

# Real and Imaginary Resolution Options for Large Financial Institutions

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11 November 2011

# Puzzle:

- Why so little consideration of bankruptcy?

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*"Ladies and gentlemen,  
is there a bankruptcy attorney on board?"*

Bankruptcy

NEXT EXIT 



What did we get instead?



*"These new regulations will fundamentally  
change the way we get around them."*

# Roadmap

- 1) Dodd-Frank Resolution (aka OLA, Title II)
- 2) Bankruptcy
- 3) Bail-in (regulator and automatic)
- 4) Reforms (herein of Chapter 14)

# 1) Dodd-Frank Resolution

- The Scheme:
  - "Three keys turn"
  - Managers removed if responsible
  - SHs, creditors take losses
  - "Must" liquidate
    - "All financial companies put into receivership under this title shall be liquidated." DFA section 214



# Misconceptions at origin

- Dubious analogy to FDIC resolution of small/medium sized banks
- Liquidation unlikely
- (see recent FDIC statements)

# Problems

- Untimely initiation
- Nontransparent, little judicial review
- Moral hazard
- Expertise (can the FDIC run a major bank?)

# Benefits

- Ability to intervene quickly with substantial funding
- Prior regulatory knowledge
- Global regulatory coordination

# Bankruptcy

- The Process:
- Automatic stay
  - Exception: derivatives, repos
- Sale of assets and/or negotiate terms of reorganization
- Creditor vote

# Benefits

- Rule of law virtues
- Curbs moral hazard
- Parties themselves make the key decisions

# Bankruptcy's Limitations

- Doesn't focus on systemic risk
- No immediate funding source
- How serious are these concerns?

# Limitations of Bankruptcy Judge

- Limited information at outset
- Limits of Article I (vs. III) status
  - Independence deficit? (14 year terms)
  - Jurisdiction deficit? (Stern v. Marshall)

### 3) Is Bail-in the Solution?

- Origins of the term: sovereign debt
- Meaning: creditors take haircuts
- How different from Dodd-Frank or BR?
  - Preserve the institution
  - Regulators' discretion channeled
  - NB: can be done in Dodd-Frank (e.g., Guynn (2011))



# Limitations of Administrator Bail-in

- Administrators still must decide who is and isn't protected (unless triggers are automatic)
- Timeliness of initiation uncertain

# Automatic triggers

- Obvious triggers (e.g., capital-based) can be gamed
- Manipulation of triggers
- Greece e.g. doesn't bode well for this approach
- Overview of a similar debate in the bankruptcy literature: Skeel (1993)

## 4) Reforms?

- Simple:
- 1) Remove "thou shalt liquidate" provision
- 2) Presumption that "living will" will be followed
- 3) Presumption that cases in bankruptcy will stay there
- 4) Stay on derivatives in BR

# Chapter 14

- 1) Regulators given standing and power to file involuntary BR
- 2) Funding rules amended to allow prepayments
- 3) Judge chosen from panel of Article III judges (and authorized to use masters)
- Cf. Bliss-Kaufman (2011)