JEB HENSARLING, TX , CHAIRMAN

United States House of Representatives
Committee on Financial Services
Washington, D.C. 20515

MAXINE WATERS, CA, RANKING MEMBER

M E M O R A N D U M

To: Members of the Committee on Financial Services

From: FSC Committee Majority Staff

Date: May 10, 2013

Subject: May 15, 2013 Oversight and Investigations Subcommittee Hearing titled "Who is Too Big to Fail: Does Title II of the Dodd-Frank Act Enshrine Taxpayer-Funded Bailouts?"

The Oversight and Investigations Subcommittee will hold a hearing titled "Who Is Too Big to Fail: Does Title II of the Dodd-Frank Act Enshrine Taxpayer-Funded Bailouts?" on Wednesday, May 15, 2013, at 10:00 a.m. in Room 2128 of the Rayburn House Office Building. This hearing will examine Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203). In particular, this hearing will consider whether Title II will result in taxpayers bailing out financial institutions that government regulators believe are "Too Big to Fail," and evaluate whether Title II allows government regulators to provide "Too Big to Fail" firms that are recapitalized and reorganized under Title II's "Orderly Liquidation Authority" with competitive advantages against other financial institutions.

This will be a one-panel hearing with the following witnesses:

- Mr. David A. Skeel – S. Samuel Arsht Professor of Corporate Law, University of Pennsylvania Law School
- Dr. John B. Taylor – Mary and Robert Raymond Professor of Economics, Stanford University
- Mr. Josh Rosner – Managing Director of Graham Fisher & Co.

Title II of the Dodd-Frank Act: Orderly Liquidation Authority

Title II of the Dodd-Frank Act contains provisions to facilitate the orderly resolution of a systemically significant bank or nonbank financial institution. In an orderly liquidation proceeding under Title II, the Federal Deposit Insurance Corporation (FDIC) acts as the receiver for a systemically significant financial institution, following a determination by the Treasury Secretary and a written recommendation of the FDIC's board of directors and the Federal Reserve Board of Governors that the financial institution is in default or danger of default and that the failure of the institution would have serious adverse effects on the financial stability of the United States. The Dodd-Frank Act provides that the Orderly Liquidation Authority (OLA) must be exercised so that: (1) the creditors and shareholders of the failed institution bear the losses of the financial company; (2) the management responsible for the condition of the financial company will not be retained; and (3) all parties, including management, directors, and third parties, will bear losses

consistent with their responsibility for the condition of the financial company, including through actions for damages, restitution, and recoupment of compensation.[1]

Initiating the Orderly Liquidation Process

Section 201: Definition of a Covered Financial Company

Only a "covered financial company" may be resolved under the OLA. The Dodd-Frank Act defines a financial company as any company that is: (1) a bank holding company; (2) a nonbank financial company supervised by the Federal Reserve; (3) a company predominantly engaged in activities that are financial in nature or incidental thereto; or (4) a subsidiary of any company that is itself predominantly engaged in financial activities (other than an insured depository institution or an insurance company.)[2] The FDIC, in consultation with the Treasury Secretary, is required to issue criteria specifying what constitutes "predominantly engaged" in "financial activities" for purposes of determining whether a firm is a "financial company."[3] No final definition has yet been issued.[4]

Section 203(a): Written Recommendation and Vote of Federal Reserve Board and FDIC Board

To initiate the OLA, Title II requires that two-thirds of the Federal Reserve Board of Governors and two-thirds of the board of directors of the FDIC vote to make a written recommendation to the Treasury Secretary to appoint the FDIC as receiver of the company. (For broker-dealers, two-thirds of the members of the Securities and Exchange Commission must vote to make a written recommendation, in addition to a two-thirds vote of the Federal Reserve Board. For insurance companies, two-thirds of the Federal Reserve Board must vote to make a written recommendation, with the approval of the Director of the Federal Insurance Office at the Treasury Department and in consultation with the FDIC.) The written recommendation must evaluate a number of factors, including whether the financial company is "in default or danger of default"; the effect that the company's failure would have on financial stability in the United States; the effect of the company's failure on the economic condition or financial stability of low-income, minority or underserved communities; the likelihood of a private sector alternative to prevent default; and an evaluation of why the company cannot be reorganized or liquidated under the Bankruptcy Code.

