STATEMENT

of

RICHARD LEVIN[1]

On behalf of the

NATIONAL BANKRUPTCY CONFERENCE

at the Hearing on

"Financial Institution Bankruptcy Act of 2015"

before the

SUBCOMMITTEE ON REGULATORY REFORM,
COMMERCIAL AND ANTITRUST LAW

of the

COMMITTEE ON THE JUDICIARY

U.S. HOUSE OF REPRESENTATIVES WASHINGTON, D.C.,

July 9, 2015

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[1] Chair, National Bankruptcy Conference and Partner, Jenner & Block LLP, New York, NY. The views expressed in this testimony are expressed solely on behalf of the National Bankruptcy Conference and do not necessarily represent the views of Mr. Levin or of Jenner & Block or any of its partners or clients.

The National Bankruptcy Conference ("**Conference**") appreciates the opportunity to participate in this hearing. The Conference is a voluntary, non- profit, non-partisan, self-supporting organization of approximately 60 lawyers, law professors, and judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws. A Fact Sheet describing the Conference and listing its Members is attached to this Statement.

The Conference recognizes that a failing systemically important financial institution (**SIFI**) faces extraordinary challenges if it were to become a debtor under the current version of the Bankruptcy Code. For that reason, and in light of the importance of an orderly and effective resolution scheme for SIFIs to our country's economy and capital markets, the Conference has made it a priority to track developments in the efforts to modify the Bankruptcy Code to address and mitigate those challenges, starting with the chapter 14 regime first proposed as part of the Resolution Project at Stanford University's Hoover Institute Working Group on Economic Policy.[2] Its Members have also participated in some of those efforts, on behalf of the Conference or in their individual capacities, and in drafting various versions of possible legislation.

The Conference's previous participation has included correspondence with Congress regarding prior SIFI bankruptcy legislative initiatives, first in a letter dated January 29, 2014 to Senators Cornyn and Toomey, commenting on S. 1861, the Taxpayer Protection and

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[2] *See, e.g.*, "Resolution of Failed Financial Institutions: Orderly Liquidation Authority and a New Chapter 14, located at http://www.federalreserve.gov/SECRS/2011/June/20110620/OP-1418/OP-1418_061511_81311_544434921739_1.pdf

Responsible Resolution Act ("**TPRRA**"), in the 113th Congress and in a letter dated June 18, 2015 to Representatives Marino and Johnson and Senators Grassley and Leahy, after the passage in the House of H.R. 5421, the Financial Institution Bankruptcy Act of 2014 ("**FIBA**"). FIBA addressed many of the technical, bankruptcy-specific aspects of TPRRA the Conference had commented on in its first letter. In our second letter, therefore, the Conference moved beyond the more technical aspects (most of which, as noted, had been addressed). It called for caution in fashioning any bankruptcy solution for resolving a SIFI, providing the Conference's suggestions for striking the right balance between the role of the judiciary and of regulators in the resolution of a SIFI; it recommended eliminating the involuntary bankruptcy process in light of due process concerns; and it noted the very real possibility that a SIFI's need for liquidity in bankruptcy might be beyond the market's funding abilities.

The more substantive concerns described in the Conference's second letter remain. Rather than summarize them here, for my testimony, I attach copies of the two letters and ask that they be included in the record as part of my testimony. The Worldwide Web references to the letters are also listed on the attached.

The Conference thanks you for this opportunity to appear to speak on this important topic and wishes to support this effort by providing any expertise and assistance you might request.

Attachments to Testimony of Richard Levin

on behalf of the

National Bankruptcy Conference

1. National Bankruptcy Conference Fact Sheet

2. Letter from National Bankruptcy Conference dated January 29, 2014 to Senators Cornyn and Toomey regarding S. 1861, 113th Congress, Taxpayer Protection and Responsible Resolution Act.
   http://www.nbconf.org/images/NBC%20Ltr%20re%20s%201861%20(Ch%2014).pdf

3. Letter from National Bankruptcy Conference dated June 18, 2105 to the Representatives Marino and Johnson and Senators Grassley and Leahy regarding Proposed Amendments to the Bankruptcy Code Relating to Resolution of Systemically Important Financial Institutions.
   http://www.nbconf.org/images/NBC_Ltr_to_Cong_re_SIFI_Bills.pdf

National Bankruptcy Conference

A non-profit, non-partisan, self-supporting organization of approximately sixty lawyers, law professors and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws.

History. The National Bankruptcy Conference (NBC) was formed from a nucleus of the nation's leading bankruptcy scholars and practitioners, who gathered informally in the 1930's at the request of Congress to assist in the drafting of major Depression-era bankruptcy law amendments, ultimately resulting in the Chandler Act of 1938. The NBC was formalized in the 1940's and has been a resource to Congress on every significant piece of bankruptcy legislation since that time. Members of the NBC formed the core of the Commission on the Bankruptcy Laws of the United States, which in 1973 proposed the overhaul of our bankruptcy laws that led to enactment of the Bankruptcy Code in 1978, and were heavily involved in the work of the National Bankruptcy Review Commission (NBRC), whose 1997 report initiated the process that led to significant amendments to the Bankruptcy Code in 2005.

Current Members. Membership in the NBC is by invitation only. Among the NBC's 60 active members are leading bankruptcy scholars at major law schools, as well as current and former judges from eleven different judicial districts and practitioners from leading law firms throughout the country who have been involved in most of the major corporate reorganization cases of the last three decades. The NBC includes leading consumer bankruptcy experts and experts on commercial, employment, pension, mass tort and tax related bankruptcy issues. It also includes former members of the congressional staff who participated in drafting the Bankruptcy Code as originally passed in 1978 and former members and staff of the NBRC. The current members of the NBC and their affiliations are set forth on the second page of this fact sheet.

Policy Positions. The Conference regularly takes substantive positions on issues implicating bankruptcy law and policy. It does not, however, take positions on behalf of any organization or interest group. Instead, the NBC seeks to reach a consensus of its members - who represent a broad spectrum of political and economic perspectives - based on their knowledge and experience as practitioners, judges and scholars. The Conference's positions are considered in light of the stated goals of our bankruptcy system: debtor rehabilitation, equal treatment of similarly situated creditors, preservation of jobs, prevention of fraud and abuse, and economical insolvency administration. Conferees are always mindful of their mutual pledge to "leave their clients at the door" when they participate in the deliberations of the Conference.

Technical and Advisory Services to Congress. To facilitate the work of Congress, the NBC offers members of Congress, Congressional Committees and their staffs the services of its Conferees as non-partisan technical advisors. These services are offered without regard to any substantive positions the NBC may take on matters of bankruptcy law and policy.

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NATIONAL BANKRUPTCY CONFERENCE

A Voluntary Organization Composed of Persons Interested in the Improvement of the Bankruptcy Code and Its Administration

January 29, 2014

Hon. John Cornyn United States Senate Washington, DC 20510	Hon. Pat Toomey United States Senate Washington, DC 20510

Re: S. 1861 – Taxpayer Protection and Responsible Resolution Act

Dear Senators Cornyn and Toomey:

The National Bankruptcy Conference (NBC) is a voluntary, non-partisan, not-for-profit organization composed of about 60 of the nation's leading bankruptcy judges, professors and practitioners. It has provided advice to Congress on bankruptcy legislation for over 75 years. I enclose a Fact Sheet, which provides further information about the NBC.

