, 126 BANKING L. J. 867, 870 (2009); Bliss & Kaufman, *supra* note 182 at 156.

[190] *See* Bliss & Kaufman, *supra* note 182 at 156. *But see* 28 U.S.C. § 157(b)(5), (c)(1), (d) (specifying bankruptcy-related matters that may or must be resolved by a federal district court rather than a bankruptcy court).

[191] 11 U.S.C. §§ 701-704. Corporate liquidations are governed by Chapter 7 of the Bankruptcy Code, *id.* § 701, while reorganizations are governed by Chapter 11, *id*. § 1101.

[192] *See id*. § 1107. *But see id*. §§ 1104, 1108 (specifying circumstances under which a bankruptcy court may "order the appointment of a trustee" to administer a Chapter 11 debtor).

[193] *Id*. § 1121.

[194] *Id*. §§ 363-366.

[195] *See* Bliss & Kaufman, *supra* note 182 at 159-60; 11 U.S.C. § 1129.

[196] FED. R. APP. P. 6; 28 U.S.C. § 158.

[197] *See* Bliss & Kaufman, *supra* note 182 at 159-60; 11 U.S.C. §§ 109(b)(2), (d) (providing that banks are ineligible for bankruptcy).

a bank's senior management without notice or a hearing and assumes control of the bank.[198] The FDIC unilaterally makes decisions related to the liquidation (pursuant to a receivership) or continued operation (pursuant to a conservatorship) of the failed bank.[199] For FDIC resolutions of a commercial bank, there is no separate oversight authority analogous to the relationship between the bankruptcy court and trustee or management, and there is no mechanism for creditors, management, or shareholders to participate in the resolution process beyond filing claims and providing requested information.[200] While some of the FDIC's decisions during this process are subject to judicial review, others—including decisions to disallow creditor claims that are not proved to the FDIC's satisfaction—are not reviewable.[201]

Bankruptcy and FDIC resolution also differ with respect to how creditors can be temporarily prevented from pursuing their claims against an insolvent debtor. In bankruptcy, creditors are temporarily barred from pursuing many of their claims by an "automatic stay" that is effective upon the filing of a bankruptcy petition,[202] and bankruptcy courts have the authority to impose certain additional stays to ensure an orderly reorganization.[203] However, a variety of financial contracts—including certain securities and commodities contracts, swaps, forwards, and repos—are exempt from the Bankruptcy Code's automatic stay.[204] Often, such contracts provide that certain rights—for example, to terminate the contract, net obligations, or liquidate collateral—are triggered by a party's entry into bankruptcy (direct default rights) or by the entry into bankruptcy of a party's parent or affiliate (cross-default rights).[205] Because of the Bankruptcy Code's "safe harbor" provisions, such rights can be exercised immediately upon the filing of a bankruptcy petition, notwithstanding the automatic stay.[206]

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[198] *See* Bliss & Kaufman, *supra* note 182 at 159-60. Although a bank's directors have the right to judicial review of a decision to appoint a conservator or receiver, 12 U.S.C. § 1821(c)(7), commentators have observed that "[t]his right appears to have been rarely exercised and never successfully," Bliss & Kaufman, *supra* note 182 at 160 n.62. *See also* Thomas W. Merrill & Margaret L. Merrill, *Dodd-Frank Orderly Liquidation Authority: Too Big for the Constitution?*, 163 U. PA. L. REV. 165, 179 (2014) (noting that although judicial review of the FDIC's decision to appoint a receiver is authorized by statute, it is "extremely difficult" to persuade a court to unwind a receivership).

[199] *See* Bliss & Kaufman, *supra* note 182 at 159-60. While the FDIC can resolve a bank by a receivership (in which the FDIC liquidates and winds up of the affairs of a failed bank) or a conservatorship (in which the FDIC continues to operate a bank as a going concern), 12 U.S.C. §§ 1821(c)-(d), the FDIC has rarely used conservatorships to resolve failed banks, *see* Hynes & Walt, *supra* note 185 at 987 n.3.

[200] *See* Hynes & Walt, *supra* note 185 at 989; Bliss & Kaufman, *supra* note 182 at 159-60.

[201] *See* 12 U.S.C. § 1821(d)(5)(E) (providing that decisions to disallow creditor claims are not reviewable).

[202] 11 U.S.C. § 362. *See also* Lewis, *supra* note 183 at 6-8.

[203] *Id*. § 105(a); *In re* Keene Corp., 164 B.R. 844, 849 (Bankr. S.D.N.Y. 1994).

[204] 11 U.S.C. §§ 362(b)(6), (7), (17), (27), 362(o), 555-56, 559-61.

Commentators have proffered a variety of arguments for and against exempting such contracts from the automatic stay. *See* Mark D. Sherrill, *In Defense of the Bankruptcy Code's Safe Harbors*, 70 BUS. LAW. 1007 (2015); Stephen J. Lubben, *Derivatives and Bankruptcy: The Flawed Case for Special Treatment*, 12 U. PA. J. BUS. L. 61 (2009); Franklin R. Edwards & Edward R. Morrison, *Derivatives and the Bankruptcy Code: Why the Special Treatment?*, 22 YALE J. ON REG. 91 (2005).

Some observers have argued that the legislative history behind the relevant safe-harbor provisions suggests that Congress was concerned that the inability of derivatives counterparties to exit contracts with a bankrupt company contributed to systemic risk by preventing counterparties from mitigating their exposure to the company. Edwards & Morrison, *supra* note 204 at 107-08.

[205] Final Rule, Restrictions on Qualified Financial Contracts of Certain FDIC-Supervised Institutions; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 Fed. Reg. 50,228, 50,231 (Oct. 30, 2017).

[206] 11 U.S.C. §§ 362(b)(6), (7), (17), (27), 362(o), 555-56, 559-61.

By contrast, while the FDIC lacks general power to stay enforcement of a failed bank's contracts,[207] it has broad power to disaffirm or repudiate certain contracts if it determines that performance would be "burdensome," and that disaffirmance or repudiation would "promote the orderly administration of the institution's affairs."[208] Moreover, counterparties to "qualified financial contracts" (QFCs)—a term defined to include certain securities or commodities contracts, swaps, forwards, and repos[209]—with a bank in an FDIC resolution are barred from exercising *direct* default rights against the bank based on its entry into resolution proceedings for one business day.[210] If the FDIC transfers a QFC to another party (as it often does when it sells a bank's assets to a healthy acquirer), default rights under the QFC are permanently stayed.[211] Accordingly, banks enjoy greater protection against "runs" by their derivatives counterparties in an FDIC resolution than do non-bank corporations in bankruptcy.

Finally, bankruptcy and FDIC resolution differ with respect to the legal priority of creditors. The Bankruptcy Code provides a list of priorities specifying the order in which creditors are to be paid.[212] During a Chapter 11 reorganization, the "absolute priority rule" bars the approval of a reorganization plan that awards property to a junior class of unsecured creditors while failing to compensate a dissenting class of senior creditors in full.[213] A bankrupt firm can also obtain debtor-in-possession financing during a reorganization, which enjoys priority over certain pre-bankruptcy debts.[214]

By contrast, if the FDIC is unable to find a healthy bank to purchase a failing bank in a "purchase and assumption" transaction (the most common method of resolving a failed bank), it generally liquidates the bank, paying off insured depositors and issuing receivership certificates to uninsured depositors and other general creditors.[215] The FDIC pays uninsured depositors and general creditors according to a statutorily prescribed priority scheme.[216] In paying these creditors, the FDIC is required to use the "least costly" resolution method—that is, the resolution method that minimizes expenditures from the deposit insurance fund.[217] However, the FDIC can waive the least-cost resolution requirement if the Treasury Secretary (in consultation with the President and with the recommendation of the Federal Reserve) determines that adhering to that requirement "would have serious adverse effects on economic conditions or financial stability"

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[207] *See* Bliss & Kaufman, *supra* note 182 at 157.

[208] 12 U.S.C. § 1821(e)(1).

[209] *Id*. § 1821(e)(8)(D)(i).

[210] *Id*. § 1821(e)(10)(B)(i)-(ii). This stay is limited to *direct* default rights—that is, rights against the bank in receivership triggered by its placement into receivership. There are no limitations on a counterparty's *cross-default* rights—that is, rights against a bank's affiliate triggered by the bank's entry into receivership.

[211] *Id*.

[212] 11 U.S.C. § 507.

[213] *See id*. § 1129(b)(2)(B)(ii); Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 202 (1988). Some courts have recognized a "new value exception" to the absolute priority rule, according to which junior creditors can receive property in a reorganization plan when they provide new value to the debtor. *See In re* Abeinsa Holding, Inc., 562 B.R. 265, 277 (Bankr. D. Del. 2016).

[214] *See* Bliss & Kaufman, *supra* note 182 at 162.

A bankruptcy trustee can also claw back or "avoid" certain preferential pre-bankruptcy transfers. 11 U.S.C. §§ 546-47, 555-56, 559-61. By contrast, bank insolvency law does not contain a mechanism for clawing back preferential transfers. Bliss & Kaufman, *supra* note 182 at 164. However, the FDIC may claw-back fraudulent transfers made within five years of a bank's closure. 12 U.S.C. § 1821(d)(17).

[215] *See* Ragalevsky & Ricardi, *supra* note 189 at 876.

[216] 12 U.S.C. § 1821(d)(11).

[217] *Id*. § 1823(c)(4).

and that alternative action "would avoid or mitigate such adverse effects."[218] Although there is no external debtor-in-possession financing during an FDIC resolution, the FDIC can offer "open bank assistance" (OBA) to a troubled bank in the form of a loan, an assumption of some or all of its liabilities, a purchase of troubled assets, or a direct infusion of capital.[219] However, OBA is "rarely used" because of the least-cost resolution requirement, among other reasons.[220]

Table 1. Differences Between Bankruptcy and FDIC Resolution

	Bankruptcy	FDIC Resolutions
Where are proceedings held?	Bankruptcy court (with certain exceptions).	Administrative proceedings before the FDIC.
What are the bases for commencing an involuntary resolution?	Among other requirements, a debtor must be "generally not paying ... debts" as they become due.	The FDIC may involuntarily seize a bank for a variety of reasons, including a bank's undercapitalization.
What happens to old management?	In a Chapter 11 reorganization, management is generally permitted to continue running the company, and has exclusive rights to develop a reorganization plan for a period of 120 days after the bankruptcy petition is filed. In a Chapter 7 liquidation, a trustee generally replaces old management and liquidates the debtor.	The FDIC generally removes old management.

[218] *Id*. § 1823(c)(4)(G). The FDIC invoked this "systemic risk exception" multiple times during the 2007-2009 financial crisis. In September 2008, the FDIC announced that Citigroup would acquire Wachovia's banking operations in a transaction assisted by the FDIC. CRISIS AND RESPONSE: AN FDIC HISTORY, 2008-2013 69 (2017). Specifically, the FDIC agreed to share future losses with Citigroup on a pre-identified pool of $312 billion in loans, in exchange for $12 billion in preferred stock and warrants. *Id*. at 75. This deal was ultimately abandoned, however, when Wells Fargo agreed to acquire all of Wachovia's operations without FDIC assistance. *Id*. at 76.