Section 203(b): Determination of Treasury Secretary to Appoint FDIC as Receiver

After the Treasury Secretary receives a written recommendation to appoint the FDIC as receiver for the company, the Secretary must make additional determinations before the company can be placed in OLA. The Treasury Secretary, in consultation with

[1] § 204(a).
[2] § 201(a)(11).
[3] § 201(b).
[4] On June 18, 2012, the FDIC issued a supplemental notice of proposed rulemaking and request for comment on the definition of "Predominantly Engaged in Activities That Are Financial in Nature or Incidental Thereto."

the President, must determine that: (1) the financial company is "in default or in danger of default"; (2) the failure of the financial company and its resolution under otherwise applicable insolvency laws would have serious adverse effects on financial stability; (3) no viable private sector alternative is available; (4) the effect on the claims of creditors, counterparties and shareholders is appropriate; (5) any action under section 204 would avoid or mitigate certain adverse effects; (6) a Federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments; and (7) the company satisfies the definition of "financial company" contained in the statute. The Treasury Secretary must document its determination regarding whether a financial company should be placed into receivership, retain the documentation for review, and notify the FDIC and the financial company of his determination.[5]

Funding the Orderly Liquidation Authority

Section 204(d): Funding for Orderly Liquidation Authority

The FDIC may, subject to certain limitations, make funds available for the orderly liquidation of a covered financial company. Among other things, the FDIC can use these funds to make loans to, or purchase the debt of, the covered financial company or any covered subsidiary; purchase or guarantee against loss the assets of the covered financial company or any covered subsidiary; assume or guarantee the obligations of the covered financial company or any covered subsidiary to one or more third parties; sell or transfer all, or any part, of such acquired assets, liabilities, or obligations of the covered financial company or any covered subsidiary; or make payments to creditors of the covered financial company or any covered subsidiary. Funds spent by the FDIC for the orderly liquidation of a covered financial company have priority over other unsecured claims against the company.

Section 210: Orderly Liquidation Fund, Orderly Liquidation Plan and Assessments to Repay the Orderly Liquidation Fund

Title II establishes the Orderly Liquidation Fund within the Treasury. Upon appointment as receiver, the FDIC has the authority to fund the costs of resolving a covered financial company by issuing obligations eligible for purchase by Treasury, up to a maximum amount for each covered financial company equal to: (1) during the 30-day period immediately following the appointment of the receiver, 10% of the covered financial company's total consolidated assets, based on its most recent financial statements

---

[5] § 203(c)(1). Section 203(c) also requires Treasury to make several reports to Congress following a determination. Within 24 hours of the FDIC's appointment as receiver, the Treasury Secretary must provide written notice of the recommendations required under Section 203(a) and the determination by the Treasury Secretary under Section 203(b), to Congressional leadership. The notice must summarize the basis for the determination. Within 60 days of being appointed receiver, the FDIC must submit a report to Congress describing the financial condition of the company, the FDIC's plan to wind down the company, the expected cost of the orderly liquidation and the reasons for any use of the Orderly Liquidation Fund, any differential treatment among similarly situated creditors, any additional payments, and any instance in which the FDIC waived any conflict of interest. The FDIC and the covered financial company's primary financial regulatory agency, if any, must appear before Congress, if requested, not later than 30 days after the date on which the FDIC files the required report. The report must be posted on the FDIC's website and updated quarterly.