The NBC has reviewed S. 1861, the "Taxpayer Protection and Responsible Resolution Act" ("TPRRA"), which you introduced last month. We have considered both the substance of the bill and the technical and drafting issues. Our substantive comments follow immediately below. In addition, consistent with our mission of providing technical assistance to Congress in this very technical area of the law, and without regard to our substantive comments, we have reviewed the legislation for technical and drafting issues that might prevent the bill from achieving its policy objectives. Following the substantive comments is our report on technical and drafting issues and our suggested solutions. We hope this report is helpful in your deliberations.

<u>Background</u>

TPRRA creates a new chapter 14 of the Bankruptcy Code available only for "covered financial corporations", which are bank holding companies or financial institutions. The chapter 14 debtor is likely to be a parent entity with its operations and regulated activities conducted through subsidiaries or affiliates. The chief departure under TPRRA from general bankruptcy concepts is to permit an expedited transfer of potentially all the assets of the debtor at the beginning of the case, to be administered outside of the confines of the debtor's case and away from the jurisdiction of the court. This is accomplished through the rapid transfer of select assets and liabilities to a new bridge holding company, a "bridgeco," whose equity interests are held in trust for the chapter 14 estate and administered by a special trustee approved by the court. A temporary stay prevents the occurrence of certain destabilizing actions during the transfer process. The expectation is that the chapter 14 debtor in possession will thereafter complete a plan process using the same provisions as under a chapter 11 case, culminating in a plan to distribute any proceeds realized by the special trustee from the equity of the bridgeco to the creditors of the parent company whose debts have not been assumed by the bridgeco as part of the asset transfer.

The bridgeco mechanism attempts to set the stage for and enable what is now commonly referred to as the Single Point of Entry strategy for resolution of SIFIs. The TPRRA does not contain any special liquidity facility and repeals title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, including the potential credit support guaranty facility and the ability of U.S. regulators to take over the resolution process if necessary to gain the cooperation of foreign regulators. The NBC has not studied the repeal of title II and thus takes no position on the repeal, focusing instead on the portions of TPRRA that contain the proposed chapter 14 provisions.

General Observations

At the outset we note that the NBC has not previously reviewed the TPRRA or any of the proposals on which it is based, so our comments and questions about the bill are necessarily preliminary and general given the limited time we have had for review. Based on our preliminary review, several members expressed serious reservations about whether the approach under TPRRA would work for SIFIs, raising as it does novel and difficult issues. We have provided a preliminary discussion of some of the most important issues below. We will continue to study the bill after submission of this initial letter and hope to provide more detailed drafting comments in the future.

The NBC generally supports the idea that resolution of covered financial corporations[1] should be done in a manner that (i) maximizes value for stakeholders, (ii) minimizes systemic disruption and moral hazard, yet (iii) protects taxpayers from loss. We accordingly support the growing global consensus that financial firms should be required to maintain a sufficient stack of loss absorbing, contractually or structurally subordinated equity and debt that can be utilized to quickly recapitalize the enterprise, as well as assets (such as intercompany loans) that can be contributed to the capital of distressed operating subsidiaries in connection with any such recapitalization. In contrast to the unitary bank model employed in some other countries, the bank holding company structure in the United States facilitates this approach by separating significant amounts of long-term unsecured debt from deposit and account-holding regulated entities, thereby adding an additional layer of loss absorbency at the holding company level.

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[1] "Covered financial corporation" is the terminology used in the TPRRA, section 3(a), adding a new section 101(9A) to the Bankruptcy Code. The entity does not have to be a SIFI, since any bank holding company can qualify for chapter 14. Some of our concerns here, particularly with respect to the need for liquidity and global coordination, are aimed primarily at SIFIs and G-SIFIs. We recognize that a limited number of smaller bank holding companies holding only US assets have been able to restructure on an expedited basis under chapter 11, and if anything, chapter 14 as proposed would potentially make such restructurings easier.

The proposed chapter 14 takes advantage of the bank holding company structure to recapitalize the covered financial corporation by permitting the rapid transfer of select assets—equity in subsidiaries and other assets held at the parent holding company—to the bridgeco, leaving significant (if not most) liabilities of the parent behind. We believe that to be successful, any such recapitalization needs to be announced and accomplished with remarkable speed to stabilize the recapitalized firm and minimize any liquidity "run" or asset fire-sales. The TPRRA addresses this by including expedited procedures to create the bridgeco. (Our detailed comments below suggest ways in which the procedures can be further expedited.) We also believe the temporary stay prohibiting the exercise of rights by counterparties to qualified financial contracts ("QFCs") has the potential to substantially reduce the short-term liquidity and collateral needs of the covered financial corporation and avoid wholesale termination of QFCs on terms disadvantageous to the covered financial corporation, aiding in its near-term stability and ability to recapitalize. Given the interconnectivity of exposure between covered financial corporations which are SIFIs through QFCs, the temporary stay may also significantly reduce the risk of contagion.

Stabilizing and permanently restructuring any financial institution, though, will require some form of immediate liquidity source and/or credit support which the TPRRA does not provide. Despite the speed of the recapitalization proposed under TPRRA, we believe, even under the best of circumstances, it will take a period of time for the market to assimilate information about the financial restructuring of the covered financial corporation before the institution's full access to market liquidity returns.[2] Without some degree of certainty that the bridgeco has sufficient liquidity on its own taking into account the specific assets and liabilities assumed and discarded, that funding will be available at the time of filing, or failing both, without advance planning, communication and coordination among the debtor, the Federal Reserve Board, and regulators worldwide, the commencement of a chapter 14 case may cause ring-fencing by regulators worldwide, flight of short-term capital and value erosion. In severe cases, these events could cause the very sort of run on the regulated subsidiary entities that the Single Point of Entry strategy seeks to avoid.

The TPRRA needs to provide for an additional source of backstop interim liquidity for those covered financial corporations which will file without sufficient liquidity to prevent flight of short-term capital and stabilize the institution, particularly if there is a risk of contagion. The backstop can be limited to fully secured commitments or advances similar to the discount window currently available to banks. At a minimum, consideration should be given to incorporating provisions similar to section 364 to

[2] The regulated banks held by the bridgeco will have access to the discount window and their deposits will be supported by deposit insurance, both of which should prevent and/or fund any run on its liquidity resources. However, covered financial corporations that are diversified financial firms will have broker dealers, insurers, and other operating subsidiaries which lack access to any credit support other than through the public markets.

permit priming liens in the bridgeco's assets and first-out provisions for any new credit support provided to bridgeco, although we question whether even this will be sufficient to entice the public markets in the early stages of the recapitalization. In any event, all of the NBC's comments below must be understood in the context of our overriding concern that a successful recapitalization which achieves all of the goals stated at the outset of this memorandum cannot be achieved in all cases without some provision for potentially significant credit and collateral support.

Section-by-Section Comments

TPRRA Sec. 3(c). *Who May be a debtor:* The court should have the power to authorize the conversion of a case under chapter 14 to a case under chapter 7 once the transfer of assets to the bridgeco has occurred pursuant to section 1406. Section 1112 should be modified to permit conversion from chapter 14 to chapter 7. Chapter 7 will be necessary in those instances when a chapter 14 debtor is not able to satisfy the requirements for confirmation of a plan, for example, when the administrative expenses cannot be paid in full in cash.

