A New Bankruptcy Code Chapter 14 to Facilitate Orderly G-SIB Resolution Without Recourse to Title II

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I. Hoover Resolutions Project

A. Focused on changes in Bankruptcy Law to facilitate use by large financial institutions

B. Goal – To make use of Title II Orderly Liquidation unnecessary (or as George Schultz states it, "to give the Secretary of Treasury a reason to say 'No'.")

C. Current Direction: Developing proposed 2.0 version of Chapter 14 responsive to single point of entry approach of the Fed and the FDIC

D. Remains a work in progress as analyses evolve

1. Refining bridge procedures
2. Accommodation of different bail-in debt proposals
3. Analysis of foreign subsidiary issues

II. Proposed Chapter 14

A. Basics

1. Quick sale to a bridge institution
2. Initiated either by management or regulators
3. Federal Reserve can initiate and Federal regulators have standing to participate
4. Designated Federal District judges in each circuit

B. Details – Recap Under Bankruptcy Code –

1. Promptly after the filing, the debtor-in-possession transfers all of its assets, including operating subsidiaries, to a debt-free bridge financial company under Section 363 of the Bankruptcy Code, to be held by a private trustee for the benefit of the bankruptcy estate

2. Approval by the bankruptcy court should be forthcoming because the assets continue to be held for the benefit of the bankruptcy estate
3. Equity and long-term debt of the debtor are left behind in the bankruptcy estate, resulting in recapitalization of the businesses transferred to the bridge
4. Operating subsidiaries are kept out of insolvency proceedings by being recapitalized with assets available at the parent or bridge financial company level, including intercompany receivables
5. Claimants in the bankruptcy estate are entitled to the residual value of the bridge financial company and any assets left behind in the bankruptcy estate, to be distributed in satisfaction of their claims in accordance with the priority of their claims

6. Builds on the expected requirements from Fed and FDIC on long term debt and intercompany receivables to facilitate SPOE resolution

7. The strategy, by keeping operating subsidiaries out of bankruptcy, avoids the most significant impediments that otherwise apply to the resolution of a large financial institution with cross-border operations

   - Reduces or eliminates the incentive to ring-fence foreign operations
   - Reduces the need to rely on cooperation from foreign authorities

8. The strategy reduces the incentive of short-term creditors to run and cause panic throughout the financial system by taking advantage of the structural subordination of long-term debt (held by U.S. financial groups mostly at the parent holding company level) to short-term debt (held at the operating subsidiary level)

C. Other Provisions

1. Bankruptcy Code would have a new provision that overrides cross-defaults in financial contracts at the operating subsidiary level based on the failure of the parent company
2. Bankruptcy code would have a new very short stay on ipso facto remedies and close out of financial contracts (similar to Federal Deposit Insurance Act) to facilitate transfer to bridge company
3. Transition provisions to continue licenses, permits and registrations, provide securities law exemptions, allow capital to be brought into compliance
4. Contemplates debtor-in-possession (DIP) financing for idiosyncratic cases. Need for a secured liquidity facility similar to the OLF for extreme economic scenarios of multiple failure when ordinary financial markets are dysfunctional and a private-sector DIP facility is unlikely to be available in sufficient amounts

III. Comments and Conclusions

A. Advantages

1. Judicial system – less regulatory discretion and uncertainty, more transparency
2. Traditional bankruptcy law procedures with compressed timetables
3. Reduces likelihood of use of Title II orderly liquidation

B. Concerns

1. Private sector DIP financing might not be available to the parent company or its non-bank subsidiaries in sufficient amounts during an extreme economic scenario when ordinary financial markets are dysfunctional even in idiosyncratic case
   a. The Bankruptcy Code has no provision like the OLF that ensures the bridge financial company access to sufficient liquidity, even on a fully secured basis, to preserve going-concern value and prevent value destruction of valuable but illiquid assets

b. Secured liquidity from the Discount Window would be available to any subsidiary bank, but Section 23A of the Federal Reserve Act limits the bank's ability to provide secured liquidity to non-bank affiliates

c. But perhaps Section 13(3) of the Federal Reserve Act could be invoked to provide such liquidity in extreme or non ideosyncratic circumstances

2. Concerns expressed by some on use of Federal judges rather than bankruptcy judges

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