The FDIC again invoked the "systemic risk exception" in November 2008 to assist Citigroup. *Id*. at 82. Pursuant to this authority, the FDIC (in conjunction with the Treasury Department, acting pursuant to a program established under the Troubled Asset Relief Program) issued an asset guarantee for a selected pool of $306 billion of Citigroup's assets, in exchange for $7 billion in preferred stock paying an 8 percent annual dividend. *Id*. at 83.

The FDIC invoked the "systemic risk exception" once more in January 2009 to assist Bank of America, which had acquired Merrill Lynch the previous September. *Id*. at 86. Pursuant to this authority, the FDIC (again in conjunction with the Treasury Department) issued an asset guarantee for a selected pool of $118 billion of loans, securities, and other assets, in exchange for $4 billion in preferred stock and warrants. *Id*. at 90-91.

In addition to invoking the "systemic risk exception" to assist individual troubled banks during the financial crisis, the FDIC also adopted the then-novel interpretation that the "systemic risk exception" allowed it to take actions to preserve the stability of the banking system more generally. *See id*. at 33-60. Pursuant to this interpretation of its authority, the FDIC implemented the Temporary Liquidity Guarantee Program, which (1) provided a limited-term guarantee for certain newly-issued debt of commercial banks, thrifts, and financial holding companies and eligible bank affiliates, and (2) fully guaranteed certain non-interest bearing transaction deposit accounts. *Id*. at 33.

[219] *See* Ragalevsky & Ricardi, *supra* note 189 at 882; Bliss & Kaufman, *supra* note 182 at 162.

[220] *See* Ragalevsky & Ricardi, *supra* note 189 at 882.

	Bankruptcy	FDIC Resolutions
How can creditors participate?	Creditors have several avenues by which they can participate in a bankruptcy proceeding. Creditors can object if the debtor takes certain actions outside the ordinary course of business, and impaired creditors can generally vote on proposed reorganization plans.	Creditors are generally limited to submitting their claims and other requested information to the FDIC.
Are debtors protected against "runs" by derivatives counterparties?	Generally not. Certain derivatives contracts are exempt from the "automatic stay."	Yes. QFC counterparties are stayed from exercising direct default rights for one business day, and are permanently stayed from exercising such rights if the FDIC transfers a QFC to a third party.

Source: CRS.

These differences between the Bankruptcy Code and FDIC resolution reflect the different priorities of their respective insolvency schemes. According to many commentators, corporate bankruptcy is principally focused on maximizing creditor recovery by preserving the "going-concern" value of a firm, or equitably distributing its assets in the event of a liquidation.[221] Accordingly, the Bankruptcy Code gives a firm's creditors a prominent role in the insolvency process, allowing them to vote on proposed reorganization plans if their interests are impaired,[222] and subjecting a trustee or management's decisions to judicial scrutiny.[223]

Bank resolution, by contrast, arguably places greater emphasis on financial stability than does the Bankruptcy Code, making the speed of the resolution process especially important.[224] Accordingly, authority over bank resolution is highly concentrated in one actor: the FDIC. With its considerable resolution powers, the FDIC is often able to seize a failed bank at the close of business on a Friday, sell many of its assets, and re-open many of its offices under the auspices of a healthy acquirer by the following Monday, minimizing negative effects on the financial system.[225]

This dual-track insolvency system, with the FDIC in charge of resolving commercial banks and bankruptcy courts tasked with non-bank insolvencies, arguably functioned effectively for much of the 20th century.[226] However, many commentators have contended that the bankruptcy system is

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221 *See* Bliss & Kaufman, *supra* note 182 at 153.

222 11 U.S.C. § 1126(a), (f); FED. R. BANKR. P. 3018.

223 *See* Hynes & Walt, *supra* note 185 at 1006.

224 *Id.* at 1007-08.

225 *Id*. at 989.

226 *See 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*, THE CLEARING HOUSE 12 (Jan. 2013), https://www.cov.com/files/Publication/714f0b24-8047-4d79-825f-55f5d1e80bdc/Presentation/PublicationAttachment/f7462820-7d03-4ed2-8b75-96b917418d8f/White_Paper_Ending_Too-Big-to-Fail.pdf. [hereinafter "Clearing House Report"] (arguing that the "bifurcated regimes worked well for a range of institutions" before the financial crisis, and that "the bank failure regime administered by the FDIC proved to be very effective in dealing in an orderly way with the wave of depository institution failures of the 1980s and 1990s"); Sheila Bair, *Beyond Bankruptcy and Bailouts*, WALL ST. J. (Apr. 5, 2010), https://www.wsj.com/articles/SB10001424052702304871704575159643688328442 (asserting that "the FDIC has a well-established process that works for failing banks"); Thomas H. Jackson, *Chapter 11F: A Proposal for the Use of Bankruptcy to Resolve Financial Institutions* 217, 217 *in* ENDING GOVERNMENT BAILOUTS AS WE KNOW THEM (Kenneth E. Scott, George P. Schultz & John B. Taylor, eds. 2009) (asserting that "[b]ankruptcy reorganization is, for
(continued...)

ill-suited for the resolution of large, complex financial institutions.[227] Specifically, observers have noted that the dependence of such institutions on short-term, highly liquid funding leaves them susceptible to "runs"—a problem exacerbated by the Bankruptcy Code's "safe harbor" provisions for certain derivatives contracts.[228] Moreover, commentators have argued that the complicated legal structures of large financial institutions make their resolution in bankruptcy difficult, because such institutions often (1) have regulated subsidiaries such as banks and insurance companies that are not themselves eligible for bankruptcy, and (2) operate their businesses without regard for the legal separateness of these entities.[229] Others have argued that reorganizing a large financial institution in bankruptcy (or continuing its subsidiaries' operations on a temporary basis until a buyer can be found) would be extraordinarily difficult, because such an institution would likely require billions of dollars of debtor-in-possession financing—a sum that "[p]rivate lending markets are not capable of providing" to a bankrupt firm, especially in a period of financial distress.[230] According to these observers, the 2007-2009 financial crisis highlighted these problems with the Bankruptcy Code, and the need to develop alternative resolution mechanisms for financial institutions not subject to the FDIC's supervision.[231]

Dodd-Frank and the Orderly Liquidation Authority

Legislative History

In March 2009, the Treasury Department released a legislative proposal for a new resolution authority "to address systemically significant financial institutions that fall outside of the existing resolution regime under the FDIC."[232] The Treasury Department argued that the financial crisis highlighted the inadequacy of the existing resolution options for large non-bank financial institutions.[233] According to the Obama Administration's Treasury Department, policymakers during the crisis were forced to choose between two untenable options for such institutions: (1) securing outside capital or committing government funds to rescue a TBTF institution (as in the case of AIG), or (2) a destabilizing bankruptcy (as in the case of Lehman).[234]

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the most part, an American success story").

[227] *See* Adam J. Levitin, *Bankruptcy's Lorelei: The Dangerous Allure of Financial Institution Bankruptcy*, 97 N.C. L. REV., (forthcoming); Paul L. Lee, *Bankruptcy Alternatives to Title II of the Dodd-Frank Act—Part I*, BANKING L. J. 437, 442-44 (Oct. 2015); BEN S. BERNANKE, THE FEDERAL RESERVE AND THE FINANCIAL CRISIS 86 (2013); Clearing House Report, *supra* note 226 at 11-17; *Resolving Globally Active, Systemically Important, Financial Institutions*, BANK OF ENGLAND (Dec. 10, 2012), https://www.fdic.gov/about/srac/2012/gsifi.pdf.

[228] U.S. GOV. ACCOUNTABILITY OFFICE, GAO-11-707, BANKRUPTCY: COMPLEX INSTITUTIONS AND INTERNATIONAL COORDINATION POSE CHALLENGES 28-30 (July 2011) [hereinafter "GAO BANKRUPTCY REPORT"].

[229] *Id*. at 30-35.

[230] Levitin, *supra* note 227 at 18.

[231] *See* Ben S. Bernanke, *Why Dodd-Frank's Orderly Liquidation Authority Should be Preserved*, THE BROOKINGS INST. (Feb. 28, 2017), https://www.brookings.edu/blog/ben-bernanke/2017/02/28/why-dodd-franks-orderly-liquidation-authority-should-be-preserved/; Merrill & Merrill, *supra* note 198 at 167; GAO BANKRUPTCY REPORT, *supra* note 228 at 28-35.

[232] *See Treasury Proposes Legislation for Resolution Authority*, U.S. DEP'T OF THE TREASURY (Mar. 25, 2009), https://www.treasury.gov/press-center/press-releases/Pages/tg70.aspx.

[233] *Id*.

[234] *Id*.

The Obama Administration accordingly proposed supplementing these options with a resolution regime "modeled on the statutory framework that governs the FDIC's exercise of emergency resolution and other authority with respect to banks."[235] Instead of "subjecting a firm to bankruptcy" or "injecting taxpayers' funds with no real control," the Treasury Department's proposed legislation would enable the federal government to put a firm into a conservatorship or receivership managed by the FDIC, which could sell or transfer the firm's assets and liabilities, renegotiate or repudiate its contracts, and address its derivatives portfolio.[236] The proposed legislation would also allow the FDIC to make loans to a financial institution placed into conservatorship or receivership, purchase the institution's obligations or assets, assume or guarantee the institution's liabilities, or purchase an equity interest in the institution.[237]

The Obama Administration's proposal provided that the Board of Governors of the Federal Reserve and the Board of the FDIC, by two-thirds votes, were to provide the Treasury Secretary with a "recommendation" concerning actions that should be taken with respect to a troubled financial company, and that the Treasury Secretary make certain findings before commencing the conservatorship or receivership.[238] The Administration's proposal allowed a seized firm to file suit requesting that the conservatorship or receivership be set aside within thirty days.[239] The proposal did not restrict the issues that the reviewing court could consider or impose a time limit on the court's review.[240]

In December 2009, the House of Representatives passed a version of the new resolution regime based on the Treasury Department's proposal.[241] Like the Treasury Department's proposal, the House bill provided for the appointment of a receiver after (1) two-thirds votes by the Board of Governors of the Federal Reserve and the Board of the FDIC, and (2) the Treasury Secretary made certain determinations.[242] The House bill also provided for a thirty-day period within which a seized firm could seek judicial review.[243] However, unlike the Treasury Department's proposal, the House bill did not grant the FDIC the authority to provide equity financing to companies during the resolution process.[244] Also in contrast to Treasury's proposal, the House bill required that any debt funding the government provided to a seized company be repaid from ex ante assessments on certain large financial institutions.[245]

A Senate bill introduced in April 2010 built on these proposals, but envisioned a slightly different process for appointing a receiver for non-bank financial institutions. The initial Senate bill required that a panel of three bankruptcy judges from the Bankruptcy Court for the District of Delaware approve the Treasury Secretary's decision to appoint a receiver for a troubled

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[235] *Id*.

[236] *Id*.

[237] *Id*.

[238] Exec. Office of the President, Resolution Authority for Large, Interconnected Financial Companies Act of 2009, tit. XII § 1203(a)-(c) (July 23, 2009).

[239] *Id*. § 1205.

[240] *Id*.

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

[242] *Id*. § 1603(a)(1).

[243] *Id*. § 1605.

[244] *See id*. § 1609.

