Real and Imaginary Resolution
Options for Large Financial Institutions

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Puzzle:

- Why so little consideration of bankruptcy?
“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)