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# Features of SIFI Resolution Regimes That Promote Resolvability: Reasons and Concerns

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Resolution Promoting Feature	Reason(s)	Concern(s)
<b>Ability to commence the resolution process <u>before</u> insolvency</b>	<p>A SIFI that has incurred losses can suffer a run on liquidity by short-term creditors that requires the forced sale of illiquid assets at discount prices, causing the SIFI to incur further losses. These further losses can render an otherwise solvent (though undercapitalized) SIFI insolvent. Maximizing the value of the SIFI group and continuing the SIFI group's critical operations may accordingly require the timely initiation of the resolution process to stabilize the SIFI's liquidity before such forced sales are required.</p>	<p>Timely initiation of the resolution process may mean that resolution procedures are initiated prior to any payment default by the SIFI, which may be considered premature by the SIFI or its investors.</p>
<b>Ability to quickly transfer a SIFI group's operations to a healthy third party in a P&amp;A Transaction</b>	<p>A speedy (i.e., over a "resolution weekend") purchase and assumption transaction, where a healthy third party takes over and continues most or all of the SIFI's operations, is perhaps the least systemically disruptive resolution strategy. A quick transfer to a third party, including customer accounts and customer property, minimizes the need for liquidity and other financial support and assures the continuity of critical operations.</p>	<p>The more quickly a P&amp;A transaction closes, the less time there is for a fair and thorough auction or for notice to affected creditors and an opportunity to object, thus increasing the risk that the SIFI group will be sold at a price that reflects an unwarranted discount to its long-term franchise value at the expense of affected investors. Selective assumption of debts by the purchaser is also a concern.</p>

# Features of SIFI Resolution Regimes That Promote Resolvability: Reasons and Concerns *(cont.)*

Resolution Promoting Feature	Reason(s)	Concern(s)
<p><b>Ability to accomplish a quick reorganization of the SIFI by transferring its operations to a bridge entity or by “bailing in” the SIFI parent’s long-term debt</b></p>	<p>Where it is impossible or undesirable to do a P&amp;A transaction with a third party, the speedy “reorganization” of the SIFI parent as an independent solvent entity may be the best way to maintain continuity of the SIFI’s critical operations, preserve the SIFI’s going concern value and avoid the complications of resolution proceedings for the SIFI’s operating subsidiaries.</p> <p>Possible methods of accomplishing such a speedy (i.e., over a “resolution weekend”) reorganization of the SIFI parent might include:</p> <ul style="list-style-type: none"> <li>i. creating a solvent SIFI parent bridge entity by transferring the assets of the failed SIFI parent to such bridge entity free and clear of some or all of the SIFI parent’s debts left behind in the SIFI parent’s resolution proceedings (along the lines of the “single point of entry” resolution strategy suggested by the FDIC), or</li> <li>ii. recapitalizing the existing SIFI parent by having a mechanism to quickly convert (“bail in”) some or all of the SIFI parent’s debts into new equity of the SIFI parent.</li> </ul>	<p>In addition to the concerns described previously about lack of notice and opportunity to object and the selective assumption of debts, control of the business after it is transferred or reorganized and the allocation of the equity of the bridge or reorganized SIFI parent among the left-behind or bailed-in creditors are concerns. The quick “bail-in” method presumes the ability to speedily determine the amount of equity that should be allocated to bailed-in creditors, raising difficult valuation issues. (See the discussion of the possible use of “relative priority” distributions in lieu of “absolute priority” distributions on slide 10.)</p>

# Features of SIFI Resolution Regimes That Promote Resolvability: Reasons and Concerns *(cont.)*

Resolution Promoting Feature	Reason(s)	Concern(s)
<b>Ability to assume and transfer to a third party or bridge entity valuable QFCs</b>	<p>Ipso facto terminations of QFC's in the Lehman Brothers case destroyed value and created myriad costly disputes. The ability of the SIFI (or its operating subsidiaries) to preserve a valuable book of QFCs and/or minimize liabilities with respect to such a book by assuming and transferring QFCs to a creditworthy bridge entity or to a third party, or by the assuming such QFCs in connection with a reorganization of the originating SIFI affiliate may be necessary to promote maximization of the SIFI group's value and to minimize systemic risk.</p>	<p>Any stay of QFC terminations to allow assumption of QFCs imposes market risk on counterparties, but the risk is limited if the delay is short. Too short a delay, however, may not allow sufficient time to evaluate the QFC book. In addition, the invalidation of QFC termination rights and assumption of the QFCs by a new or reorganized entity changes the risk bargained for by the counterparty unless performance by the new or reorganized entity can be adequately assured.</p>
<b>Ability to override QFC cross-defaults to affiliated entities</b>	<p>SIFIs typically manage QFC exposure "firm wide" under normal operating conditions and counterparties may insist on inter-affiliate cross-defaults, including upon bankruptcy or insolvency of an affiliate, especially where the affiliate is a credit support party (for example, a guarantor). To preserve the value of a QFC book and permit its assumption and/or transfer it is necessary to override these cross-defaults in the same way as conventional ipso facto defaults may be overridden.</p>	<p>If credit support is provided by affiliates, overriding inter-affiliate cross-defaults could effectively result in the loss of such credit support by the holder of the transferred or assumed QFC.</p>