[245] *Id*. §§ 1604(d) & 1609(n).

company.[246] However, this panel of bankruptcy judges would consider only one of the Treasury Secretary's various findings: that the relevant firm is in default or in danger of default.[247] The Senate bill also imposed a variety of secrecy requirements related to resolution proceedings. The bill provided that (1) the Treasury Secretary's petition to the bankruptcy panel would be filed under seal, (2) proceedings before the panel would be held "[o]n a strictly confidential basis," and (3) criminal penalties would be imposed on persons who disclosed information about the proceedings.[248] The panel would be required to rule within 24 hours of receiving the petition.[249]

After the initial Senate bill was introduced, Senator Christopher Dodd proposed a series of amendments.[250] Among other things, the amendments provided that the Treasury Secretary would petition the U.S. District Court for the District of Columbia instead of a panel of bankruptcy judges for the appointment of a receiver.[251] The amendments further provided that the district court would review two of the Treasury Secretary's determinations: (1) that the firm to be placed into receivership satisfied the statutory definition of a "financial company," and (2) that the firm is in default or in danger of default.[252] The Senate passed the revised bill on May 20, 2010.[253]

A Conference Committee resolved the differences between the House and Senate bills.[254] Among other things, the Conference Committee report adopted an ex post assessment process on large financial institutions to repay any government funding providing during the resolution process, in place of the ex ante assessment in the House bill.[255] The House and Senate passed the Conference Committee report in late June and mid-July 2010, respectively,[256] and President Obama signed Dodd-Frank on July 21, 2010.[257]

Title II and the Orderly Liquidation Authority

These various legislative proceedings culminated in Title II of Dodd-Frank, which creates an "Orderly Liquidation Authority" (OLA) pursuant to which the FDIC can serve as the receiver for "failing financial companies that pose a significant risk to the financial stability of the United States."[258] Title II can be invoked only for "covered financial companies" and "covered brokers and dealers."[259] Title II defines a "covered financial company" as a "financial company"[260] that is

[246] Restoring American Financial Stability Act of 2010, S. 3217, 111th Cong. § 203 (as substituted Apr. 29, 2010).

[247] *Id*. § 202(b)(1)(A)(iii)-(iv).

[248] *Id*. §§ 202(b)(1)(A)(ii)-(iii), 202(b)(1)(C).

[249] *Id*. § 202(b)(1)(A)(iii).

[250] 156 CONG. REC. S3139-40 (daily ed. May 5, 2010).

[251] Restoring American Financial Stability Act of 2010, H.R. 4173 § 202(a)(1)(A)(i) (111th Cong. (as substituted in the Senate, May 20, 2010)).

[252] *Id*. § 202(a)(1)(A)(i).

[253] 156 CONG. REC. S4708 (daily ed. May 20, 2010).

[254] H.R. REP. No. 111-517 (2010) (Conf. Rep.).

[255] H.R. REP. No. 111-517 § 210(n)(9).

[256] *See* Brady Dennis, *Congress Passes Financial Reform Bill*, WASH. POST. (July 16, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/07/15/AR2010071500464.html.

[257] *See* Helene Cooper, *Obama Signs Overhaul of Financial System*, N.Y. TIMES (July 21, 2010), https://www.nytimes.com/2010/07/22/business/22regulate.html?hp.

[258] 12 U.S.C. § 5384(a).

[259] *Id*. §§ 5384-85.

[260] The term "financial company" is defined to mean (1) "bank holding companies," as that term is defined in the Bank Holding Company Act (BHCA); (2) non-bank financial companies supervised by the Federal Reserve; (3) any company predominantly engaged in activities that the Federal Reserve has determined are financial in nature or (continued...)

not an insured depository institution, and for which a "systemic risk determination" has been made.[261] Title II defines a "covered broker or dealer" as a broker or dealer that is registered with the Securities and Exchange Commission (SEC) and is a member of the Securities Investor Protection Corporation.[262]

The Decision to Invoke Title II

Under Title II, certain designated federal regulators may recommend to the Treasury Secretary the appointment of the FDIC as receiver of a financial company.[263] The Federal Reserve and the SEC will make the recommendation if the company or its largest subsidiary is a broker or dealer.[264] The Federal Reserve and the Director of the Federal Insurance Office will make the recommendation if the company is an insurance company.[265] The Federal Reserve and the FDIC will make the recommendation in all other cases.[266] Such a recommendation requires a vote of at least two-thirds of the members of the Board of Governors of the Federal Reserve, and (1) at least two-thirds of the SEC members then serving (in the case of a broker or dealer), (2) the Director of the Federal Insurance Office (in the case of an insurance company), or (3) two-thirds of the members of the FDIC's Board of Directors (in all other cases).[267] Any such recommendation shall contain

1. an evaluation of whether the financial company is in default or danger of default;
2. a description of the effect that the default of the financial company would have on financial stability in the United States;
3. a description of the effect that the default of the financial company would have on economic conditions or financial stability for low income, minority, or underserved communities;
4. a recommendation regarding the nature and the extent of actions to be taken regarding the financial company;
5. an evaluation of the likelihood of a private sector alternative to prevent the default of the financial company;

(...continued)

incidental thereto for purposes of the BHCA; or (4) any subsidiary of any company in the three foregoing categories that is predominantly engaged in activities that the Federal Reserve has determined are financial in nature or incidental thereto for purposes of the BHCA, except if those subsidiaries are insured depository institutions or insurance companies. *Id*. § 5381(a)(11).

The Bank Holding Company Act defines a "bank holding company" as "any company which has control over any bank or over any company that is or becomes a bank holding company." *Id*. § 1841(a)(1). For purposes of this definition, a company "has control over a bank or over any company" if (1) the company directly or indirectly owns, controls, or has the power to vote 25 percent or more of any class of voting securities of the bank or company, (2) the company controls in any manner the election of a majority of the directors or trustees of the bank or company, or (3) the Federal Reserve determines that the company directly or indirectly exercises a controlling influence over the management or policies of a bank or company. *Id*. § 1841(a)(2).

[261] *Id*. § 5381(a)(8).

[262] *Id*. § 5381(a)(7).

[263] *Id*. § 5383(a)(1).

[264] *Id*. § 5383(a)(1)(B).

[265] *Id*. § 5383(a)(1)(C).

[266] *Id*. § 5383(a)(1)(A).

[267] *Id*. § 5383(a)(1).

6. an evaluation of why a case under the Bankruptcy Code is not appropriate for the financial company;
7. an evaluation of the effects on creditors, counterparties, and shareholders of the financial company and other market participants; and
8. an evaluation of whether the company satisfies the definition of a "financial company."[268]

Upon a written recommendation, the Treasury Secretary shall seek appointment of the FDIC as receiver of the financial company if (in consultation with the President) he makes a "systemic risk determination"—that is, if he makes the following seven determinations:

1. the financial company is in default or in danger of default;[269]
2. the failure of the financial company and its resolution under otherwise applicable federal or state law would have serious adverse effects on financial stability in the United States;
3. no viable private sector alternative is available to prevent the default of the financial company;
4. any effect on the claims or interests of creditors, counterparties, and shareholders of the financial company and other market participants as a result of actions to be taken under the relevant subchapter is appropriate, given the impact that any such action would have on financial stability in the United States;
5. the relevant action would avoid or mitigate such adverse effects, taking into consideration the effectiveness of the action in mitigating potential adverse effects on the financial system, the cost to the general fund of the Treasury Department, and the potential to increase excessive risk taking on the part of creditors, counterparties, and shareholders in the financial company;
6. a federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments that are subject to the regulatory order; and
7. the company satisfies the definition of a "financial company."[270]

Upon making a "systemic risk determination," the Treasury Secretary must notify the financial company and the FDIC.[271] If the company's board of directors consents to the appointment of the FDIC as receiver, the Treasury Secretary must appoint the FDIC as receiver.[272] If the company's board of directors does not consent to the appointment, the Treasury Secretary can petition the U.S. District Court for the District of Columbia for an order authorizing the appointment.[273] The court must then hold a "strictly confidential" hearing at which it reviews (under the "arbitrary and

[268] *Id*. § 5383(a)(2).

[269] For purposes of the relevant subchapter of Title II, a financial company is considered to be "in default or in danger of default" if (1) a case has been, or likely will promptly be, commenced with respect to it under the Bankruptcy Code, (2) the financial company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion, (3) the assets of the financial company are, or are likely to be, less than its obligations to creditors and others, or (4) the financial company is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business. *Id*. § 5383(c)(4).

[270] *Id*. § 5383(b).

[271] *Id*. § 5382(a)(1)(A)(i).

[272] *Id*.

[273] *Id*.

capricious" standard) two of the Treasury Secretary's determinations: (1) the company is in default or in danger of default, and (2) the company is a "financial company."[274]

If the court determines that these determinations are not arbitrary and capricious, it must issue an order immediately authorizing the Treasury Secretary to appoint the FDIC as receiver of the financial company.[275] If the court does not make a determination within 24 hours after receiving the petition, the petition is deemed granted by operation of law.[276] The court's determination is "final," and "not ... subject to any stay or injunction pending appeal."[277] Moreover, any appeal of the district court's decision must be considered "on an expedited basis."[278] Title II also imposes criminal penalties on persons who "recklessly disclose[]" a systemic risk determination by the Treasury Secretary or the pendency of court proceedings related to such a determination.[279]

The FDIC's Powers as Receiver

Upon its appointment as receiver, the FDIC succeeds to all rights, titles, powers, and privileges of the company and its assets, and of any stockholder, member, officer or director.[280] The FDIC may continue the company's business and "liquidate" and "wind-up" its affairs "in such manner as [it] deems appropriate."[281] Pursuant to this authority, the FDIC may sell the company's assets,[282] merge the company with another company,[283] transfer its assets or liabilities to another company,[284] or transfer the company's assets or liabilities to a newly created "bridge financial company."[285]

The creation of a bridge company allows the FDIC to continue the troubled company's critical businesses on a temporary basis until it can find a buyer or liquidate the company.[286] This new entity would "not be saddled with the shareholders, debt, senior executives or bad assets and operations that led to the failure of the covered financial company."[287] QFCs transferred to a

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[274] 12 U.S.C. § 5382(a)(1)(A)(iii).

[275] *Id*. § 5382(a)(1)(A)(iv)(I). If the court determines that these determinations are arbitrary and capricious, it must immediately provide the Treasury Secretary "a written statement of each reason supporting its determination, and afford the Secretary an immediate opportunity to amend and refile the petition." *Id*. § 5382(a)(1)(A)(iv)(II).

[276] *Id*. § 5382(a)(1)(A)(v).

[277] *Id*. § 5382(a)(1)(B).

[278] *Id*. § 5382(a)(2)(A)(iii). *See also id*. § 5382(a)(2)(B)(iii) (providing that the Supreme Court shall consider any appeals from the U.S. Court of Appeals from the D.C. Circuit "on an expedited basis").

[279] *Id*. § 5382(a)(1)(C).

[280] *Id*. § 5390(a)(1)(A).

[281] *Id*. § 5390(a)(1)(D).

[282] *Id*.

[283] For mergers requiring approval by a federal agency, transactions may not be consummated before the 5th calendar day after the day of approval by the relevant agency. *Id*. § 5390(a)(1)(G)(ii)(I).

[284] *Id*. § 5390(a)(1)(D).

[285] *Id*. §§ 5390(a)(1)(D), 5390(a)(1)(F), 5390(h). Any judicial action to which a bridge financial company becomes a party by virtue of its acquisition of assets or assumption of liabilities of a financial company can be stayed for a period of up to 45 days, at the request of the bridge financial company. *Id*. § 5390(h)(6). A bridge company established by the FDIC terminates two years after it is granted its charter, unless the FDIC extends its status for up to three additional one-year periods. *Id*. § 5390(h)(12).