TPRRA Sec. 3(b). *Applicability of chapters*: Rather than create a full plan process in chapter 14 or create the bridgeco mechanism within existing chapter 11, TPRRA adds a new section 103(m), which incorporates the chapter 11 plan process into chapter 14. Given this approach, section 1401 should be expanded in a manner similar to section 901 after a thorough review of provisions in the other chapters of the Bankruptcy Code to be sure their omission or inclusion is intentional.

Bankruptcy Code Sec. 1401. *Inapplicability of other sections*: See above.

Bankruptcy Code Sec. 1402. *Definition of "capital structure debt"*: The definition creates a category of liabilities that are not permitted to be transferred over to the bridgeco. It is critical to the success of a chapter 14 recapitalization that many liabilities presumptively do not get assumed by the bridgeco. But great care should be taken with this definition. Liabilities transferred over to bridgeco will presumably receive much better recoveries than those left behind. The potential preferential treatment of certain obligations and liabilities violates the fundamental bankruptcy policy of equality of distribution and should occur only in furtherance of the chapter 14 goals. We considered whether to approach the exercise by restricting the types of debts that bridgeco could assume rather than defining the liabilities that must remain with the chapter 14 debtor, but determined that the Bankruptcy Code should give the Federal Reserve Board and the special trustee flexibility in creating the optimum bridgeco. In any event, the NBC is concerned that debt can be too easily structured to avoid characterization as capital structure debt if the definition is based on the original maturity date and suggests that the following concept would not be as easily manipulated: all unsecured debt for borrowed money for which the debtor is the primary obligator.

Bankruptcy Code Sec. 1403. *Commencement of case*: The successful recapitalization under chapter 14 requires speed and certainty. After the fact challenges to either the appropriateness of the filing or the creation of the trust will undermine the very maintenance or restoration of market confidence and prompt access to sources of liquidity the bridgeco mechanism is designed to achieve. It is critical that the statute be unambiguous, standards clear and opportunity to undo non-existent. Similarly, we anticipate that before the chapter 14 petition is filed, most if not all of the planning for the creation of the bridgeco will have occurred by the Federal Reserve Board and the debtor in coordination with other relevant regulators, sources of funding and, in some cases, potential buyers. A meaningful judicial review process of even one day could jeopardize the process, and the NBC is concerned that the proposed one-day judicial process would not be meaningful in any event given the import of the findings the court is required to make.

We therefore propose here and in other places that certain actions would require Federal Reserve Board approval in lieu of a notice and hearing before a court. We would remove the requirement of a court determination in section 1403(a)(2)(B) and require that for any petition to be accepted, the Federal Reserve Board must make the finding and certification described in section 1403(a)(2)(A). Removing the judicial approval construct would also mean removing the appeal process. To the extent it is considered either necessary or desirable to limit the type of filing that is not subject to judicial review further, we would still recommend removing the judicial approval construct under section 1403(a)(2)(B) so long as the covered financial company has not objected to the Board's action within some very limited period of time. We also recommend that in the event the debtor has either filed the petition or consented to the petition at the time it is filed, the members of the board of directors and management involved in that decision should be able to make it free from any threat of recrimination or penalty from the constituents at the chapter 14 entity. The filing triggers an immediate transfer of potentially all the assets of the chapter 14 entity for a recapitalization process that will be largely without judicial review and will not be undertaken solely for the benefit of the chapter 14 constituents. It is easy to imagine that the constituents' representatives will challenge the decision-making process that results in the extraordinary transfer of assets without legally required approvals under constituent documents, exchange rules and state laws requiring shareholder approval and the like. We would therefore recommend that the statute include some form of safe harbor or exculpation protecting members of the debtor's board of directors and management for participating in the decision-making process, albeit a narrowly crafted one.

Bankruptcy Code Sec. 1404. *Regulator*: None.

Bankruptcy Code Sec. 1405. *Special trustee and bridge company*. As a preliminary observation, we believe the TPRRA anticipates that either the chapter 14 debtor will have created an intermediary entity which can act as the bridgeco shortly before the filing or one will be created simultaneously with the filing. In either event, the section should more clearly distinguish between (1) the new holding company to which the assets and certain liabilities of the chapter 14 debtor are transferred, (2) the trust, which holds the equity of the new holding company, and (3) the equity of the subsidiaries held, after the transfer, by the new holding company. Section 1405(a)(1) appropriately requires that the entity should not be a preexisting company which has liabilities and assets prior to the filing, For additional clarification, some consideration should be given to insulating this new bridgeco from preexisting liabilities that attach by operation of law on a joint and/or several basis (for example, certain tax liabilities). Ideally, the provision should also contemplate the transfer of lower-tiered equity interests in a multi-tiered enterprise, while skipping the assets and liabilities of intermediate funding entities, so that bridgeco can recapitalize not only by the conversion of the parent debt to equity but also by similar recapitalization of mezzanine type financing, for example, trust preferred securities, although this additional type of selection requires more detailed analysis.

Management of bridgeco and guardianship of the bridgeco interests will be significant factors in the effort to restore or maintain market confidence. In addition, similar to our comment with respect to section 1403, the designation of the special trustee and management of bridgeco must be rapid and certain. To the extent the Federal Reserve Board has appointed a person (or entity) to act as special trustee at the time the request to create the trust is filed, that appointment should be final, absent subsequent gross negligence, fraud, or similar misconduct. Likewise, the Federal Reserve Board's consent to the designation of senior management at bridgeco should be required, again with the expectation that these individuals will have been selected prior to the actual filing. Once the trust has been established and the selected assets and liabilities transferred, the powers of the special trustee would include the power to replace and appoint new senior management without further court approval. At the chapter 14 case level, we believe that once the bridgeco order has been entered, the mandatory appointment of a trustee rather than the continued control of prior management as a debtor in possession under section 1107 is appropriate. (This should not preclude any party in interest from seeking the appointment of a trustee sooner, and some consideration should be given to an expedited request process if the Federal Reserve Board wants a trustee at the chapter 14 debtor immediately upon filing.) The chapter 14 debtor is not an operating entity after the transfer, and there is no particular expertise existing management has for the negotiation of the allocation of value among the chapter 14 constituents or administration of the claims allowance process. Removal of existing management from the chapter 14 process should add to the perception of fairness in the overall process.

Section 1405(b)(3) requires the special trustee to provide notice to the parties in interest in the chapter 14 of certain corporate actions, including significant actions affecting the assets and liabilities of the bridgeco. Nothing further is provided for, leaving open the possibility that creditors and even equity interest holders in the parent can object in court but equally leaving open the possibility that there is no recourse beyond the ability to voice an objection. The special trustee will require extraordinary skills in executing its fiduciary duties under extreme stress and time constraints. It may seem beyond dispute that there is little a special trustee could do which would harm the chapter 14 constituents beyond the filing itself, but experience has taught us that it is a rare bankruptcy case in which valuation and strategy disputes do not exist. We would recommend that rather than such an open-ended process creating uncertainty both as to the finality of actions taken by the special trustee and the special trustee's potential legal exposure for taking those actions, the statute permit (but not require) the special trustee to specify any actions it intends to take in furtherance of the recapitalization of bridgeco and its subsidiaries and, so long as the Federal Reserve Board does not object to any of those actions, to allow the bridgeco order to reference such actions and immunize the special trustee and the bridgeco's directors and officers from any liability to the chapter 14 parties-in-interest for taking those actions.