# Features of SIFI Resolution Regimes That Promote Resolvability: Reasons and Concerns (cont.)

Resolution Promoting Feature	Reason(s)	Concern(s)
<p><b>Ability to discriminate in favor of some creditors or creditor classes over others</b></p>	<p>From a systemic point of view, it may be desirable to satisfy short-term liabilities of the SIFI, such as deposits, money market obligations, mark-to-market obligations, securities and other settlement obligations and ordinary-course operating liabilities to prevent the financial system from “seizing up,” even if long-term creditors of the SIFI cannot be paid in full. Because, during a financial crisis, the holders of many of these short-term liabilities can “run,” such creditors have, in a practical sense, a priority over longer term obligations. The fact that such short term liabilities can and do “run” during financial distress can lead to an accelerated liquidity crisis for the SIFI, making the SIFI harder to resolve and making it harder to realize value for longer term creditors. Short-term funding keeps the SIFI running and preserves its franchise value in the same way “critical vendors” do for a manufacturing company. For these reasons, and because of the public interest in maintaining the operations of a SIFI, policymakers have generally assumed that at the outset of the resolution process (if not before) it would be essential to announce that certain short term liabilities will be paid in full under virtually all circumstances – in effect, giving them priority over longer term liabilities, even if, by their terms, the longer term obligations are <i>pari passu</i> with the short term obligations as a matter of applicable non-bankruptcy law. The adverse impact of such “discrimination” is thought to be mitigated if the disfavored creditors’ ultimate recovery is enhanced by the discrimination (i.e., the disfavored creditors will receive a better recovery than they would have received had the discrimination not occurred).</p>	<p>If decisions to discriminate between classes of creditors to mitigate to systemic risk are discretionary rather than rule-based, the possibility of ad hoc discrimination creates costly uncertainties. How will the market price the risk of the future exercise of such discretion? When a failure occurs, on what basis will decisions to discriminate be made? Can the counterfactual (the disfavored creditors are better off) really be determined and will there be an opportunity to dispute that determination? Is there any realistic way for there to be <i>ex ante</i> judicial review of such a determination or to provide an <i>ex post</i> remedy? Can these problems be addressed by limiting the discretion to discriminate to a pre-identified subset of short-term liabilities? Or will advance designation of classes to receive more favorable treatment dis-incentivize credit monitoring by the favored classes or reduce the availability to the SIFI of longer term credit?</p>

# Features of SIFI Resolution Regimes That Promote Resolvability: Reasons and Concerns *(cont.)*

Resolution Promoting Feature	Reason(s)	Concern(s)
<p><b>Providing for an external source of post-failure “priming” financing to meet the liquidity and capital needs of SIFI operating subsidiaries</b></p>	<p>Maximizing the SIFI group’s value in resolution (preventing forced sales) and maintaining the continuity of the SIFI group’s systemically critical operations to mitigate systemic risk may require a substantial infusion of liquidity and/or capital promptly upon commencement of the resolution process. While it may be possible for the holding company to contribute unencumbered assets (for example, the holding company’s claims against its operating subsidiaries) to the capital of solvent but undercapitalized operating subsidiaries, it may also be necessary to obtain additional funds to meet liquidity and capital needs. The resolution procedure thus needs to provide a source for new financing that may not otherwise be available in the market and allow such financing to “prime” (have priority over) holding company creditors and shareholders (for example, by providing for loans to a newly created, debt-free SIFI bridge parent or “superpriority” loans to a reorganizing SIFI parent at appropriate interest rates). The resolution procedure would also have to provide a mechanism for allowing the use of the liquidity so obtained as a source of liquidity and/or further capital for the SIFI’s operating subsidiaries in order to preserve their going concern value and mitigate systemic risk. Such infusions for operating subsidiaries with priming financing obtained by the SIFI parent or a bridge entity forces losses incurred by the operating subsidiaries to be absorbed by pre-failure creditors of the SIFI parent and the SIFI parent’s shareholders. Such an emergency priming financing is a possible use of loans from the Orderly Liquidation Fund (OLF) under Title II of Dodd-Frank in a “single point of entry” resolution under OLA.</p>	<p>If such emergency infusions would not otherwise be available in the market, should they be provided by government sources, even if, as in the case of the OLF, taxpayers are protected? Under what circumstances should the SIFI parent be allowed to contribute its assets or funds it borrows to operating subsidiaries? Who is to decide this question and what remedies do SIFI parent creditors have if they disagree?</p>