[286] Clearing House Report, *supra* note 226 at 23; Interim Final Rule, Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4,207, 4,209 (Jan. 25, 2011).

[287] Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. at 4,209. Title II exempts a bridge company created by the FDIC from all federal, state, and local taxes. 12 U.S.C. § 5390(h)(10). For a discussion of how the FDIC envisions transferring the assets of a failed company to a (continued...)

bridge company cannot be terminated simply because they are assumed by the bridge company.[288] According to the FDIC, this provision "is an important tool to avoid market destabilization because, unlike the Bankruptcy Code, it can prevent the immediate and disorderly liquidation of collateral during a period of market distress."[289]

Title II also specifies the priorities governing payment of unsecured claims, mandating that the costs of the receivership be paid first.[290] Claims owed to the United States are paid second, followed by a rank-ordering of other categories of unsecured claims.[291] However, Title II allows the FDIC to depart from this statutory priority list and make "additional payments" to "any claimant or category claimants" if it "determines that such payments ... are necessary or appropriate to minimize losses to the [FDIC]."[292] Title II also requires that the FDIC treat all similarly situated creditors similarly, except when the FDIC determines that not doing so is necessary to (1) maximize the assets of the covered financial company, (2) continue operations that are "essential to implementation of the receivership," (3) maximize the present value return from the sale or other disposition of covered financial company's assets, or (4) minimize the amount of any loss realized upon the sale or other disposition of the covered financial company's assets.[293] Despite granting these powers to the FDIC, Title II provides that "in no event" shall a creditor receive less than it would have received if the FDIC had not been appointed receiver and the company had instead been liquidated under Chapter 7 of the Bankruptcy Code.[294]

As in bank resolutions, the FDIC has the authority to disallow any claims not proved to its satisfaction.[295] A claimant may contest such determinations by filing suit in the federal district where the relevant financial company's principal place of business is located.[296] Title II also provides that the FDIC may disaffirm or repudiate any contract or lease of a company in receivership if it determines that performance would be "burdensome" and that doing so "will promote the orderly administration of the affairs of the covered financial company."[297] The FDIC

(...continued)

bridge company, and exchanging equity and debt in the bridge company for claims against the failed company, see "Single Point of Entry (SPOE) Resolution" *infra*.

288 12 U.S.C. § 5390(c)(10)(B)(i)(II).

289 Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. at 4,209. Along these lines, the FDIC has contended that "[t]he absence of funding for continuing valuable contracts and the rights of counterparties under the Bankruptcy Code to immediately terminate [QFCs] resulted in a loss of billions of dollars in market value to the bankruptcy estate in the Lehman insolvency." *Id*.

290 12 U.S.C. § 5390(b)(1).

291 *Id*.

292 *Id*. § 5390(d)(4)(A). This power is subject to the caveat that the FDIC may not make any "additional payments" to a claimant or category of claimants "that would result in any claimant receiving more than the face value amount of any claim." *Id*. § 5390(d)(4)(B).

293 *Id*. § 5390(b)(4). *See also id*. § 5390(h)(5)(E) (imposing the same "equitable treatment" requirement and similar exceptions when the FDIC transfers assets or liabilities to a bridge financial company). If the FDIC exercises its authority to treat similarly situated creditors differently under any of these provisions, it must file a report with the Senate Committee on Banking, Housing, and Urban Affairs and the House of Representatives Committee on Financial Services identifying the claimants that have received special treatment, the amount of any additional payments, and the reason for such action. *Id*. § 5383(c)(3)(A)(vi).

294 *Id*. § 5390(a)(7)(B), (d)(2).

295 *Id*. § 5390(a)(3)(D).

296 *Id*. § 5390(a)(4).

297 *Id*. § 5390(c)(1). Damages for the disaffirmance or repudiation of a contract to which a company in receivership is a party are limited to "actual direct compensatory damages," and do not include "punitive or exemplary damages," "damages for lost profits or opportunity," or "damages for pain and suffering." *Id*. § 5390(c)(3)(A)-(B). However, (continued...)

may transfer its rights under a contract or lease to an acquirer of a financial company's assets, despite any contractual provisions excusing a counterparty from performance in the event of the financial company's insolvency, the appointment of a receiver, or similar circumstances.[298] The FDIC also has the authority to sue to avoid fraudulent transfers, preferences, and improper setoffs, like a trustee in bankruptcy.[299] Finally, Title II gives the FDIC the authority to "recover from any current or former senior executive or director substantially responsible for the failed condition of [a] covered financial company any compensation received during the 2-year period preceding" the FDIC's appointment as receiver.[300]

Although Title II gives the FDIC broad powers to resolve troubled companies, it also imposes a number of mandatory conditions on its conduct as a receiver. Specifically, Title II provides that the FDIC shall

1. determine that any actions it takes as receiver are "necessary for purposes of the financial stability of the United States, and not for the purpose of preserving the covered financial company";
2. "ensure that the shareholders of a covered financial company do not receive payment until after all other claims and the [Orderly Liquidation] Fund are fully paid";
3. ensure that unsecured creditors bear losses in accordance with statutorily prescribed priorities;
4. "ensure that management responsible for the failed condition of the covered financial company is removed";
5. "ensure that the members of the board of directors ... responsible for the failed condition of the covered financial company are removed"; and
6. not take an equity interest in or become a shareholder of any covered financial company.[301]

Title II limits judicial review over the FDIC's actions as receiver. Specifically, Title II provides that except as otherwise provided, no court has jurisdiction over (1) claims for payment from or a determination of rights with respect to the assets of a company in receivership, or (2) any claim relating to acts or omissions of such companies or the FDIC as receiver.[302] Moreover, except as otherwise provided, "no court may take any action to restrain or affect the exercise of powers or functions of the receiver," and "any remedy against the [FDIC] or receiver shall be limited to money damages."[303]

(...continued)

damages for the disaffirmance or repudiation of a QFC are "deemed to include normal and reasonable costs of other reasonable measures of damages utilized in the industries for such contract and agreement claims." *Id.* § 5390(c)(3)(C).

[298] *Id*. § 5390(c)(13).

[299] *Id*. § 5390(a)(11)(A)-(B), 5390(a)(12).

[300] *Id*. § 5390(s)(1). In cases of fraud, "no time limit shall apply" to the FDIC's power to recoup executive or director compensation. *Id*.

[301] *Id*. § 5386.

[302] *Id*. § 5390(a)(9)(D).

[303] *Id*. § 5390(e).

Funding a Resolution Under Title II

Title II allows for the creation of an "Orderly Liquidation Fund" (OLF) funded with money the FDIC may borrow from the Treasury Department.[304] The FDIC's borrowing cannot exceed 10 percent of a financial company's total consolidated assets during the first 30 days of a receivership, or 90 percent of total consolidated assets that are available for repayment thereafter.[305] The FDIC can "in its discretion" and "as necessary and appropriate" make OLF funds "available to the receivership," including by making loans to the company in receivership or purchasing or guaranteeing its assets.[306] However, the FDIC can use the OLF only after developing an orderly liquidation plan for a company in receivership "that is acceptable to" the Treasury Secretary.[307]

Despite granting the FDIC the authority to make loans to a company in receivership from the OLF, Title II provides that taxpayers "shall bear no losses" from an OLA resolution.[308] Any funds expended in the liquidation of a financial company must be "recovered from the disposition of assets of such financial company, or shall be the responsibility of the financial sector, through assessments."[309] Any loans the FDIC makes to a company in receivership from the OLF enjoy priority over all other unsecured creditors.[310] If a company's assets are insufficient to pay the sums borrowed from the Treasury Department within 60 months of their issuance, the FDIC must charge "one or more risk-based assessments" on any creditors that received "additional payments" from the FDIC pursuant to its authority to treat some creditors more favorably than similarly situated creditors.[311] If those funds are also inadequate to satisfy the FDIC's obligations to the Treasury Secretary, the FDIC must impose additional assessments on "eligible financial companies" and financial companies with total consolidated assets equal to or greater than $50 billion.[312]

Title II's Treatment of QFCs

Title II contains a number of provisions addressing QFCs, which are defined to encompass "any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement that the [FDIC] determines by regulation, resolution, or

[304] *Id*. § 5390(n)(5).

[305] *Id*. § 5390(n)(6).

[306] *Id*. § 5384(d).

[307] *Id*. § 5390(n)(9)(A).

[308] *Id*. § 5394(c). *See also id*. § 5384(a)(1) (explaining that the purpose of Title II is "to provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard," and that "[t]he authority provided in this subchapter shall be exercised in the manner that best fulfills such purpose, so that ... creditors and shareholders will bear the losses of the financial company.").

[309] *Id*. § 5394(b).

[310] *Id*. § 5390(b)(1)(B).

[311] *Id*. § 5390(o)(1)(B), 5390(o)(1)(D)(i). The FDIC may extend this period if it "determines that an extension is necessary to avoid a serious adverse effect on the financial system of the United States." *Id*. § 5390(o)(1)(C).

[312] *Id*. § 5390(o)(1)(D)(ii). The term "eligible financial company" is defined to mean "any bank holding company with total consolidated assets equal to or greater $50 billion and any nonbank financial company supervised by the Board of Governors [of the Federal Reserve]." *Id*. § 5390(o)(1)(A). The FDIC must impose such assessments pursuant to a "risk matrix" that takes into account a variety of factors, including a financial company's risk to the financial system, the extent to which the company has benefitted or likely would benefit from the orderly liquidation of a company placed into receivership, and any other risk-related factors the FDIC determines to be appropriate. *Id*. § 5390(o)(4).

order to be a [QFC] for purposes of this paragraph."[313] As in FDIC bank resolutions, Title II stays the exercise of any *direct* default rights under a QFC—that is, rights against the institution in receivership triggered by the institution's placement into receivership—for one business day.[314] If the FDIC transfers a QFC to a third party, including a bridge financial company, Title II permanently stays the exercise of direct default rights.[315] Moreover, unlike the rules governing FDIC resolutions, Title II addresses *cross-default* rights under QFCs using a similar procedure. Specifically, Title II empowers the FDIC to "enforce contracts of subsidiaries or affiliates" of a company in receivership that are guaranteed or otherwise support by or linked to the company, notwithstanding any cross-default rights.[316] If a QFC is supported by a guarantee or otherwise supported by a company in receivership, the FDIC must take certain steps to protect the QFC counterparty's interests by the end of the business day following the company's entry into receivership.[317]

Administrative Rules

The OLA has never been used. However, federal agencies have promulgated a number of rules that affect Title II in important ways. Section 209 of Dodd-Frank directs the FDIC, in consultation with FSOC, to "prescribe such rules or regulations as the [FDIC] considers necessary or appropriate to implement [Title II], including 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."[318] A number of other provisions also direct the FDIC to promulgate rules addressing specific issues under Title II.[319] Moreover, other provisions in Dodd-Frank and federal statutes allow federal regulatory agencies to promulgate rules that have important implications for Title II.[320] This subsection provides a general overview of some of the key administrative rules related to Title II.

