

NATIONAL BANKRUPTCY CONFERENCE

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

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SHARI A. BEDKER

March 17, 2017

Honorable Michael Crapo
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, D.C. 20510

Honorable Sherrrod Brown
Ranking Member
Committee on Banking, Housing, and
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Honorable Jeb Hensarling
Chairman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Honorable Maxine Waters
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Honorable Chuck Grassley
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Honorable Dianne Feinstein
Ranking Member
Committee on the Judiciary
United States Senate
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Honorable Bob Goodlatte
Chairman
Committee on the Judiciary
United States House of Representatives
Washington, DC 20515

Honorable John Conyers, Jr.
Ranking Member
Committee on the Judiciary
United States House of Representatives
Washington, D.C. 20515

Re: **Resolution of Systemically Important Financial Institutions**

Dear Reps. Hensarling, Goodlatte, Waters and Conyers and Sens. Crapo, Grassley, Brown and Feinstein:

The National Bankruptcy Conference (the “**NBC**” or the “**Conference**”) 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.

I am writing on behalf of the NBC about recent legislative proposals relating to the resolution of financially distressed systemically important financial institutions (“**SIFIs**”). These include various proposed amendments to the Bankruptcy Code and proposals to repeal Title II of the Dodd-Frank Act (“**Orderly Liquidation Authority**” or “**OLA**”). During the last Congress several bills were introduced to amend the Bankruptcy Code to add provisions to facilitate SIFI resolution (collectively, the “**Proposed**

Bankruptcy Code Amendments).¹ The Proposed Bankruptcy Code Amendments are expected to be reintroduced in this Congress, whether as standalone bills or in connection with broader financial regulation legislation, such as a reintroduced version of the Financial CHOICE Act.² The Senate version of the Proposed Bankruptcy Code Amendments and the Financial CHOICE Act introduced in the last Congress both included provisions seeking to repeal OLA.

The NBC has previously written letters commenting on the House and Senate versions of the Proposed Bankruptcy Code Amendments (FIBA and TPRRA, respectively) and has offered testimony at hearings on versions of the House bill.³ Our most recent letter on the subject, dated June 18, 2015 (the “**2015 NBC Letter**”), is attached.

We are writing at this time because the Conference remains concerned that Orderly Liquidation Authority, which is similar in many respects to the resolution regime for failing banks under the Federal Deposit Insurance Act,⁴ might be repealed without being replaced by some other regulator-supervised resolution procedure for SIFIs.⁵ As we indicated in the 2015 NBC Letter, we are concerned that the 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. Likewise, bankruptcy might not be the best forum in which to foster cooperation by non-U.S. regulators of foreign subsidiaries whose adverse actions could prevent the orderly resolution of the firm. Consequently, the Conference believes a regulator-supervised resolution regime with resolution tools similar to those contained in OLA should continue to be available even if special provisions are added to the Bankruptcy Code with respect to the resolution of SIFIs.

We recognize that U.S. regulators have taken steps to facilitate the orderly resolution of SIFIs in bankruptcy. As we anticipated in the 2015 NBC Letter, SIFIs now must maintain substantial amounts of equity and long-term debt at the firm’s bank holding company that is structurally subordinated to the debts of the firm’s subsidiaries (“**Total Loss Absorbing Capacity**” or “**TLAC**”),⁶ which provide the SIFI’s holding

¹ Financial Institution Bankruptcy Act of 2016, H.R. 2947, 114th Cong. (2016) (“**FIBA**”); Taxpayer Protection and Responsible Resolution Act, S. 1840, 114th Cong. (2015) and S. 1841, 114th Cong. (2015) (“**TPRRA**”).

² Financial CHOICE Act of 2016, H.R. 5983, 114th Cong. (2016).