# Features of SIFI Resolution Regimes That Promote Resolvability: Reasons and Concerns *(cont.)*

Resolution Promoting Feature	Reason(s)	Concern(s)
<p><b>Providing mechanisms to allow prompt cooperation among home and host country resolving authorities at the time of failure</b></p>	<p>In many, if not most, host countries the resolution of the local operations of a SIFI will be controlled by host country regulatory authorities who, either by law or as a practical matter, will be more concerned about protecting local interests and than about the global systemic impact of the SIFI failure, especially if the systemic impact mainly affects other countries. This may cause host country authorities to ringfence local assets and operations of the SIFI for the benefit of local creditors even if that causes substantial disruption in the SIFI's critical operations or constrains the ability to resolve other parts of the SIFI. Such ringfencing is entirely incompatible with continued operation of a number of systemically critical operations such as global clearing, payment, settlement businesses that cross borders and entity lines. To continue such operations on a consolidated basis, the relevant host country authorities must have the legal power to cooperate and the willingness to do so instead of ringfencing to protect local interests, and, as discussed on slide 7, home country authorities may need the ability to agree to special treatment of host country depositors and other creditors, or to other conditions, in order to obtain such cooperation from host country authorities.</p>	<p>Home and host country authorities may not have the legal authority to cooperate and, even where the authority exists, it is typically exercised by regulatory authorities on an extra-judicial (highly discretionary) negotiated basis. Cooperation may be highly dependent upon ad hoc quid pro quos that are difficult to reconcile with rules-based resolution and judicial supervision of resolution processes.</p>

# Features of SIFI Resolution Regimes That Promote Resolvability: Reasons and Concerns *(cont.)*

Resolution Promoting Feature	Reason(s)	Concern(s)
<b>Ability of home country authorities to make advance agreements with host country authorities regarding the treatment of host country interests</b>	<p>To discourage ring fencing by host country resolution authorities, it may be desirable for home and host country resolution authorities to enter into advance agreements or protocols that provide for (i) deference by host country authorities to the home country authorities with regard to most aspects of the resolution process, and (ii) pre-determined treatment of host country interests after a failure, even if some home country interests are treated less favorably. The ability to enter into understandings and to provide sufficient comfort they will be performed presumes that substantial discretion is available to home and host country authorities.</p>	<p>Pre-agreeing how home country resolution authorities will address host country interests (e.g., assuring <i>pari-passu treatment</i> of host country depositors) presumes home country authorities have both the <i>power and discretion</i> to provide such assurances. For the reasons noted above, there are concerns about ad hoc quid pro quos that may need to be provided to host country authorities to obtain cooperation.</p>
<b>Ability to waive (or extend) home country depositor preference to host country creditors</b>	<p>Under the resolution regimes of some host countries, there is no “depositor preference” and all creditors — depositors or otherwise — are entitled to equal treatment. In such host countries, local resolution authorities may expect local creditors of an operating entity (such as a local branch of a foreign bank) to be treated no less favorably than the most favorably treated home country creditors (e.g., preferred depositors). In such cases, home country authorities may need the power to afford host country creditors such equal treatment, even if non-preferred home country creditors receive less.</p>	<p>Concerns similar to those raised about discretionary granting of quid pro quos for cross-border cooperation and the selective assumption of liabilities in a P&amp;A or by a bridge entity are raised here.</p>
<b>Ability to subsidize systemically critical affiliates</b>	<p>In order to minimize systemic disruption and maximize the SIFI’s value, it may be desirable to prevent commencement of resolution procedures for certain subsidiaries. These could include entities within or outside the home country. To prevent lower tier entities from failing, the debtor SIFI or a bridge entity may have to guarantee or provide capital to support pre-failure creditors of such subsidiaries.</p>	<p>Concerns similar to those raised about discretionary granting of quid pro quos for cross-border cooperation and the selective assumption of liabilities in a P&amp;A or by a bridge entity are raised here.</p>