The disclosure statement is a crucial element of the plan proposal process; informed consent is essential. There are known difficulties in gathering and understanding information when a debtor loses access to its books and records. Here, a significant portion of the debtor's books and records may be transferred to the bridgeco and no longer in the control of the chapter 14 entity. The standard for the chapter 14 trustee's access to that information in the current proposal seems unnecessarily high. We recommend that in lieu of "necessary" in section 1405(b)(2)(B), the special trustee should make the information available if "necessary or advisable".

Bankruptcy Code Section 1406: *Special transfer of property of the estate*. This section, authorizing transfers of assets into the trust, should make clear that once assets have been transferred into the trust, they are no longer part of the chapter 14 estate by adding a new sentence following the first sentence of section 1406(a): "Property ceases to be property of the estate once the court has ordered the transfer and the transfer has occurred." (Conforming clarifications may also be required to sections 1407 and 1408.) Section 1406(c)(3) should be deleted: the bridgeco will not be a deposit holding entity under any circumstances. To the extent that this provision refers to deposits which the chapter 14 entity itself holds as depositor at any of its subsidiaries, there should be no absolute requirement that all such deposits go over to the bridgeco. Once the bridgeco has been created and assets have gone over, the chapter 14 estate will have no access to cash flow. Conceivably, it might be able to get new (probably expensive) financing, but to the extent it has sufficient cash to fund its chapter 14 administrative expenses and fees, it should be allowed to retain at least some cash for that purpose.

Section 1406(c)(4) requires the court to find by a preponderance of the evidence that the Federal Reserve Board has certified as to adequate assurance of future performance of contacts, leases and liabilities assumed by the bridgeco. We are not certain that this requirement adds anything beyond the certification by the Federal Reserve Board itself, and in any event, believe that the Federal Reserve Board certification should be sufficient. We would therefore recommend substituting a requirement that the Federal Reserve Board provide the certification in a filing with the court for the current section 1406(c)(4). Further, as with our earlier comments on sections 1403 and 1405, we believe that the Federal Reserve Board's consent should also be required. While there is no time period prescribed for the judicial review in this section, the temporary stays in section 1407 and 1408 create a practical 48-hour limit for the review process. We believe it will be far more valuable for the statute to encourage an active dialogue between the Federal Reserve Board and the prospective debtor (whether as a continuation of the living will dialogue or otherwise) and to that end, the specifics of bridgeco should be in hand and approved by the Federal Reserve Board by the time the filing is made with the court.

We believe that the TPRRA should specifically address the treatment of liens in assets which are transferred to the bridgeco. Section 363(k) provides for credit bidding, but we do not expect that the transfer to bridgeco will occur in any sort of auction process. One possibility would be for the liens to transfer with the assets on a nonrecourse basis; there could also be a mechanism for bridgeco essentially to purchase the collateral by giving the secured creditor cash equal to the value of the lien (although this would have to be accomplished in a manner that did not interfere with the expedited transfer at the beginning of the case). As a practical matter, there may not be much of any secured debt at the chapter 14 entity, but to the extent there is, the transfer process currently leaves the treatment of liens uncertain.

Bankruptcy Code Section 1407. *Automatic stay; assumed debt*: See below.

Bankruptcy Code Section 1408. *Treatment of qualified financial contracts and affiliate contracts*: Both this section and section 1407 create special stay provisions and are addressed together here. These special stay provisions go beyond established bankruptcy concepts by staying actions against nondebtors and their assets which would otherwise occur because of the condition of the chapter 14 debtor and the transfer to the bridgeco. They also significantly curtail actions by counterparties under QFCs, which normally are protected by a variety of safe harbor provisions under the Bankruptcy Code, safe harbors which include, importantly, special carveouts from the automatic stay under section 362. Both of these new special stay provisions are in our view appropriately limited in duration and scope; they are necessary to give the Single Point of Entry approach to recapitalization a brief moment in time to freeze the effect of the chapter 14 filing until the bridgeco is up and running and has assumed the liabilities, contracts and leases it wants in order to recapitalize.

The transfer provisions are similar to, but not identical to, section 365. Significantly, the bridgeco has the power to assume notwithstanding any state or contractual restrictions, but not the power to assign in a subsequent transaction. We considered whether these special provisions should extend to a subsequent transfer, and concluded that on balance, because of the indeterminate duration of the bridgeco and the myriad of potential transactions it may engage in during that time, it was better not to give special treatment to subsequent transfers.[3]

[3] Sections 1407 and 1408 identify assumptions, assumptions and assignments, and assignment in various places. We believe the intent in each case is in connection with the transfer to bridgeco and not a subsequent transfer. It is possible that a more consistent use of the different terminology is required. As time permits, we recommend a thorough review of this terminology to avoid confusion later.

We note that in a number of places, these special provisions preclude the termination or modification of rights or obligations during the period in which the special stay provisions are in effect. We believe particularly in light of the fact that debt instruments are included in these special provisions, that the sections should specifically reference acceleration (that is, eliminate or stay any acceleration) and any other modification that occurs automatically upon the occurrence of one the specified events. For example, most debt instruments provide for automatic acceleration of debt upon the debtor's (and sometimes, any of its significant affiliate's) bankruptcy filing. There is no need for this automatic acceleration for debt that is assumed by the bridgeco within the prescribed time limits, and unwinding it may be more than a matter of simply reinstating the debt. Likewise, some securitizations have "flip" or "extinction" clauses which purport to change contractual entitlements to waterfalls upon a bankruptcy filing. These should also not be triggered automatically upon the filing. In other words, the concepts termination and modification should clearly include any alteration in the contractual or legal status quo that occurs because of the events specified, and for the periods specified, in the applicable subsections of sections 1407 and 1408.

The NBC does not have substantive comments on any of the sections following section 1408.

Technical and Drafting Comments

As a general comment, the NBC believes it would be preferable to include the provisions on covered financial corporations in a new subchapter V of chapter 11, instead of adding a new chapter 14. Most of the provisions of chapter 11 are applicable to such cases, fewer Bankruptcy Code sections would have to be amended, and it would cause less confusion if the new provisions on covered financial corporations were placed in a new subchapter of chapter 11.

Other comments relate to specific provisions. References are to the new provisions of titles 11 and 28, rather than the bill sections.

§ 103(*l*) – As proposed ("Chapter 14 of this title applies only in a case under this title concerning a covered financial corporation"), this subsection suggests that chapter 14 would apply if a covered financial institution files a chapter 7 or chapter 11 petition (even though section 109 would not make it eligible for such a filing). To make it clearer, we suggest: "Chapter 14 of this title applies only in a case under such chapter." That also conforms to the style of section 103 (see 103(i) and (j)).

§ 103(m) – The new section 103(m) is fine, but if it is added to the Code it will conflict with section 103(g). Therefore, section 103(g) should be amended as follows: "Except as provided in sections 103(m) and ~~section~~ 901 of this title,…"

§ 109(i) – To conform to the style used in other subsections of section 109 (see section 109(d), (e) and (f)), change section 109(i) to: "Only a covered financial corporation may be a debtor in a case under chapter 14 of this title."

§ 1401 – Change to read: "Sections 321(c) and 322(b) of this title do not apply in a case under this title."

§ 1402(2) – Change to read "…. under section 1405(a) of this title."

