

New Federal Initiatives Project

**Resolution Authority over Systemically
Important Financial Companies**

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RESOLUTION AUTHORITY OVER SYSTEMICALLY IMPORTANT FINANCIAL COMPANIES

One of the key elements of the Obama administration's financial reform efforts is to address the supervision of systemically important financial institutions. As a result of perceived weaknesses in the regulatory framework, the administration proposes to enhance supervision of entities such as AIG, Bear Stearns and Lehman Brothers under the belief that such supervision could have potentially avoided the present crisis or, at a minimum, mitigated the consequences.

Hand in hand with supervision, the administration proposes to give the FDIC the authority to "resolve" these systemically important institutions. Modeled after the bank receivership provisions of the Federal Deposit Insurance Act, the administration would give the FDIC enhanced authority to take control of these institutions as "conservator" (with the eye towards rehabilitating the institutions to facilitate their return to the private sector) or "receiver" (with the responsibility to conduct a liquidation of the business and assets of the institution and to apply the proceeds of such liquidation to the claims of creditors).

As a general matter, if appointed conservator or receiver, the FDIC would be given plenary power to administer the affairs of the institution. It would succeed to the "rights, titles, powers and privileges" of the company, as well as those of "any stockholder, member, accountholder, depository, officer, or director" of the company and the assets thereof. There is limited judicial oversight of the FDIC, and it would be granted plenary power as conservator or receiver to carry out its obligations and responsibilities.

There are substantial differences in the FDIC receivership procedures and those set forth in the Bankruptcy Code. A bankruptcy is conducted under the watchful eye of a judge, with recognized procedures permitting the participation of interested parties. An FDIC receivership, however, is essentially under the sole management of the FDIC. Creditors and claimants are essentially passive bystanders. The proposed legislation adopts the FDIC receivership model, and with it comes a series of important challenges.

There are numerous important issues associated with the proposal.

First, what entities are to be covered? Banks, insurance companies and broker-dealers are already subject to specialized insolvency regimes. How will the new framework affect the resolution of these institutions?

Second, when and by whom will a determination be made that an institution is "systemically important" and thus subject to the new framework? Entities subject to the new framework are already subject to the provisions of the Bankruptcy Code. Thus, any movement away from the Bankruptcy Code towards a receivership regime modeled on the Federal Deposit Insurance Act may result in significant changes in the rights and obligations of creditors and claimants.

Third, given the differences in rights, obligations and procedures, would it be wise to reconcile, as much as possible, the FDIC and Bankruptcy frameworks to eliminate the uncertainties so that creditors and investors can accurately assess in advance their exposure? The differences in these two regimes can create such uncertainties in the minds of investors and creditors that it could cause funding difficulties for these large institutions, exacerbating the very crisis the legislation intends to avoid.

Fourth, if resolution is the best course, which is the best agency to carry out this resolution authority? The FDIC has certain natural advantages, since it already "resolves" banks. However, large, complex institutions are dramatically different than banks, and the FDIC has no particular expertise in addressing

multinational securities institutions, asset management companies, insurance companies, mutual fund complexes or investment banks that might be deemed to be systemically important.

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Related Materials:

“Treasury’s Proposed Resolution Authority for Systemically Significant Financial Companies,” by John Douglas: http://www.fed-soc.org/publications/pubid.1652/pub_detail.asp

Treasury’s legislative proposal: http://www.financialstability.gov/docs/regulatoryreform/title-XII_resolution-authority_072309.pdf

White Paper on Regulatory Reform: http://www.financialstability.gov/docs/regs/FinalReport_web.pdf
(the parts discussing resolution authority are on pages 76 - 79).