Early FDIC Rules

In January 2011, the FDIC promulgated a rule addressing a variety of discrete topics.[321] Among other things, the rule addressed the provisions in Title II that allow the FDIC as receiver to pay certain creditors more than similarly situated creditors if it makes certain findings related to maximizing recovery for the receivership.[322] Responding to criticism that the relevant statutory

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[313] *Id*. § 5390(c)(8)(D)(i).

[314] *Id*. § 5390(c)(10)(B)(i)(I).

[315] *Id*. § 5390(c)(10)(B)(i)(II).

[316] *Id*. § 5390(c)(16).

[317] *Id*.

[318] *Id*. § 5389.

[319] *See id*. §§ 5390(a)(7)(D) (directing the FDIC to promulgate regulations "to establish an interest rate for or to make payments of post-insolvency interest to creditors" of a receivership estate); 5390(b)(1)(C)-(D) (directing the FDIC to promulgate regulations regarding the inflation index for certain employee compensation and benefit claims); 5390(s)(3) (directing the FDIC to promulgate regulations implementing Title II's provision regarding claw-backs of executive and director compensation).

[320] *See* 12 U.S.C. § 5365(a)(1) (allowing the Federal Reserve to impose enhanced prudential standards on bank holding companies with more than $50 billion in assets).

[321] Interim Final Rule, Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4,207, 4,209 (Jan. 25, 2011).

[322] *See* 12 U.S.C. §§ 5390(b)(4), 5390(d)(4)(A), 5390(h)(5)(E).

provision permitted it to bailout favored creditors,[323] the FDIC clarified that it will not use this authority to make such "additional payments" to creditors who hold certain unsecured senior debt with a term of more than 360 days or to holders of subordinated debt or shareholders.[324] The FDIC explained that it will evaluate whether to make "additional payments" to holders of shorter-term debt "on a case-by-case basis" and that such payments will be "very rare."[325] Possible examples of creditors who might receive such payments, the FDIC noted, include providers of "essential and necessary service[s]," and creditors with contract claims that are tied to performance bonds or other credit support needed for the company to continue other valuable contracts.[326]

In July 2011, the FDIC promulgated another rule addressing a variety of issues.[327] Among other things, the rule provided that for purposes of Title II's provision allowing the FDIC to recover compensation from executives and directors "substantially responsible" for the failure of a covered financial company, a person will be deemed "substantially responsible" if "he or she failed to conduct his or her responsibilities with the degree of skill and care of an ordinarily prudent person in a like position would exercise under similar circumstances."[328] In establishing a negligence standard for recovery of executive or director compensation, the FDIC rejected proposals to adopt a stricter standard such as gross negligence.[329] The FDIC's rule further provided that a senior executive or director will be presumed to be "substantially responsible" for the failure of a covered financial company in certain circumstances.[330]

Single Point of Entry (SPOE) Resolution (FDIC Notice for Public Comment)

Arguably, the FDIC's most prominent refinement of its Title II authorities has involved its general strategy for resolving a financial company in receivership.[331] In December 2013, the FDIC proposed for public comment a notice describing its "Single Point of Entry" (SPOE) strategy for implementing its Title II authority.[332] As background, in the United States, large financial

[323] *See* Statement of Republican Policy on H.R. 4173, the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (June 30, 2010), https://repcloakroom.house.gov/news/documentsingle.aspx?DocumentID=193034.

[324] Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. at 4,211.

[325] *Id*. at 4,211-4,212. *See also id*. at 4,212 ("Short-term debt holders (including, without limitation, holders of commercial paper and derivatives counterparties) are highly unlikely to meet the criteria set forth in the statute for permitting payment of additional amounts.").

[326] *Id*. at 4,212.

[327] 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 (July 15, 2011).

[328] *Id*. at 41,631.

[329] *Id*.

[330] *Id*. The FDIC's rule also addressed issues concerning personal service agreements with a failed financial company, the treatment of insurance company subsidiaries, the treatment of fraudulent and preferential transfers, and the priority of certain claims, among other issues. *Id*. at 41,630-41,638.

[331] *See* David A. Skeel, Jr., *Single Point of Entry and the Bankruptcy Alternative* in ACROSS THE GREAT DIVIDE: NEW PERSPECTIVES ON THE FINANCIAL CRISIS 311, 312-13 (Martin Neil Baily & John B. Taylor eds., 2014) (characterizing the Single Point of Entry strategy as "remarkable" and "quite promising," and noting that it has generated "much enthusiasm among regulators"); Lee, *supra* note 227 at 466-67 (noting that the FDIC has "actively engaged" with the Bank of England, European Commission, Japan Financial Services Authority, and Swiss Financial Market Supervisory Authority in developing and promoting the Single Point of Entry strategy).

[332] Notice, Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76,614 (Dec. 18, 2013).

institutions are generally organized under a holding company structure, with a top-tier parent company and sometimes hundreds or even thousands of subsidiaries spanning different countries.[333] Functions and business lines often are not aligned with the structures of individual subsidiaries, and funding is often allocated among subsidiaries as needed.[334] Moreover, many holding companies own bank and non-bank subsidiaries that are subject to different insolvency regimes, complicating their orderly resolution.[335]

Under its SPOE approach, the FDIC would be appointed as receiver of only the top-tier U.S. holding company of a troubled financial institution, and the institution's subsidiaries would remain open and continue operations.[336] The FDIC would create a bridge financial company into which it would transfer the assets of the holding company.[337] Certain liabilities of the holding company (principally, the company's long-term debt) would remain in the receivership, and losses would be allocated among the holding company's creditors according to the statutory priorities established under Title II.[338] In exchange for their claims, the holding company's creditors would receive debt, equity, or contingent securities (such as warrants or options) in the newly established bridge company.[339] As a result of this process, the bridge company would no longer be burdened by certain debts of the holding company, leaving it with a stronger balance sheet.[340]

Under the SPOE approach, the FDIC would select new management for the bridge company, and the holding company's subsidiaries would continue operating, "allowing them to continue critical operations for the financial system and avoid the disruption that would otherwise accompany their closings."[341] While the FDIC indicated that it "intends to maximize the use of private funding" in a Title II resolution, it noted that it could provide guarantees of new debt issued by the bridge company, or provide the bridge company with funding from the OLF in order to facilitate an orderly resolution.[342]

In its December 2013 notice, the FDIC sought comment on a number of aspects of its SPOE strategy, including the level and types of capital and debt that large institutions should be required to maintain to optimize the SPOE resolution strategy, how the OLF should be used in a resolution, and the treatment of the foreign operations of a failed financial company under Title II.[343] The comment period ended on January 13, 2014, and the FDIC has yet to promulgate a final rule concerning its SPOE strategy.

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[333] *Id*. at 76,615.

[334] *Id*. In this type of holding company structure, the top-tier parent company raises equity capital and then provides it to its subsidiaries. *Id*.

[335] Dafna Avraham, Patricia Selvaggi & James Vickery, *A Structural View of U.S. Bank Holding Companies*, FED. RES. BANK OF NEW YORK ECON. POL. REV. 65 (July 2012), https://www.newyorkfed.org/medialibrary/media/research/epr/12v18n2/1207avra.pdf.

[336] *Id*. at 76,616.

[337] *Id*.

[338] *Id*. Claims of critical vendors and guarantees related to the holding company's subsidiaries may be transferred to the bridge company. *Id*.

[339] *Id*. The FDIC explained that warrants or options (which would enable claimants to recover value in the event that a valuation underestimates the market value of the holding company) may be used to protect creditors of the holding company in lower priority classes against the possibility of undervaluation of their claims. *Id*. at 76,618.

[340] *Id*. at 76,616.

[341] *Id*.

[342] *Id*.

[343] *Id*. at 76,624. For a general summary of submitted comments, see Lee *supra* note 227 at 473-74.

Total Loss-Absorbing Capacity (TLAC) and "Clean Holding Companies"

In December 2016, pursuant to its authority under Section 165 of Dodd-Frank to impose enhanced prudential standards on large bank holding companies, the Federal Reserve finalized a rule imposing "total loss-absorbing capacity" (TLAC) and "clean holding company" requirements on such companies[344]—a rule that some commentators have described as "essential to the execution of the SPOE resolution strategy."[345] Under the rule, bank holding companies of U.S. global systemically important banks (G-SIBs)[346] and top-tier U.S. intermediate holding companies of foreign G-SIBs are required to maintain minimum levels of long-term debt and certain types of capital (which together represent a bank's TLAC).[347] The "clean holding company" requirements prohibit the relevant holding companies from (1) issuing short-term debt to third parties (i.e., to entities other than their subsidiaries), (2) entering into QFCs with third parties, (3) having liabilities that are guaranteed by their subsidiaries or subject to contractual offset rights for their subsidiaries' creditors, or (4) issuing certain guarantees of their subsidiaries liabilities, if the liabilities provide default rights based on the resolution of the holding company.[348]

The TLAC requirements supplement other regulatory capital requirements, which "are intended to ensure that a banking organization has sufficient capital to remain a going concern."[349] Like other regulatory capital requirements, the TLAC rule is directed at strengthening the resiliency of large bank holding companies in the event that they experience financial distress.[350] However, the TLAC requirements also have the additional goal of improving the resolvability of such companies in the event of distress or failure.[351] The requirements attempt to accomplish this goal by requiring that large bank holding companies hold minimum levels of long-term debt, which can serve as the source of new capital in the event of financial distress.[352] Specifically, unlike regulatory capital (which is likely to be significantly depleted as a result of financial distress) and short-term debt (which must be continually refinanced or "rolled over," and is susceptible to "runs" in the event of financial distress), long-term debt can serve as the source of new capital because it can be reduced in a resolution or bankruptcy proceeding, increasing the ratio of a firm's assets to its liabilities and thereby increasing its equity.[353] Commentators have accordingly

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[344] Final Rule, Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations, 82 Fed. Reg. 8,266 (Jan. 24, 2017) [hereinafter "TLAC Rule"].

[345] ORDERLY LIQUIDATION AUTHORITY AND BANKRUPTCY REFORM, U.S. DEP'T OF THE TREASURY 16 (Feb. 21, 2018), https://home.treasury.gov/sites/default/files/2018-02/OLA_REPORT.pdf. [hereinafter "OLA Treasury Report"].

[346] Under the Third Basel Accord (Basel III), an international regulatory framework agreed upon by members of the Basel Committee on Banking Supervision, banks identified as G-SIBs are subject to enhanced prudential regulation. *See Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement*, BANK FOR INT'L SETTLEMENTS, https://www.bis.org/bcbs/gsib/ (last updated Nov. 21, 2017). For purposes of the Federal Reserve's implementation of Basel III, whether a bank qualifies as a G-SIB is determined based on a methodology that considers the bank's size, interconnectedness, cross-jurisdictional activity, substitutability, and complexity. *See GSIB Framework Denominators*, BD. OF GOV. OF THE FED. RES. SYS., https://www.federalreserve.gov/supervisionreg/basel/denominators.htm.(last updated Dec. 14, 2017).

[347] TLAC Rule, *supra* note 344 at 8,266.

[348] *Id*. at 8,272,

[349] *Id*. at 8,267.

[350] *Id*. at 8,266.

[351] *Id*.

[352] *Id*. at 8,267.