available; and (2) after such 30-day period, 90% of the fair value of the company's total consolidated assets that are available for repayment.[6] The FDIC may not use any of its funding as receiver for any covered financial company unless and until it has submitted an orderly liquidation plan for such company that is acceptable to the Treasury Secretary.[7] The FDIC and the Treasury Secretary must reach an agreement providing for a specific plan meeting certain criteria and schedule for the repayment of borrowings from Treasury.[8]

The FDIC must repay its borrowings from Treasury within 60 months, or such longer period as approved by Treasury.[9] If necessary, the FDIC can impose assessments "as soon as practicable" on any claimant that received excess benefits over what such claimant was entitled to receive in a Chapter 7 liquidation or in a Securities Investor Protection Corporation proceeding, except where the excess payments were deemed necessary to receivership or a bridge financial company.[10] If there is still a shortfall, then the FDIC is required to recover the shortfall from imposing graduated risk-based assessments upon "eligible financial companies" (defined as any bank holding company with total consolidated assets of $50 billion or more and any nonbank financial company designated as systemically important by the inter-agency Financial Stability Oversight Council) and financial companies with total consolidated assets of $50 billion or more. The FDIC must notify each financial company that is subject to such assessments, and any such financial company must pay the assessment.[11] The FDIC may also recoup compensation from senior executives who are responsible for the failure of a covered financial company to recapitalize the Orderly Liquidation Fund. [12]

Other Provisions of Section 210: Bridge Financial Companies and Creditors Similarly Situated

As receiver for a failed financial company or in anticipation of becoming the receiver of such a company or companies, the FDIC may organize a bridge financial company which can assume liabilities of a covered company or companies, purchase assets of a covered company or companies, or perform any other function that the receiver deems appropriate.[13] The FDIC may grant a federal charter for a bridge financial company; however, Title II provides that a bridge financial company has no federal agency status and

[6] § 210(n)(5) and §§ 210(n)(6).
[7] § 210(n)(9)(B)(i). Section 210(n)(9)(B)(ii) also requires the FDIC and Treasury to report to Congress on this repayment plan. According to this section of the statute, the FDIC and Treasury Secretary must "consult with the Committee on Banking, Housing and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the terms of the repayment schedule agreement," and must "submit a copy of the repayment schedule" to the Congressional committees no later than 30 days after the date on which any amount is provided to the FDIC by the Treasury Secretary.
[8] § 210(n)(9)(B)(i).
[9] § 210(o)(1-3).
[10] § 210(o)(1)(D)(i).
[11] § 210(o)(3).
[12] § 210(s). According to this section of the statute, the FDIC must issue rules to govern the FDIC's power to recover up to two years of compensation, or for an unlimited time period in the case of fraud, "from any current or former senior executive or director substantially responsible" for the failure of a covered financial company.
[13] § 210(a)(1)(F) and § 210(h)(1).

that its employees are not employees of the United States.[14] Title II also provides that a bridge financial company must terminate at the end of the two-year period following the date it was chartered. At its discretion, the FDIC can authorize three one-year extensions of this deadline.[15]

Title II requires that all creditors similarly situated in terms of priority of claims must be similarly treated, unless the FDIC determines it is necessary to treat them differently to accomplish one of the following goals: (1) to maximize the value of the assets of the covered financial company; (2) to initiate and continue operations essential to implementation of the receivership or any bridge financial company; (3) to maximize the present value return from the sale or other disposition of the assets of the covered financial company; or (4) to minimize the amount of any loss realized upon the sale or other disposition of the assets of the covered financial company.[16]

Section 214: Prohibition on Taxpayer Funding

Title II includes provisions that purport to prohibit the use of taxpayer funds. Section 214(a) provides that "no taxpayer funds may be used to prevent the liquidation of any financial company under this title." Section 214(b) requires that all funds expended in the liquidation of a covered financial company be recovered from the disposition of assets or through assessments on the financial sector. Section 214(c) provides that "taxpayers shall bear no losses from the exercise of any authority" under Title II.

# # #

[14] § 210(h)(2) and 210(h)(8).
[15] § 210(h)(12).
[16] § 210(b)(4).