# Features of SIFI Resolution Regimes That Promote Resolvability: Reasons and Concerns *(cont.)*

Resolution Promoting Feature	Reason(s)	Concern(s)
<p><b>Mechanisms to assure continued access to intercompany services and technology</b></p>	<p>Services and technology utilized by multiple SIFI affiliates may be isolated in a single entity and access of affiliates of the SIFI to such services and technology may be cut off by commencement of the resolution process because of the “siloing” of entities in their respective insolvency processes (OLA, Bankruptcy Code, FDIA, SIPA, host country insolvency proceedings). To mitigate systemic risk a resolution scheme might have to provide the resolution authority with the discretion to provide uninterrupted services to affiliates even after failure (and for affiliates to pay for such services on a current basis on cost-plus terms, even if services were provided at or below cost pre-insolvency.)</p>	<p>Continuing the supply of services and access to technology may not be in the interest of the debtor that is supplying the services or owns the technology, or that entity may be in proceedings that require liquidation, cutting off the services. Resolution planning may be required to create contractual incentives or structural solutions to this problem.</p>
<p><b>Ability to pay certain creditors and move funds between affiliates immediately prior to failure to mitigate systemic risk without the risk of later avoidance</b></p>	<p>Just as it may be necessary to favor some creditors over others after failure to mitigate systemic risks, it may be desirable from a systemic point of view to permit certain creditors or affiliates to receive transfers on the eve of failure without running the risk that such transfers will be subject to avoidance. For example, posting collateral to financial market utilities or mark-to-market counterparties may be necessary to permit continuity of operations and avoid contagion. In addition, it may be advantageous for holding company assets, deposits with subsidiaries and other intercompany obligations to be contributed to the capital of affiliates during the immediate pre-failure period to facilitate resolution in a manner that mitigates systemic risk (including for purposes of keeping such entities out of resolution procedures.)</p>	<p>There would need to be finality with respect to such transfers to mitigate systemic risk — for example, transfers by a holding company to an operating subsidiary to restore its capital. However, even if mitigating systemic risk and/or leaving other creditors of the transferor entity “no worse off” were a sound basis for providing a safe harbor for such transfers, how can the appropriateness of such transactions be reviewed and what remedies can be made available in the event the applicable tests are not met without disturbing the finality of such transfers?</p>

# Features of SIFI Resolution Regimes That Promote Resolvability: Reasons and Concerns *(cont.)*

Resolution Promoting Feature	Reason(s)	Concern(s)
<p><b>Ex-ante judicial review of transactions outside the ordinary course of business or that depart from non-bankruptcy priorities</b></p>	<p>Generally speaking, transactions outside the ordinary course of business or transactions that involve departures from non-bankruptcy legal priorities require prior court approval in cases under the Bankruptcy Code. The creation of a bridge entity and the selective assumption of liabilities are the types of transactions that would normally require adequate notice and prior scrutiny by an impartial court. Traditionally, however, prior judicial review has not been required for certain types of regulated entities, like banks and insurance companies, where great discretion is afforded regulators to effectuate these types of transactions (for example under the FDIA), thereby avoiding cumbersome court process where speed and finality are essential. Many argue that regulator-approved transactions by SIFIs, which generally are affiliates of or raise systemic concerns similar to those raised by regulated entities, should similarly be excepted from ex ante judicial review.</p>	<p>By-passing prior judicial review of regulator approved transactions effectuated to resolve a SIFI creates substantial uncertainty that imposes significant costs, especially where ex post remedies are limited or non-existent.</p>
<p><b>Ex-post remedies for resolution actions that are found after the fact to have been implemented in bad faith or in a manner otherwise inconsistent with applicable law</b></p>	<p>Ex post remedies arguably can be a substitute for prior review if ex post remedies are truly available, timely and adequate. To the extent regulatory action is deemed necessary without ex ante judicial review or supervision, it is especially important that adequate ex post remedies be made available.</p>	<p>The adequacy of ex post remedies depends upon access to an impartial forum, the standard of review (amount of deference to regulatory determinations), timeliness, the quantifiability of harm, having a source of compensation and the adequacy of compensation as a remedy. There is a concern over whether ex post remedies are likely to be adequate in the SIFI resolution context.</p>

# Features of SIFI Resolution Regimes That Promote Resolvability: Reasons and Concerns *(cont.)*

Resolution Promoting Feature	Reason(s)	Concern(s)
<p><b>The ability to allocate equity and other distributions among stakeholders who absorb losses in a SIFI reorganization in accordance with “relative priorities” (rather than imposing the absolute priority rule)</b></p>	<p>Valuations always engender lengthy and costly disputes in insolvency proceedings. This would be especially so in a financial panic where true value of financial assets is highly uncertain. If the resolution process permits reorganization and recapitalization rather than liquidation, allowing distributions of senior and junior debt and equity securities to left-behind and/or bailed-in creditors in the order of their relative priorities, rather than imposing the absolute priority rule, would reduce the need for a valuation of the reorganized SIFI as a predicate to distributions at a time when asset values are uncertain. Relative priority securities can be traded in the market, where their value can be set by market forces, and governance rights can be adjusted based on the market’s determination regarding which classes are in or out of the money after distributions have been made.</p>	<p>Absolute priority is a fixed principle of U.S. bankruptcy laws and relative priority, in connection with which even junior classes, such as shareholders, receive junior contingent rights siphons “option value” from more senior classes and is arguably objectionable on the grounds that reducing the severity of the “recognition event” (bankruptcy) creates a moral hazard.</p>

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