³ See Letter from Nat’l Bankr. Conf. to Reps. Marino and Johnson and Sens. Grassley and Leahy regarding Proposed Amendments to the Bankr. Code Relating to Resolution of Systemically Important Financial Institutions (June 18, 2015), http://newnbc.wpengine.com/wp-content/uploads/2015/07/2015-Jun-18-NBC_Ltr_to_Cong_re_SIFI_Bills.pdf; Letter from Nat’l Bankr. Conf. to Sens. Cornyn and Toomey regarding S. 1861, Taxpayer Protection and Responsible Resolution Act, 113th Cong. (Jan. 29, 2014), <http://newnbc.wpengine.com/wp-content/uploads/2015/07/NBC-Ltr-re-s-1861-Ch-14.pdf>; *Financial Institution Bankruptcy Act of 2015: Hearing on H.R. 2947 Before the Subcomm. on Regulatory Reform, Commercial and Antitrust Law of the H. Comm. on the Judiciary*, 114th Cong. 85-89 (2015) (statement of Richard Levin, Chair, Nat’l Bankr. Conf.), https://judiciary.house.gov/wp-content/uploads/2016/02/114-35_95425.pdf; *Exploring Chapter 11 Reform: Corporate and Financial Institution Insolvencies; Treatment of Derivatives: Hearing Before the Subcomm. on Regulatory Reform, Commercial and Antitrust Law of the H. Comm. on the Judiciary*, 113th Cong. 51-57 (2014) (statement of Jane Lee Vris, Chair, Cap. Mkts. Comm., Nat’l Bankr. Conf.), https://judiciary.house.gov/wp-content/uploads/2016/02/113-90_87331.pdf.

⁴ Federal Deposit Insurance Act, 12 U.S.C. §§ 1821 et seq.

⁵ It is legally permissible to invoke OLA only if the Secretary of the Treasury determines that use of the Bankruptcy Code to resolve a financial firm “would have serious adverse effects on financial stability in the United States” and the use of OLA would “avoid or mitigate those adverse effects.” Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 § 203(b)(2) (2010) (codified at 12 U.S.C. § 5383(b)(2)) hereinafter Dodd-Frank Act.

⁶ Final Rule Regarding 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. 8266 (Jan. 24, 2017) (codified at 12 C.F.R. pt. 252). Under the Final Rule,

company with the ability to recapitalize its material subsidiaries during times of financial stress. After the subsidiaries are recapitalized, only the parent holding company would need to be placed in bankruptcy or resolution proceedings, and the firm's losses would be borne solely by the firm's TLAC investors, rather than taxpayers.

Both FIBA and TPRRA seek to amend the Bankruptcy Code to facilitate this "single point of entry" approach to resolution, which would minimize systemic disruptions by allowing the SIFI's material subsidiaries to continue to meet their obligations to depositors, customers and counterparties without interruption. However, as explained in the 2015 NBC Letter, distressed financial firms often suffer "runs" as a result of rapid withdrawals of assets by depositors and customers fleeing the risk of a potentially failing firm. As a result, the success of a single point of entry approach will be dependent upon the recapitalized firm having sufficient liquid assets to meet withdrawals and other obligations until any run subsides and confidence in the firm is restored.

U.S. SIFIs are now required to maintain large amounts of high quality liquid assets on their balance sheets and adopt financial triggers to assure that the firm's resolution commences at a time when the firm's material subsidiaries have sufficient resources to complete the resolution process.⁷ It is, however, impossible to predict how long a post-recapitalization run might continue. Under such circumstances, the recapitalized subsidiaries of the firm could be forced to sell assets at distressed prices to meet the run, further depressing market prices, imposing additional losses on the firm and creating losses at other firms that mark their balance sheets to market. In light of this risk of contagion, it is highly important that a resolution regime with the tools necessary to prevent this kind of harm to the U.S. financial system remain available.

It has long been recognized that contagion risk from a panic run on solvent financial firms can be avoided by allowing firms to borrow on a fully secured basis from the central bank against their unencumbered assets as necessary to meet outflows, instead of dumping their assets on the market. This can be accomplished without creating moral hazard or risk of loss to the central bank if the financial backstop is limited to fully secured loans to solvent entities at fully compensatory rates of interest that discourage unnecessary borrowing and, if loans are made, assures that investors in the firm bear an appropriate cost for borrowing the funds.⁸

The Conference, accordingly, strongly believes that any recapitalization procedure to restore the solvency of a distressed SIFI's subsidiaries, whether under the

TLAC must represent between 21.5% and 23.0% of each firm's risk-weighted assets (based on recently reported financial information). See *id.*; Financial Stability Board, 2016 List of Global Systemically Important Banks (G-SIBs) (2016), <http://www.fsb.org/wpcontent/uploads/2016-list-of-global-systemically-important-banks-G-SIBs.pdf>. Long term debt of the SIFI's bank holding company is structurally subordinated to the operating liabilities incurred by the firm's subsidiaries.