§ 1402(4) – First, the list of sections referenced in this provision should include section 561. Also, the referenced sections do not define "contractual right." Therefore, change section 1402(4) to the following: "The term 'qualified financial contract' means any contract ~~as defined~~ of the kind described in section 555, 556, 559, ~~or~~ 560, or 561 of this title."

§ 1402(5) – Change to "The term 'qualified financial contract' means any contract of a kind ~~specified~~ defined in paragraph (25) …" Note that the sections cited do contain definitions. Also, add "of this title" after "section 761).

§ 1402 – The use of the word "trustee" used in sections 1405, 1406 and elsewhere is confusing. Chapter 11 uses that term to mean a person appointed or elected under section 1104. Although section 1107 generally gives the debtor in possession the rights and powers of a trustee, it is unclear whether "trustee" in chapter 14 is meant to include a DIP when a trustee has not been appointed. For example, see section 1405(a), which says "On request of the trustee or the Board, the court may order the trustee to appoint …" Is it intended that a DIP can make that request if there is no trustee? Does the court order the DIP to appoint the special trustee? To make it clear, we suggest that a definition of "trustee" be included in section 1402. If it is intended that "trustee" mean a DIP if there is no trustee, section 1402 can define "trustee" to mean "a person that has been appointed or elected under section 1104 of this title, and that has been qualified under section 322 of this title, to serve as trustee in the case or, in the absence of such person, the debtor in possession."

§ 1403(a)(2) – The way the proposed provision is organized, a Board petition certifying circumstance (IV) requires a duplicate certification of imminent financial harm to financial stability in the US (see 1403(a)(2)(A)(i)(IV) and (a)(2)(ii), which are both required). We suggest that (IV) be changed by ending it after "sufficiently soon", thereby deleting "such that the immediate commencement of a case …. financial stability in the United States." An alternative fix would be to move the provision that is now 1403(a)(2)(A)(ii) to follow (a)(2)(A)(i)(III) and then have what is now (a)(2)(A)(IV) as an alternative basis for a Board petition.

§ 1403(a)(2)(B) – This refers to the "bankruptcy court" making a determination that the requirements for commencing the case have been satisfied. Is it intended that 28 USC § 157 does not apply? Does the bankruptcy court's authority to make this determination depend on a reference under section 157(a)? Can a district judge withdraw the reference under section 157(d)? If not, perhaps section 1403(a)(2)(B) should start with "Notwithstanding section 157 of title 28." If it is not intended that section 157 be displaced, it may be better to say "court," instead of "bankruptcy court." This also applies in other places where "bankruptcy court" is used. Similarly, section 1403(c)(1) and (2) refer to the "district court" hearing an appeal. If a district judge withdraws the reference and there is an appeal, it should go to the court of appeals.

§ 1403(b)(1) – As proposed, the hearing must be within 12 hours after a certification under section (a)(2)(A), but there is nothing that prevents the certification from being made (signed) before the petition is filed. To avoid the 12-hour period from expiring prepetition, change "makes a certification under subsection (a)(2)(A)" to "files a petition under subsection (a)(2)." The certification must be in the petition. In addition, on lines 19-20, will the wording "with notice only to" create a potential problem if someone else (other than the listed entities) gets actual notice? Would the court proceeding then not be a "hearing described in this subsection"? It may help to insert "given by the Board" between "notice" and "only". This also seems like an indirect way to prohibit notice to other parties (which is apparently the intent). Perhaps change section 1403(b)(2) to directly prohibit such notice ("Only the Board and the entities listed in paragraph (1) may receive notice, attend, or participate in a hearing…").

§ 1403(b)(2) – Change the last sentence as follows: "Transcripts of such hearings shall be sealed until the ~~end of~~ the case is closed." The "end of the case" is ambiguous and not consistent with Code style.

§ 1403(c) – First, the provision is silent about further appeals to the court of appeals. If the intent is to limit appeals to the district court level, an exception should be provided to make the relevant provisions of title 28 (§§158, 1291, 1292) inapplicable. If an appeal to the court of appeals is contemplated, providing for an expedited appeal should be considered. Second, (c)(1) says that a covered financial corporation may file an appeal, but it is silent on whether the Board may file an appeal if the bankruptcy judge dismisses the case because it finds that the Board has failed to meet its burden to prove that the requirements for the filing have been satisfied? The negative inference is that the Board does not have the right to appeal, but it is not clear? Are they to be treated as the SEC is under section 1109(a)? This should be clarified. It could be clarified by amending proposed section 1404(a). Third, section 1403(c)(2) is missing language specifying within 12 hours of *what* shall the district court review the determination. Should it be "within 12 hours of such determination?

§ 1403(d)(2) – Though this may be a substantive comment, it has been suggested that "bankruptcy court shall immediately order" should be changed to "bankruptcy court shall promptly order" to give the court some leeway if it is impractical to issue the order exactly when the time to appeal has expired or when the district court affirms.

§ 1403(d)(2)(B)(i) – Change it to read "the period for appeal … has ~~passed~~ expired without an appeal."

§ 1404 – The provisions regarding the Board's and the FDIC's standing are unclear. Does "case or proceeding under this title" mean only a proceeding that arises under title 11, or does it have a broader meaning (any proceeding arising under title 11, or arising in or related to a case under title 11)? The "in connection with" phrase is also unclear in section 1404(b). Also, the authority should be limited to chapter 14 cases (similar to the limitation in section 1109 to "a case under this chapter"). We believe it would be clearer if changed to: "The Federal Deposit Insurance Corporation may raise and may appear and be heard on any issue ~~in any case or proceeding under this title in connection with~~ involving a transfer under section 1406 <u>in a case under this chapter or in any proceeding within such a case</u>." Similar changes should be considered for section 1404(a).

§ 1405(a)(2) – It is unclear as to which "estate" this paragraph is referencing. It probably should be changed to "… are property of the estate <u>of a debtor under this chapter</u>" or something similar. We make the same comments with respect to sections 1405(b)(1), 1406, 1408(f)(1), 1408(f)(3), and 1409(a).

§ 1405(b)(1) – The special trustee is supposed to be paid "from the assets of the trust and not from property of the estate," but under (a) the assets of the trust are the equity securities of the bridge company and those equity securities are property of the estate (and to be held by the special trustee for the sole benefit of the estate, so the estate continues to hold the beneficial interest of the equity securities). Which assets of the trust would not be property of the estate and, therefore, could be used to pay the special trustee? Consider clarifying this paragraph.

§ 1406(b)(8) – Change to "the United States trustee <u>or bankruptcy administrator</u>."

§ 1406(c)(3) – The proposed transfer must provide for "the transfer of any accounts of depositors of the debtor…" Since the debtor is the bank holding company, not the bank, how can the debtor transfer deposit accounts (which are not property of the estate in the holding company's bankruptcy case)?

§ 1406(c)(4) – Change "leased" to "lease" on lime 14 (typo).

§ 1407(a)(1) – Change as follows: "… any debt, contract, lease, or agreement <u>of the kind</u> described in paragraph (2) …." This conforms to the phrasing in section 1407(c)(1) and in (c)(2) on page 20, lines 11-12, and page 21, lines 9-10.

§ 1407(a)(1)(B)(iv)(III) – on page 18, lines 1-2, delete "of the bridge company" because the phrase repeats in (a)(a) on line 3.

§ 1408(a) – The list of sections referenced at the beginning of section 1408(a) probably should include section 362(o). Consider changing the subsection as follows: "Notwithstanding sections 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), <u>362(o),</u> 555, …."