[353] *Id*.

argued that because of the loss-absorbing capacity of long-term debt, the availability of TLAC at the holding company level "generate[s] market confidence to help avoid runs on deposits and other liabilities ... that could otherwise lead to financial contagion."[354] Similarly, the "clean holding company" requirements have the potential to help facilitate the orderly resolution of a financial institution by simplifying the holdings of its top-level holding company.[355]

QFCs

In 2017, the Federal Reserve, FDIC, and Office of the Comptroller of the Currency (OCC) finalized rules restricting the types of QFCs into which certain regulated banks and bank holding companies can enter.[356] The rules were directed at plugging gaps in provisions of the Bankruptcy Code, FDIC receivership authority, and Title II involving default rights under QFCs.

As discussed above, the Bankruptcy Code generally subjects creditors to an automatic stay that prevents them from enforcing certain rights (for example, to terminate a contract, set-off obligations, or liquidate collateral) upon the filing of a bankruptcy petition.[357] However, the Bankruptcy Code also provides a "safe harbor" that allows counterparties to a variety of financial contracts—including certain securities and commodities contracts, swaps, forwards, and repos—to exercise their rights against a debtor that are triggered by its entry into bankruptcy.[358] Moreover, the Bankruptcy Code does not stay the exercise of cross-default rights (i.e., rights against a company triggered by the entry of a company's parent, subsidiary, or affiliate into bankruptcy).[359] These "safe harbors" potentially exacerbate the risk of "runs" against a company or its affiliates triggered by bankruptcy proceedings.[360]

By contrast, as noted above, in *non-Title II* bank resolutions under the Federal Deposit Insurance Act (FDIA), counterparties to QFCs—a term defined as encompassing many of the same financial contracts exempt from the Bankruptcy Code's automatic stay—are stayed from exercising *direct* default rights for one business day, and are permanently stayed from exercising such rights if the FDIC transfers QFCs to a third party.[361] However, there is no similar stay applicable to *cross-default* rights.[362] Accordingly, while derivatives counterparties are temporarily stayed from exercising default rights against a bank triggered by the bank's entry into a non-Title II FDIC resolution, they are not stayed from exercising default rights against a *parent or affiliate* of a bank triggered by the bank's entry into a non-Title II FDIC resolution. The absence of such a stay creates the possibility that a bank's entry into a non-Title II FDIC resolution could trigger

[354] OLA Treasury Report, *supra* note 345 at 16.

[355] *Id*.

[356] Final Rule, Mandatory Contractual Stay Requirements for Qualified Financial Contracts, 82 Fed. Reg. 56,630 (Nov. 29, 2017) [hereinafter "OCC QFC Rule"]; Final Rule, Restrictions on Qualified Financial Contracts of Certain FDIC-Supervised Institutions; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 Fed. Reg. 50,228 (Oct. 30, 2017) [hereinafter "FDIC QFC Rule"]; Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 Fed. Reg. 42,882 (Sept. 12, 2017) [hereinafter "Federal Reserve QFC Rule"].

[357] 11 U.S.C. § 362.

[358] *Id*. §§ 362(b)(6), (7), (17), (27), 362(o), 555-56, 559-61.

[359] FDIC QFC Rule, *supra* note 356 at 50,231.

[360] OCC QFC Rule, *supra* note 356 at 56,633.

[361] 12 U.S.C. § 1821(e)(10)(B)(i)-(ii).

[362] FDIC QFC Rule, *supra* note 356 at 50,231.

"runs" on its parent holding company or its affiliates.[363] Moreover, commentators have raised the possibility that foreign courts may not enforce the FDIA's stay-and-transfer provisions concerning direct default rights, disadvantaging domestic QFC counterparties relative to foreign QFC counterparties, and exacerbating the risk of "runs" against a bank's parent or affiliates.[364]

Finally, in a Title II resolution, QFC counterparties are stayed from exercising *direct* default rights for one business day, and are permanently stayed from exercising such rights if the FDIC transfers a QFC to a third party (as in *non-Title II* FDIC resolutions).[365] Moreover, the FDIC can "enforce contracts of subsidiaries or affiliates" of a company in receivership that are guaranteed or otherwise supported by or linked to the company, notwithstanding any *cross-default* rights.[366] However, as with non-Title II FDIC resolutions, commentators have raised the possibility that foreign courts may not enforce Title II's stay-and-transfer provisions.[367]

Table 2. QFCs Under the Bankruptcy Code, Federal Deposit Insurance Act, and Title II

	Bankruptcy Code	Federal Deposit Insurance Act	Title II
Direct default rights	Certain derivatives contracts are exempt from the "automatic stay," allowing counterparties to immediately exercise rights against a debtor triggered by the debtor's entry into bankruptcy. This leaves bankrupt debtors susceptible to "runs."	Counterparties to QFCs are stayed from exercising rights against a bank triggered by the bank's entry into resolution proceedings for **one business day**. Counterparties to QFCs are **permanently** stayed from exercising such rights if the FDIC transfers a QFC to a third party. However, it is possible that foreign courts may refuse to enforce these limitations.	Counterparties to QFCs are stayed from exercising rights against a financial company triggered by the financial company's entry into resolution proceedings for **one business day**. Counterparties to QFCs are **permanently** stayed from exercising such rights if the FDIC transfers a QFC to a third party. However, it is possible that foreign courts may refuse to enforce these limitations.

[363] *Id*. at 50,234.

[364] OCC QFC Rule, *supra* note 356 at 56,635; FDIC QFC Rule, *supra* note 356 at 50,243; Federal Reserve QFC Rule, *supra* note 356 at 42,885-42,890.

[365] 12 U.S.C. § 5390(c)(10), 5390(c)(16).

[366] *Id*.

[367] OCC QFC Rule, *supra* note 356 at 56,635; FDIC QFC Rule, *supra* note 356 at 50,243; Federal Reserve QFC Rule, *supra* note 356 at 42,885-42,890.

	Bankruptcy Code	Federal Deposit Insurance Act	Title II
Cross-default rights	No limitations on rights against a debtor's parent, subsidiaries, or affiliates triggered by the debtor's entry into bankruptcy, leaving a debtor's parent, subsidiaries, and affiliates susceptible to "runs."	No limitations on rights against a bank's parent, subsidiaries, or affiliates triggered by a bank's entry into resolution proceedings, leaving a bank's parent, subsidiaries, and affiliates susceptible to "runs."	The FDIC can enforce contracts of a failed company's subsidiaries or affiliates that are guaranteed or otherwise supported by or linked to the failed company, notwithstanding any cross-default rights. However, it is possible that foreign courts may refuse to enforce these limitations.

Source: CRS.

In promulgating its QFC rules, the Federal Reserve, FDIC, and OCC were concerned with plugging certain gaps the Bankruptcy Code, the FDIA, and Title II involving default rights under QFCs. Specifically, the agencies were concerned with scenarios in which the entry of one institution into bankruptcy, a non-Title II FDIC resolution, or a Title II resolution would prompt a "run" by its derivatives counterparties or by the derivatives counterparties of its parent, subsidiary, or affiliate.[368] The QFC rules provide that certain institutions regulated by the agencies[369] may enter into a QFC only if (1) the QFC includes terms explicitly providing that, in the event that the institution enters into a Title II proceeding or a non-Title II resolution, any default rights or transfer restrictions under the QFC are subject to the stay-and-transfer limitations imposed under the relevant insolvency scheme, and (2) the QFC does not allow counterparties to exercise *cross-default* rights against the institution.[370]

The QFC rules accordingly require QFCs entered into by the relevant institutions to affirmatively opt into the stay-and-transfer provisions of the FDIA and Title II, thereby minimizing the risk that a QFC counterparty in a foreign court would successfully challenge stay-and-transfer actions taken by the FDIC.[371] Moreover, the rule prohibits the relevant institutions from entering into QFCs that give counterparties cross-default rights against them, thereby minimizing the risk that

[368] OCC QFC Rule, *supra* note 356 at 56,631-56,632; FDIC QFC Rule, *supra* note 356 at 50,230; Federal Reserve QFC Rule, *supra* note 356 at 42,882-42,886.

[369] The OCC's QFC rule applies to national banks or federal savings associations not under a bank holding company with more than $700 billion in assets, and national banks and federal savings associations that are subsidiaries of a G-SIB holding company, among other institutions. OCC QFC Rule, *supra* note 356 at 56,636-56,638. The FDIC's QFC rule applies to state-chartered banks that are not members of the Federal Reserve system and their subsidiaries. FDIC QFC Rule, *supra* note 356 at 50,234. The Federal Reserve's QFC rule applies to U.S. top-tier bank holding companies identified by the Federal Reserve as G-SIBs, the subsidiaries of any U.S. G-SIB (other than national banks, federal savings associations, state nonmember banks, and state savings associations), and the U.S. operations of any foreign G-SIBs (other than national banks, federal savings associations, state nonmember banks, and state savings associations). Federal Reserve QFC Rule, *supra* note 356 at 42,882.

[370] OCC QFC Rule, *supra* note 356 at 56,645; FDIC QFC Rule, *supra* note 356 at 50,234; Federal Reserve QFC Rule, *supra* note 356 at 42,889. However, the final rules do not prohibit the relevant institutions from entering into QFCs that provide counterparties with *direct* default rights. OCC QFC Rule, *supra* note 356 at 56,647; FDIC QFC Rule, *supra* note 356 at 50,234; Federal Reserve QFC Rule, *supra* note 356 at 42,887.

[371] OCC QFC Rule, *supra* note 356 at 56,645; FDIC QFC Rule, *supra* note 356 at 50,234; Federal Reserve QFC Rule, *supra* note 356 at 42,889.

the bankruptcy or resolution of the institutions' parents or affiliates will trigger "runs" against them.[372]

Criticisms of Title II and Responses

Title II has attracted criticism and generated a number of alternative proposals concerning the resolution of large financial institutions. Some critics have argued that the broad powers that Title II grants the FDIC—both in determining whether to place a firm into receivership and in conducting a resolution—create uncertainty about creditors' rights, raising the cost of credit for financial institutions.[373] Other commentators have contended that by granting the FDIC the authority to extend credit to companies in receivership, Title II effectively formalizes a practice of bailing out large financial institutions.[374] Still others have criticized the imposition of ex post assessments on the financial industry to recoup OLF expenditures not recovered from a firm in receivership, arguing that "taxing" prudently operated firms for the benefit of mismanaged firms creates moral hazard and free-rider problems.[375] Finally, some observers have raised constitutional concerns with Title II's (1) 24-hour period for judicial review of the FDIC's decision to place a firm into receivership,[376] (2) limitation of judicial review to only two of the seven factors the Treasury Secretary must consider in making a systemic risk determination,[377] (3) imposition of criminal penalties on persons who disclose information about a systemic risk determination or related judicial proceedings,[378] and (4) allowance of compensation claw-backs from executives and directors determined to have been "substantially responsible" for the failure of a firm in receivership.[379]

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[372] *Id.*

[373] *See* Peter J. Wallison, *The Error at the Heart of the Dodd-Frank Act*, AM. ENTER. INST. (Sept. 6, 2011), http://www.aei.org/publication/the-error-at-the-heart-of-the-dodd-frank-act/.