⁷ See, e.g., Fed. Deposit Ins. Corp., Guidance for 2017 § 165(d) Annual Resolution Plan Submissions By Domestic Covered Companies that Submitted Resolution Plans in July 2015.

⁸ This approach to central bank lender-of-last-resort lending was famously advocated by Walter Bagehot over 140 years ago in his book *Lombard Street*. See WALTER BAGEHOT, *LOMBARD STREET: A DESCRIPTION OF THE MONEY MARKET* (1873). Bagehot said that central banks should "lend freely" to "solvent" banks on "what is reckoned in ordinary times as good security" at "the rate of interest as high as may be necessary" to prevent a drain on the central bank. *Id.* at 56, 65 and 198. As we noted in the 2015 NBC Letter, lending against good collateral to assure the central bank does not suffer a loss is what distinguishes appropriate lender-of-last-resort lending from a "bail out." In the case of the largest U.S. SIFIs, there should be ample unencumbered assets to secure such loans so they can be structured to be free of any risk of loss to the central bank. If there is concern over other forms of support currently permitted under OLA, such concerns can be addressed by limiting the type of support available to fully secured loans at interest rates sufficient to provide adequate compensation to the lender.

Bankruptcy Code or a special resolution regime like OLA, should make provision for a backup source of fully secured loans as a bridge for the recapitalized firm until cash outflows abate and the firm's access to credit in the market returns, or assets can be sold in an orderly fashion at non-fire sale prices. A resolution procedure with such a backup source of temporary secured loans is a necessary last line of defense if the recapitalized firm's liquid assets, despite all precautions, run out.

Retaining a backstop regulator-supervised resolution regime with a source of temporary secured loans like OLA has a number of beneficial effects, even if the recapitalized SIFI cannot access the loans in its bankruptcy proceedings, and can only do so in a regulator-supervised process. Corporate bankruptcy experts know that having a debtor-in-possession financing commitment restores market confidence in the debtor and often restores the debtor's access to credit, reducing or eliminating the need to use the financing. In a similar manner, the ability of regulators to trigger a regulator-supervised resolution procedure to provide temporary secured loans if necessary should help accelerate stabilization of the SIFI's recapitalized subsidiaries even if the SIFI is being resolved under the Bankruptcy Code.

Moreover, as we noted in the 2015 NBC Letter, the ability of U.S. regulators to assume control of the resolution process may be required to elicit cooperation from non-U.S. regulators in countries where a recapitalized SIFI operates. This is another important safeguard against systemic risk and potential conflict and dysfunction among the multinational components of a SIFI. The knowledge that U.S. regulators can, if necessary, step in to assume control of the resolution process will help discourage non-U.S. regulators, who are unfamiliar with and apprehensive about judicially supervised U.S. bankruptcy proceedings, from "ringfencing"⁹ or seizing a SIFI's foreign branches or subsidiaries.

Whatever progress may be made in developing better strategies for resolving SIFIs under the Bankruptcy Code and whatever amendments may be made to the Bankruptcy Code to facilitate execution of such strategies, it is impossible to anticipate all possible causes and consequences of a SIFI's failure. The possibility cannot be dismissed that there will be at least some cases where the additional tools available under a regulatory resolution regime like OLA, including the availability of fully secured temporary government loans, will be needed to avert dire systemic consequences. Accordingly, the NBC urges that a regulator-supervised resolution option for U.S. SIFIs be retained in some form, and in particular that a source of fully secured temporary government loans remain available to facilitate the stabilization of solvent, recapitalized subsidiaries of SIFIs in resolution.

Please let us know if we can provide further information or if the NBC can be of assistance in any other way.

Sincerely,



Jane Lee Vris, Chair

⁹ "Ringfencing" in this context refers to various forms of action by a local regulator to limit outflows from a regulated entity to assure local depositors or creditors are paid.

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Improvement of the Bankruptcy Code and Its Administration

June 18, 2015

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ADMINISTRATIVE OFFICE

SHARI A. BEDKER

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

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

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 ("TPRRR"), 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 TPRRR. 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 TPRRR (the "NBC TPRRR 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 TPRRR and FIBA might be introduced in the current Congress, the Conference wants to provide several additional comments regarding certain aspects of TPRRR and FIBA, and more generally on the subject of the resolution of SIFIs in a bankruptcy case.

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

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

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 recapitalization¹ 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 a *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 depository 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 be 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.

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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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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