§ 1408(c)(1)—We believe the intent is to nullify certain provisions in a debt, contract, lease, or agreement <u>once it has been assumed by bridgeco</u>, and we recommend that this clarification be made. (This would be similar to the language in section 1408(d) which does specify that the relevant agreement must have been assumed and assigned to the bridgeco.)

§ 1408(e) – We question whether the reference to section 1407(b) was intended to be a reference to section 1407(a)(1).

28 U.S.C. § 298(b)(1) – The phrase "bankruptcy judges who are experts in cases under title 11 in which a financial institution is a debtor" may be either too high a standard or too unclear? Does taking a course on such cases (perhaps one to be offered by the Federal Judicial Center) make a judge an expert? Does one become an "expert" only by presiding over at least one such case? Assuming it does, are there as many as 10 bankruptcy judges sitting at the same time that have presided over such cases? Should the standard be made clearer and also lowered a bit so that judges who have never presided over a financial institution case, but have completed an FJC course of study or another reputable course of study designed for such cases, and/or have backgrounds in private practice involving financial institutions, be eligible (which would result in a greater pool and in more geographic diversity among the judges)?

28 U.S.C. § 298(f)(1) – The reference to "bridge company formed under section 1405" (page 30, lines 18-19) should be changed because the bridge company is not "formed" under section 1405. We assume it is formed under state law (such as a Delaware corporation). The phrase "formed under section 1405" should be deleted. Since "bridge company" is defined in section 1402, the sentence in section 298(f)(1) should work well without that phrase.

Conclusion

We hope these comments are useful in your deliberations. We conclude by noting that this is important legislation, one that is deserving of far more attention and study than we have been able to give it in the time allotted. To the extent the legislative time table permits, the NBC would welcome the opportunity to continue its analysis and submit further recommendations.

With best regards.

Sincerely,

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NATIONAL BANKRUPTCY CONFERENCE

A Voluntary Organization Composed of Persons Interested in the Improvement of the Bankruptcy Code and Its Administration

June 18, 2015

Honorable Tom Marino
Chairman
Subcommittee on Regulatory Reform,
Commercial and Antitrust Law
House of Representatives
Washington, DC 20515

Honorable Chuck Grassley
Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510

Honorable Hank Johnson
Ranking Member,
Subcommittee on Regulatory Reform,
Commercial and Antitrust Law
House of Representatives
Washington, DC 20515

Honorable Patrick J. Leahy
Ranking Member
Committee on the Judiciary
United States Senate
Washington, DC 20510

Re: **Proposed Amendments to Bankruptcy Code Relating to Resolution of Systemically Important Financial Institutions**

Dear Reps. Marino and Johnson and Sens. Grassley and Leahy,

The National Bankruptcy Conference (**NBC**) is a voluntary, non-partisan, not-for-profit organization composed of about 60 of the nation's leading bankruptcy judges, professors and practitioners. It has provided advice to Congress on bankruptcy legislation for nearly 80 years. I enclose a Fact Sheet, which provides further information about the NBC.

In 2013 and 2014, two bills were introduced to amend the Bankruptcy Code to add special procedures for the resolution of systemically important financial institutions ("**SIFIs**")—the Taxpayer Protection and Responsible Resolution Act, S. 1861 ("**TPRRA**"), which would have added a new chapter 14 to the Bankruptcy Code, and the Financial Institution Bankruptcy Act of 2014, H.R. 5421 ("**FIBA**"), which would have added a new subchapter V to chapter 11 of the Bankruptcy Code. The Senate did not take any action on TPRRA. FIBA was passed by the House just before adjournment of the 113th Congress, on December 1, 2014.

In a letter dated January 29, 2014 to Senators John Cornyn and Pat Toomey, the Conference commented on TPRRA (the "**NBC TPRRA Letter**"). Later in 2014, members of the Conference's Capital Markets Committee met with the House Judiciary Committee staff to provide technical comments regarding FIBA, but the Conference did not provide written comments regarding FIBA. Because bills similar to TPRRA and FIBA might be introduced in the current Congress, the Conference wants to provide several additional comments regarding certain aspects of TPRRA and FIBA, and more generally on the subject of the resolution of SIFIs in a bankruptcy case.

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The Conference appreciates the efforts of the last Congress to improve the Bankruptcy Code to facilitate the resolution of SIFIs. However, the problems entailed in resolving a SIFI in a bankruptcy case are very difficult, and, under the proposals introduced during the last Congress, could be intractable. While TPRRA and FIBA offered tools to address some of these problems (for example, by facilitating the use by SIFIs of single point of entry recapitalization[1] and by limiting early termination rights in qualified financial contracts if certain conditions are met), other obstacles and issues were not addressed at all or were not addressed adequately in either of the bills.

The Conference has a number of significant concerns, including the following:

- Generally, the Conference believes a bankruptcy process might not be best equipped to offer the expertise, speed and decisiveness needed to balance systemic risk against other competing goals in connection with resolution of a SIFI. The Conference strongly believes that laws in place with regard to a regulator-controlled SIFI resolution process, like the Federal Deposit Insurance Act ("**FDIA**") and Orderly Liquidation Authority under Title II of the Dodd-Frank Act ("**OLA**"), should continue to be available even if special provisions are added to the Bankruptcy Code to attempt to facilitate the resolution of SIFIs in bankruptcy. The Conference accordingly opposes provisions that would suspend or limit the powers regulators now possess with regard to the resolution of SIFIs.

- For similar reasons, the Conference believes regulators should be afforded significant involvement in and supervision over the ongoing operations of a SIFI being resolved in a bankruptcy case. Regulators should have the authority to appoint a trustee and to closely supervise and, if necessary, specify limitations and conditions on the ongoing operations of the firm. The Conference believes that any amendments to the Bankruptcy Code relating to the resolution to SIFIs should make it clear that regulators have these powers despite the pendency of the bankruptcy.

- On the other hand, while the Conference believes regulators should have a more significant role in a SIFI's bankruptcy, the Conference believes regulators should not be granted authority to commence a bankruptcy case against a SIFI. FIBA, which provided the Federal Reserve with authority to file an involuntary petition against a SIFI, made clear that, as practical matter, there would be no meaningful opportunity to contest such a petition or to appeal entry of the order for relief. While the Conference considered the possibility of authorizing regulators to file ta *voluntary* petition on behalf of a SIFI, the Conference concluded that a regulator's ability to exercise its

[1] Of course, effective recapitalization as an element of SPOE requires a firm to have a sufficient amount of loss absorbing unsecured debt that is contractually or structurally subordinated to operating liabilities of the SIFI (for example, unsecured debt issued by the firm's bank holding company). Requirements to maintain such debt are expected be established by the Federal Reserve's proposed rule establishing the nature and amount of the unsecured subordinated debt at the holding company level that is necessary to make SPOE effective.

authority under the FDIA, SIPA, OLA and other special resolution regimes would provide a sufficient incentive for a SIFI to timely commence a voluntary bankruptcy case.

- The Conference believes that any procedure contemplating use of bankruptcy proceedings to recapitalize a SIFI should not include provisions, like those in TPRRA, limiting the availability of lender-of-last-resort liquidity for a recapitalized firm and in fact should include provisions to facilitate making lender-of-last-resort interim liquidity, on a fully secured basis, available to all members of the SIFI group, including the bank and broker-dealer operations of the recapitalized firm.