[374] *See* Lalita Clozel, *Will Trump Target FDIC's Dodd-Frank Resolution Powers?*, AM. BANKER (Dec. 12, 2016), https://www.americanbanker.com/news/will-trump-target-fdics-dodd-frank-resolution-powers; FAILING TO END "TOO BIG TO FAIL": AN ASSESSMENT OF THE DODD-FRANK ACT FOUR YEARS LATER, Report Prepared by the Republican Staff on the Comm. on Fin. Servs., U.S. House of Representatives at 87-88 (July 2014); *Examining How the Dodd-Frank Act Could Result in More Taxpayer-Funded Bailouts*, Hearing in H. Comm. on Fin. Servs., 113th Cong. (June 26, 2013) (opening remarks of Chairman Jeb Hensarling) ("Regrettably, Dodd-Frank not only fails to end too-big-to-fail and its attendant taxpayer bailouts; it actually codifies them into law ... Title II, Section 210, notwithstanding its ex post funding language, clearly creates a taxpayer-funded bailout system that the CBO estimates will cost taxpayers over $20 billion.").

[375] Viral V. Acharya, Barry Adler, Matthew Richardson & Nouriel Roubini, *Resolution Authority*, in REGULATING WALL STREET: THE DODD-FRANK ACT AND THE NEW ARCHITECTURE OF GLOBAL FINANCE 213, 228 (Viral V. Acharya, Thomas Cooley, Matthew Richardson & Ingo Walter eds., 2011); Arthur E. Wilmarth, Jr., *The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-to-Fail Problem*, 89 OR. L. REV. 951, 1021 (2011).

[376] Merrill & Merrill, *supra* note 198 at 207-08.

[377] *Id*. at 208-09.

[378] *Id*. at 230-34; Wallison, *supra* note 373.

[379] Merrill & Merrill, *supra* note 198 at 238. In the *State Bank of Big Spring* case discussed in note 159 *supra*, certain plaintiffs also challenged the constitutionality of the OLA, arguing that it violated the separation of powers, the Fifth Amendment's Takings Clause, and Article I Section 8's requirement that bankruptcy laws be "uniform." *See* Second Amended Complaint for Declaratory and Injunctive Relief ¶¶ 9-11, State Nat. Bank of Big Spring v. Lew, 958 F. Supp. 127 (D.D.C. 2013). However, the D.C. Circuit affirmed an order dismissing those claims, reasoning that the plaintiffs lacked standing and that their claims were not ripe because the OLA had not been invoked. State Nat. Bank of Big Spring v. Lew, 795 F.3d 48, 56-57 (D.C. Cir. 2015).

Other criticisms of Title II include arguments that (1) the FDIC lacks the expertise necessary to resolve large, complex financial institutions, *see* Wallison *supra* note 373; FAILING TO END "TOO BIG TO FAIL," *supra* note 374 at 64; (2) exempting companies in receivership from taxation amounts to a disguised bailout, FAILING TO END "TOO BIG TO (continued...)

Defenders of Title II have rejected the argument that the OLA promotes moral hazard, noting that a Title II resolution would result in "the extinction of the firm's equity and the wholesale replacement of its board and management."[380] Others have rejected arguments that Title II puts taxpayers at risk, noting that it requires that the FDIC be reimbursed in full for any OLF expenditures.[381]

In responding to the argument that Title II grants the FDIC excessive discretion, commentators have argued that the level of discretion granted by Title II is "fundamentally the same" as that which the FDIC is granted in resolving failed commercial banks.[382] Moreover, in reflecting on crisis management, former Treasury Secretary and President of the New York Fed Timothy Geithner has argued that a certain level of uncertainty regarding "how fast a government will escalate its support" and "how far that support will extend" is beneficial, "leav[ing] investors in and creditors of financial institutions with a healthy sense of fear" that "should lessen the harmful incentives that a strong backstop creates."[383]

In responding to constitutional concerns regarding Title II's limitations on judicial review, one commentator has argued that "it is within Congress's power to set the standard for judicial review," analogizing the deferential standards imposed under Title II to those imposed by the Administrative Procedure Act.[384] This commentator has argued that the 24-hour period for judicial review of a decision to invoke the OLA "is appropriate for the urgency of the issue," and that Title II accordingly provides for due process, if not "as much process as some might like."[385]

Other commentators have focused on the shortcomings of bankruptcy in defending Title II. Some observers have argued that bankruptcy does not offer the speed or opportunity for coordination with foreign financial regulators required to resolve a large institution during a period of financial turmoil.[386] Other defenders of Title II have argued that during times of financial distress, bankruptcy could function effectively for a large financial institution only with "massive government assistance" such as debtor-in-possession financing, effectively allowing the federal

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(...continued)

FAIL," *supra* note 374 at 75-76; and (3) by forcing holding company creditors to absorb losses, the FDIC's SPOE strategy undermines market discipline for a firm's operating subsidiaries, *see* Kwon-Yong Jin, *How to Eat an Elephant: Corporate Group Structure of Systemically Important Institutions, Orderly Liquidation Authority, and Single Point of Entry Resolution*, 124 YALE L. J. 1746, 1765 (2015); Joe Adler, *Likely Battle Ahead for FDIC's "Single Point" Resolution Plan*, AM. BANKER (Dec. 10, 2013), https://www.americanbanker.com/news/likely-battle-ahead-for-fdics-single-point-resolution-plan.

[380] Bernanke, *supra* note 231. *See also* Michael Helfer, *We Need Chapter 14—And We Need Title II*, *in* ACROSS THE GREAT DIVIDE: NEW PERSPECTIVES ON THE FINANCIAL CRISIS 335, 339 (Martin Neil Baily & John B. Taylor eds., 2014) (rejecting the argument that Title II promotes moral hazard, and noting that according to a September 2013 paper issued by the Treasury Department, senior unsecured borrowing costs for large bank holding companies had risen more than those of small regional bank holding companies).

[381] Bernanke, *supra* note 231; Lawrence H. Summers, *Congress is Considering an Extremely Dangerous Idea Almost Nobody has Heard of*, WASH. POST. WONKBLOG (Jan. 18, 2017), https://www.washingtonpost.com/news/wonk/wp/2017/01/18/congress-is-considering-an-extremely-dangerous-idea-almost-nobody-has-heard-of/?utm_term=.77b8db85dd60; Helfer, *supra* note 380 at 338-39.

[382] Helfer, *supra* note 380 at 338.

[383] Timothy F. Geithner, *Are We Safe Yet?: How to Manage Financial Crises*, FOREIGN AFFAIRS (January/February 2017), https://www.foreignaffairs.com/articles/united-states/2016-12-12/are-we-safe-yet.

[384] Levitin, *supra* note 227 at 12; 5 U.S.C. § 706.

[385] Levitin, *supra* note 227 at 12.

[386] Bernanke, *supra* note 231; Lalita Clozel, *Trump Invites Trouble in Targeting FDIC Resolution Powers*, AM. BANKER (Apr. 21, 2017), https://www.americanbanker.com/news/trump-invites-trouble-in-targeting-fdic-resolution-powers; Helfer, *supra* note 380 at 337.

government "to call the shots in the bankruptcy," because "that is what [debtor-in-possession] lenders do."[387] According to this view, an effective form of financial institution bankruptcy (in which the federal government could lend to troubled institutions in periods when private financing is likely to be unavailable) would end up replicating many of the features its proponents dislike about Title II.[388]

Proposals to Alter Title II

Proposed Legislation

Legislation proposed in both the House of Representatives and the Senate has focused on amending the Bankruptcy Code to enhance its ability to resolve large financial institutions, either as a replacement for Title II or as a supplement to it.[389]

During the post-crisis debate over financial reform, a bill introduced in the House (H.R. 3310, 111th Cong.) proposed a new Chapter 14 to the Bankruptcy Code to address the resolution of large non-bank financial institutions.[390] In the proposed Chapter 14, the Bankruptcy Code's "safe harbor" provisions for certain derivatives contracts would not have automatically applied.[391] Instead, the bankruptcy court would make a specific determination upon a motion by the debtor whether the debtor should be subject to any or all of the special provisions of the Bankruptcy Code exempting derivatives and other financial contracts from the automatic stay.[392] The bill would also have prohibited a trustee for an institution in Chapter 14 bankruptcy from obtaining credit "if the source of that credit either directly or indirectly is the United States."[393]

Scholars at the Hoover Institution have also developed proposed amendments to the Bankruptcy Code directed at resolving large financial institutions.[394] In 2010, Professor Thomas Jackson published a proposal to create a new chapter of the Bankruptcy Code in which exclusions for banks, insurance companies, and broker-dealers would not apply.[395] Under the proposal, a financial institution's primary regulator could file an involuntary bankruptcy petition, and a bankruptcy case would be assigned by the Chief Judge of the relevant federal court of appeals to a member of a previously designated panel of special masters.[396] Pursuant to Professor Jackson's proposal, QFCs secured by cash or "cash-like" collateral would enjoy the benefits of the

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387 *See* Levitin, *supra* note 227 at 7-8.

388 *Id*. *See also* Paul L. Lee, *The Case Against Repealing Title II of the Dodd-Frank Act*, COLUMBIA L. SCH. BLUE SKY BLOG (Dec. 12, 2016), http://clsbluesky.law.columbia.edu/2016/12/12/the-case-against-repealing-title-ii-of-the-dodd-frank-act/ (arguing that "the solution to a systemic financial crisis will not be found in Title II or the Bankruptcy Code but in broad-based government liquidity programs to support the financial system.").

389 *See* Paul L. Lee, *Bankruptcy Alternatives to Title II of the Dodd-Frank Act—Part II*, BANKING L. J. 503 (Nov./Dec. 2015).

390 *See* Consumer Protection and Regulatory Enhancement Act, H.R. 3310, 111th Cong. (2009).

391 *Id*. § 102(f).

392 *Id*. In making this determination, the proposed legislation directed the bankruptcy court 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." *Id*.

393 *Id*. § 102(e).

394 *See* Jackson, *supra* note 226 at 217.

395 *Id*. at 229. As discussed, broker-dealers are currently allowed to file for Chapter 7 bankruptcy, but cannot be reorganized under Chapter 11. 11 U.S.C. § 109(b), (d).

396 Jackson, *supra* note 226 at 227, 231-32.

Bankruptcy Code's "safe harbor," but all other QFCs would be subject to the automatic stay and other Bankruptcy Code provisions.[397] The financial institution's regulator would be given special standing to raise motions and the right to file a plan of reorganization.[398] Unlike H.R. 3310 (the bankruptcy bill introduced during debates over financial reform), the institution's regulator would be allowed to provide the bankrupt firm with debtor-in-possession financing subject to the Bankruptcy Code's traditional rules governing the priority of claims.[399] Professor Jackson has released a number of revised versions of his proposal since 2010.[400]

These proposals appear to have served as the basis for a series of legislative proposals to amend the Bankruptcy Code. In April 2017, the House of Representatives passed one of these bills, the Financial Institution Bankruptcy Act of 2017 (FIBA).[401] FIBA creates a new subchapter V of Chapter 11 of the Bankruptcy Code for bank holding companies and financial institutions with over $50 billion in assets.[402] Bankruptcy proceedings under subchapter V would be heard by one of 10 bankruptcy judges designated by the Chief Justice of the Supreme Court.[403] While a case under the new subchapter V could be commenced only by a financial institution itself (and not involuntarily by a regulator), federal regulators could "appear and be heard on any issue in any case or proceeding" under subchapter V.[404] As in the SPOE approach developed by the FDIC for Title II resolutions, a holding company entering subchapter V bankruptcy could transfer certain assets (primarily its equity in subsidiaries and derivatives) to a newly formed bridge company upon the court's determination that the transfer is "necessary to prevent serious adverse effects on financial stability," among other things.[405] The Act also would impose a 48-hour automatic stay on the termination, acceleration, or modification of certain contracts, including QFCs of a financial institution or its affiliates.[406]

The Financial CHOICE Act of 2017, which passed the House in June 2017, also proposes a number of changes to the Bankruptcy Code.[407] The relevant CHOICE Act provisions largely track the reforms in FIBA concerning the creation of a new subchapter V; the appointment of a bankruptcy judge drawn from a panel designated by the Chief Justice of the Supreme Court; the commencement of a bankruptcy case; the transfer of property to a bridge company; and the automatic stay.[408] However, unlike FIBA, the CHOICE Act would repeal Title II.[409]

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[397] *Id*. at 232-38.

[398] *Id*. at 238.

[399] *Id*. at 239-41.

[400] *See* Thomas H. Jackson, *Building on Bankruptcy: A Revised Chapter 14 Proposal for the Recapitalization, Reorganization, or Liquidation of Large Financial Institutions*, *in* MAKING FAILURE FEASIBLE: HOW BANKRUPTCY REFORM CAN END "TOO BIG TO FAIL" 15 (Kenneth E. Scott, Thomas H. Jackson & John B. Taylor, eds. 2015); Thomas H. Jackson, *Bankruptcy Code Chapter 14: A Proposal*, *in* BANKRUPTCY NOT BAILOUT: A SPECIAL CHAPTER 14 (Kenneth E. Scott & John B. Taylor, eds., 2012).

[401] *See* H.R. 1667, 115th Cong. (2017).

[402] *Id*. § 2.

[403] *Id*. § 4.

[404] *Id*. § 3.

[405] *Id*.

[406] *Id*.

[407] H.R. 10, 115th Cong. (2017).

[408] *Id*. § 122.

[409] *Id*. § 111.

Other proposals to amend the Bankruptcy Code to deal with large financial institutions have been introduced in the Senate. S. 1840, the Taxpayer Protection and Responsible Resolution Act (introduced in the 114th Congress), differs from FIBA and the CHOICE Act as a formal matter by creating a separate Chapter 14 of the Bankruptcy Code as opposed to a new subchapter of Chapter 11.[410] However, like FIBA and the CHOICE Act, S. 1840 would have provided that (1) a bankruptcy judge drawn from a panel of 10 judges designated by the Chief Justice would preside over proceedings under the new regime;[411] (2) only a financial institution could commence bankruptcy proceedings, but federal regulators could appear and be heard in a bankruptcy case;[412] (3) the court could approve the transfer of an institution's assets to a bridge company after making certain determinations; and (4) certain contractual rights against a debtor institution would be stayed for 48 hours.[413] Like the CHOICE Act (but unlike FIBA), S. 1840 would have repealed Title II.[414] Moreover, unlike FIBA and the CHOICE Act, S. 1840 would have explicitly prohibited the Federal Reserve from making advances to a financial corporation in bankruptcy or to a bridge company.[415]

The Trump Administration's Views

The Trump Administration's Treasury Department has endorsed efforts to amend the Bankruptcy Code to deal with large financial institutions, and expressed support for reforming (but not repealing) Title II. In February 2018, the Treasury Department issued a report in which it recommended retaining Title II "as an emergency tool for use under only extraordinary circumstances," but proposed a number of reforms to address what it characterized as "serious defects" in its original design.[416] The report "unequivocally" concluded that "bankruptcy should be the resolution method of first resort" for large financial institutions, while recommending "significant reforms to make bankruptcy a more effective option for financial firms."[417]

In recommending changes to Title II, the Treasury Department proposed reforms aimed at (1) limiting the FDIC's discretion in managing a receivership, (2) protecting taxpayers against losses, and (3) strengthening judicial review of the decision to invoke Title II.[418] Specifically, in order to limit the FDIC's discretion, the Treasury Department proposed (1) restricting the FDIC's ability to treat similarly situated creditors differently in a Title II resolution,[419] (2) providing that a bankruptcy court (instead of the FDIC) adjudicate claims against a Title II receivership,[420] (3) clarifying the circumstances in which a financial company is "in default or in danger of default" for purposes of invoking Title II,[421] (3) repealing the tax-exempt status of a bridge

[410] Taxpayer Protection and Responsible Resolution Act, S. 1840 § 2, 114th Cong. (2015).

[411] *Id*. § 4.

[412] *Id*. § 3.

[413] *Id*.

[414] *Id*. § 5.

[415] *Id*. § 6.

[416] OLA Treasury Report, *supra* note 345 at 2.

[417] *Id*.

[418] *Id*. at 5-6.

[419] *Id*. at 32-34.

[420] *Id*. at 34-35.

[421] *Id*. at 35-36.

company in a Title II receivership,[422] and (4) confirming that the FDIC is committed to the SPOE strategy.[423]

In order to protect taxpayers against losses, the Treasury Department proposed (1) limiting the duration of any advances from the OLF,[424] (2) that loan guarantees be preferred over direct lending to companies in receivership,[425] (3) that the FDIC lend to companies in receivership only on a secured basis,[426] and (4) imposing any industry-wide assessments necessary to recoup OLF funds "as soon as reasonably possible."[427]

In order to strengthen judicial review of the decision to invoke Title II, the Treasury Department recommended allowing a court to review all seven of the Treasury Secretary's required findings (as opposed to only two), and allowing for ex post judicial review after a receiver is appointed, without a statutory time limit for the court to issue a decision.[428]

[422] *Id*. at 36.

[423] *Id*. at 36-37.

[424] *Id*. at 37.

[425] *Id*. at 37-38.

[426] *Id*. at 38.

[427] *Id*. at 39.

[428] *Id*. at 40-41.

Appendix. Glossary

Automatic stay	A protection that the Bankruptcy Code provides a debtor against collection activities and many other actions by creditors. This protection does not apply to certain **derivative contracts**.
Bridge financial company	A company that the FDIC can create pursuant to Title II of Dodd-Frank in order to resolve the failure of a **systemically important financial institution ("SIFI")**. Under Title II, the FDIC can transfer certain assets and liabilities of a SIFI into a bridge financial company to continue the SIFI's critical businesses on a temporary basis. The bridge financial company would not be saddled with certain debts of the SIFI, and the FDIC would appoint new management to oversee its operations.
Conservatorship	A method by which the FDIC can resolve the failure of a commercial bank, pursuant to which the FDIC or its agent continues to operate the bank in order to preserve the bank's value as a "going concern." *Compare with* **Receivership**.
Cross-default rights	Contractual rights (i.e., to terminate a contract, net obligations, or liquidate collateral) triggered by the entry of a party's parent or affiliate into bankruptcy or other resolution proceedings. *Compare with* **Direct default rights**.
Derivative contract	A contract (such as a forward, future, option, or swap) whose value depends on the value of some other asset, such as a commodity, interest rate, currency, bond, or stock. Derivatives often provide counterparties with **direct default rights** and/or **cross-default rights**, and certain derivatives are exempt from the Bankruptcy Code's **automatic stay**. These features increase the risks of **liquidity "runs"** for parties to derivative contracts.
Direct default rights	Contractual rights (i.e., to terminate a contract, net obligations, or liquidate collateral) triggered by a party's entry into bankruptcy or other resolution proceedings. *Compare with* **Cross-default rights**.
"Discount window"	A program pursuant to which the Federal Reserve lends to commercial banks in need of liquidity, generally at a penalty rate of interest.
Financial contagion	A process by which a **liquidity "run"** on one financial institution triggers a broader loss of confidence in the financial system, leading to "runs" on other institutions.
Global systemically important banks ("G-SIBs")	Banks subject to enhanced prudential regulations pursuant to the Federal Reserve's implementation of the Third Basel Accord (Basel III), an international regulatory framework agreed upon by members of the Basel Committee on Banking Supervision. The Federal Reserve requires G-SIBs to maintain minimum levels of **total loss-absorbing capacity (TLAC)** and has imposed certain requirements for **qualified financial contracts ("QFCs")** entered into by certain holding companies of G-SIBs.
Liquidity "run"	A process by which large numbers of a financial institution's short-term creditors rush to withdraw their assets from the institution because of concerns about its solvency, forcing the institution to sell its illiquid assets at significantly discounted prices. *See also* **Financial contagion**, **Maturity transformation**.
Maturity transformation	A process by which financial institutions issue short-term debt while investing in longer-term assets, leaving them vulnerable to **liquidity "runs."**
Money market fund	Funds that generally invest in high-quality, liquid, short-term securities and give their investors the right to withdraw their share of the fund's assets on demand. Unlike commercial banks, money market funds are not required to obtain deposit insurance, and do not have access to the Federal Reserve's **"discount window,"** leaving them vulnerable to **liquidity "runs."**

Moral hazard	A situation in which a party is protected from risk, creating incentives to engage in excessively risky activities. Arguably, rescuing shareholders or creditors of troubled financial institutions promotes moral hazard.
Orderly Liquidation Authority ("OLA")	A resolution regime established under Title II of Dodd-Frank that is available to resolve the distress or failure of **systemically important financial institutions** outside of the Bankruptcy Code.
Over-the-counter ("OTC") derivative	A **derivative contract** that is individually negotiated by parties dealing directly with one another, as opposed to a derivative contract that is traded on an organized exchange.
Qualified financial contracts ("QFCs")	Certain **derivative contracts** subject to (1) stay-and-transfer provisions in Title II resolutions and non-Title II bank resolutions and (2) certain restrictions imposed by rules adopted by the Federal Reserve, FDIC, and OCC in 2017.
Receivership	A method by which the FDIC can resolve the failure of a commercial bank, pursuant to which it liquidates the bank's assets. *Compare with* **Conservatorship**.
Repurchase agreement ("repo")	An agreement pursuant to which one party sells securities to another party for cash, while simultaneously agreeing to repurchase the same or similar securities at some time in the future at a premium. Certain "repos" fall within the definitions of **qualified financial contracts ("QFCs")** in Title II and the Federal Deposit Insurance Act.
Single Point of Entry ("SPOE")	A strategy for implementing the FDIC's Title II authority outlined in a December 2013 notice, pursuant to which the FDIC would be appointed as receiver of only the top-tier U.S. holding company of a troubled financial institution, and the institution's subsidiaries would remain open and continue operations after the FDIC transfers the holding company's assets to a **bridge financial company**.
Systemically important financial institutions ("SIFIs")	A term used to describe financial institutions whose failure could have serious adverse effects on the financial system. The term is most often used to refer to institutions subject to enhanced prudential regulation under Title I of Dodd-Frank, or institutions for which Dodd-Frank's Title II resolution regime could be invoked. *See also* **Too-big-to-fail ("TBTF") financial institutions**.
Too-big-to-fail ("TBTF") financial institutions	A colloquial term used to describe financial institutions whose failure could have serious adverse effects on the financial system.
Total Loss-Absorbing Capacity ("TLAC")	Certain types of long-term debt and capital. The Federal Reserve requires certain holding companies of **global systemically important banks ("G-SIBs")** to maintain minimum levels of **TLAC** in order to enhance their resolvability. This requirement is based on the idea that long-term debt can serve as the source of new capital for a distressed firm because debt-holders' claims on a company's assets can be reduced in a resolution or bankruptcy proceeding.
Tri-Party Repo	**A repurchase agreement ("repo")** pursuant to which a "clearing bank" intermediates between a repo lender and a repo borrower.

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