- The Conference believes that a bankruptcy case for resolving a SIFI, like any other reorganization case, should be handled by a bankruptcy judge with expertise reorganizing insolvent firms, not by a district judge, and the Conference supports both the appointment of panels of judges who can develop the necessary relevant expertise and a judicial selection process like the one contained in FIBA.

We address each of the above concerns in greater detail below.

Existing Non-Bankruptcy Resolution Regimes Should Not Be Repealed

As a preliminary observation, the Conference notes that in virtually all countries, including the United States, regulators have historically controlled the process of resolving distressed banks. In the United States, for example, insured depositary institutions have been resolved by the Federal Deposit Insurance Corporation (FDIC) under the FDIA. On the other hand, until recently, the involvement of national regulators in the resolution procedures for bank holding companies and broker-dealers has been less uniform. In the United States, for example, the bankruptcy of a bank holding company has been addressed using a conventional bankruptcy case under the Bankruptcy Code, and, while broker-dealers are eligible to be liquidated under chapter 7 of the Bankruptcy Code, the resolution of larger broker-dealers has typically proceeded under the supervision of a trustee selected by the Securities Investor Protection Corporation ("SIPC") in proceedings under the Securities Investor Protection Act (SIPA), in which SIPC plays a major ongoing role.

Since the financial crisis that began in 2008, many countries, including the United States, have enacted "special resolution regimes" that give financial regulators greater control of the resolution of large financial firms, including not only OLA in the United States, but also the Bank Resolution and Recovery Directive in the European Union, and legislation in the United Kingdom, Germany and Japan, among other countries.[2]

[2] For a summary of international legislative developments through late 2014, *see* Financial Stability Board, *Towards full implementation of the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions, Report to the G20 on progress in reform of resolution regimes and resolution planning for global systemically important financial institutions (G-SIFIs)* (FSB, 12 November 2014) (the "FSB Progress Report").

Importantly, the new legislation typically includes authority for regulators to supervise the resolution of broker-dealers as well as banks, which, for these foreign countries, is a departure from the state of affairs that existed in 2008, where, for example, local broker-dealers affiliated with Lehman Brothers were placed in ordinary insolvency proceedings supervised by a variety of administrators, liquidators and other controlling persons in many parts of the world.

This global trend of providing national regulators with authority to control not just the resolution of banks, but also the resolution of broker-dealers and other operations of global financial firms has had the beneficial effect of encouraging cross-border coordination and advance planning among regulators for the orderly resolution of such firms, reducing the risk of conflict between the administration of a multi-national SIFI's domestic and foreign components. Through the Financial Stability Board and other official channels, global regulators have developed common approaches to the effective resolution of SIFIs, including such matters as key attributes of effective resolution regimes, requirements for capital and total loss absorbing capacity (TLAC), and bail-in (recapitalization) techniques.[3] Regulators have also coordinated to impose requirements that market practices be changed to enhance resolvability. They have, for example, advocated a protocol (announced prior to the Brisbane G-20 Summit in November 2014) for international recognition by contract of provisions in special resolution regimes that limit termination rights in over-the-counter derivatives contracts.[4] Such termination rights were among the major impediments to the orderly resolution of Lehman Brothers and reportedly a source of tens of billions of dollars of value-erosion in that case.[5] In addition, regulators are coordinating firm-specific resolution planning by forming "Colleges of Regulators" for individual firms. In short, lines of communication are now open and there is increasing alignment in approaches among regulators around the world who will control the resolution of parts of a SIFI in key countries, making it far more likely that a multi-national SIFI can be resolved in a speedy and coordinated manner should it ever become necessary.

[3] *See* the above cited FSB Progress Report.

[4] This protocol, known as the "ISDA Protocol" has already been subscribed to by eighteen G-SIFIs and adherence to the protocol is expected to be expanded pursuant to regulations expected to be promulgated by regulators in jurisdictions where those firms are based, including the United States. The approach contained in the protocol is also expected to be extended to other types of financial contracts, such as repurchase agreements. *See* http://www2.isda.org/news/major-banks-agree-to-sign-isda-resolution-stay-protocol (announcement by ISDA that 18 global banks have agreed to adhere to the ISDA Protocol).

[5] One recent source cites estimates for the loss in value to the Lehman Brothers bankruptcy estate from the close-out of the firm's derivatives ranging from $50 to $75 billion. *See* Mark J. Roe and Stephen D. Adams, *Restructuring Failed Financial Firms in Bankruptcy: Selling Lehman's Derivatives Portfolio*, (April 24, 2015, 32 Yale Journal on Regulation, forthcoming) at http://poseidon01.ssrn.com/delivery.php?ID=676067083085098093122026068120065078034050019023060074029023106088102016030125088099032060018032059046053102106092029017124010126023030041068069029117101029092070078041003091025067082106121078027064002072099004121028075008086065006104007026072&EXT=pdf&TYPE=2

While these developments do not mean that the Bankruptcy Code should not be improved to better address the resolution of SIFIs, the Conference strongly believes that laws in place with regard to a regulator controlled SIFI resolution procedure, like the FDIA and OLA, should continue to be available even if the Bankruptcy Code is amended to better address the resolution of SIFIs. In all circumstances effective resolution of a SIFI will be heavily dependent on the confidence and cooperation of regulators in other countries where the SIFI operates, and the ability of U.S. regulators to assume full control of the resolution process to elicit the cooperation from non-U.S. regulators is an essential insurance policy against systemic risk and potential conflict and dysfunction among the multinational components of a SIFI. Greater control of U.S. regulators over any bankruptcy resolution procedure (as suggested below) and the knowledge that U.S. regulators can, if necessary, invoke regulator-controlled resolution procedures are both essential to obtaining the necessary support and cooperation from non-U.S. regulators for the orderly resolution of the firm.

Regulatory Supervision and Control of the Recapitalized Firm

To benefit from all of the work that has been done to coordinate the resolution of a SIFI in multiple countries and to benefit from regulators' expertise regarding how best to resolve the firm, the Conference also believes that regulators should have a very significant role in any bankruptcy case seeking to resolve a SIFI. The expertise of U.S. regulators, who will be "on site" at the financially distressed firm at the time resolution proceedings are commenced and the need for U.S. regulators to coordinate the firm's resolution with controlling regulators in other countries means heavy involvement by U.S. regulators will be critical if adverse systemic effects from the failure of the SIFI are to be prevented or minimized. Put another way, the ability to elicit cooperation from regulators controlling the resolution of the foreign components of a multinational SIFI will likely be compromised if such regulators believe U.S. regulators will not able to exercise an appropriate level of supervision and control over the U.S. components of the SIFI.

Moreover, bankruptcy courts are not experts in the operations of global financial firms, and after a firm has failed, it is unlikely they will be qualified to exercise necessary supervision over the firm. The firm's primary regulators will, among other things, be in the best position to appoint the controlling manager (whatever the title of the officeholder) and, as under Title II of the Dodd-Frank Act, they should be given the authority to do so.

Finally, unlike normal bankruptcies, where equality of treatment of similarly situated creditors, preservation of going concern value and rehabilitation of the firm are the principal goals, in SIFI resolutions the goal of minimizing systemic risk is the most important goal. Regulators are not only best situated to identify systemic risk, but also in the best position to determine how to balance that risk against other goals. This is not to say that regulators should be given total carte blanche to ignore traditional bankruptcy goals, but they need to be in a position to act expertly, quickly and decisively, taking into account both the interest of stakeholders and the public interest, so an appropriate balance can be struck.

For all of the above reasons, the Conference believes regulators should be afforded significant involvement in and supervision over the ongoing operations of a SIFI being resolved in bankruptcy case.

Filing of a Petition by Regulators

While the Conference believes regulators should have greater involvement in a bankruptcy case regarding a SIFI, the Conference is concerned about granting regulators authority to commence a bankruptcy case against a SIFI. FIBA, for example, provides for the commencement of an involuntary case against a SIFI under proposed subchapter V of chapter 11. It provides for a very truncated (16 hour) period to contest the petition and, if necessary, obtain a ruling on an appeal from the order for relief in the case. While the Conference understands the reasons for the abbreviated process due to the need to implement the recapitalization of the firm over the proverbial "resolution weekend" to provide certainty to markets and counterparties and prevent contagion, the Conference submits it is unrealistic to think that such a compressed process for vetting petitions for involuntary relief will afford an opponent of the petition, be it the SIFI itself or a holder or a claim or interest, any real opportunity to contest the petition or the courts any real opportunity to make an informed and reasoned decision on the merits. The limited time for a hearing on and appeal of the order for relief is unrealistically short.

One alternative considered by the Conference was the possibility of allowing regulators to step into the shoes of the SIFI and file a voluntary bankruptcy petition on its behalf, just as regulators could commence regulator-controlled resolution proceedings under other laws, but the Conference concluded that entirely removing the parties' opportunity to contest the regulator's decision to invoke the bankruptcy process was not a real solution to the lack of a sufficient time to contest the petition. The articulated justification for allowing regulators to act is to prevent the SIFI's management from delaying its own petition if necessary to assure orderly resolution of the firm. However, the Conference believes the authority of regulators to act under existing laws, like OLA, the Federal Deposit Insurance Act and the Securities Investor Protection Act, sufficiently serve this purpose. Consequently, the Conference concluded that regulators should not be provided with authority to commence a bankruptcy case against a SIFI, but instead regulators should retain the threat of proceeding under other laws if the SIFI fails to act.[6]

[6] If limitations were placed on the availability of regulator-controlled resolution procedures, which, as noted above, the Conference opposes, the Conference would favor the ability of a regulator to commence a case by filing a voluntary petition on behalf of the debtor in lieu of commencing an involuntary case. If the provision of FIBA affording regulators the ability to commence involuntary proceedings is nonetheless retained, the Conference believes that judges should be given the longest practicable time period to consider and render a decision on the appropriateness of an involuntary petition, and the Conference believes the requisite 48-hour minimum notice should be given to the Chief Judge of the Circuit in which the bankruptcy judge sits, rather than to the Administrative Office of the U.S. Courts.

Lender-of-Last Resort Liquidity

As suggested in the NBC TPRRA Letter, meeting the liquidity needs of a distressed SIFI is essential to successfully resolving the firm without creating undue systemic risk. The business of a SIFI is "maturity transformation"—taking short term loans from depositors and other stakeholders and turning them into long term investments in the economy, like mortgages and corporate loans. When a financial firm becomes distressed, depositors and customers panic and, rather than risk their savings and investments, they make precipitous withdrawals from the firm. In short, they "run." Unlike the typical debtor, where creditors can be stayed from collecting debts until the reorganization is completed, staying a SIFI's depositors and customers from making withdrawals creates systemic disruption and contagion risk. If the firm is to be reorganized, the firm needs to be recapitalized virtually overnight (i.e., over a "resolution weekend"), and the recapitalized firm has to open up on the next business day with sufficient liquidity to meet withdrawals until the "run" subsides and confidence in the firm is restored. By facilitating the creation of a new, non-bankrupt bank holding company to which the recapitalized bank and broker dealer operations of a debtor bank holding company can be speedily transferred for the benefit of the estate, both FIBA and TPRRA seek to facilitate this type of recapitalization. If, however, the recapitalized firm is forced to sell assets to meet a run, market prices will be further depressed, imposing additional losses on the firm and creating losses at other firms who mark their balance sheets to market. The only way to prevent this type of transmission of balance sheet losses and the resulting contagion is for the recapitalized firm to borrow against its unencumbered assets as necessary to meet the outflows, instead of dumping its assets on the market. Secured lender-of-last-resort lending to fully capitalized banks has long been thought justified for just this reason.[7]

A crucial distinction needs to be made between a government bailout of shareholders and creditors by adding equity capital to an insolvent firm on the one hand, and traditional secured lender-of-last-resort liquidity provided to a recapitalized firm on the other. In the former case, taxpayers absorb the firm's losses. In the latter case, private sector shareholders and creditors absorb the firm's losses, and fully secured loans are made only to a recapitalized firm.

The Conference strongly believes that to be successful, any recapitalization procedure, whether under the Bankruptcy Code or under a special resolution regime like OLA, requires a non-market backstop liquidity source as a bridge for the recapitalized firm until liquidity outflows abate and access to market liquidity returns. For this reason, the Conference opposes provisions (like those in TPRRA) that do not provide for lender-of-last-resort liquidity even after a firm's bank and broker-dealer operations have been recapitalized, and supports instead adding provisions that provide assurance that some form of lender-of-last-resort liquidity will be available, on a fully secured basis, for use in all entities in the SIFI group, including the bank and broker-dealer businesses of the recapitalized firm.

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[7] Bagehot, Walter, *Lombard Street: A Description of the Money Market* (1873). *See also* Bipartisan Policy Center, *Too Big to Fail: The Path to a Solution (May 2013).*

Selection Procedure for Judges

In its review of FIBA, the Conference considered the judicial selection process for the resolution of SIFIs under the Bankruptcy Code. The Conference believes that, for the reasons outlined above, specialized expertise and advance judicial training is required for the judge who would preside over the resolution of a SIFI. Moreover, the Conference believes that bankruptcy judges, who regularly deal with the reorganization of financially distressed firms, are better equipped than federal district judges to deal with insolvencies of financial firms. However, even bankruptcy judges do not share regulators' financial-institution specific expertise, and they would require special training to address resolution of a SIFI.

The Conference accordingly supports the idea that, if special procedures are added to the Bankruptcy Code to facilitate the resolution of SIFIs, expert panels of court of appeals judges and bankruptcy judges should be designated in advance by the Chief Justice to address such cases, as provided in Section 4 of FIBA. The Conference also favors a mechanism for selecting a presiding judge from among the designated judges that is similar to the one included in FIBA (where the chief judge for the court of appeals in the circuit where the case is pending selects the presiding judge). The designation of panels of judges is, of course, best coupled with training to help the designated judges develop the requisite expertise to handle complex SIFI bankruptcies, and the Federal Judicial Center might consider offering regular educational programs and written materials to assist the designated judges in addressing issues likely to arise in such cases.

Conclusion

We hope that these comments are useful if bills are proposed in the 114th Congress seeking to amend the Bankruptcy Code to address SIFI resolution. As noted above, the prior legislative proposals did not address various significant issues and failed to effectively mitigate the risk of cross-border dysfunction and conflict in connection with the resolution of multinational SIFI's. The NBC welcomes the opportunity to review and analyze legislation on this subject introduced in the current Congress and to submit further comments and recommendations, including those addressing the issues not previously covered.

Sincerely,

/s/ Richard Levin

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