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VIA Email
Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 Seventeenth Street, N.W.
Washington, D.C. 29429

Re: The Resolution Of Systemically Important Financial Institutions: The Single Point Of Entry Strategy

Dear Mr. Feldman:

I welcome the opportunity to comment on the FDIC's Single Point of Entry Strategy for implementing Dodd Frank's Orderly Liquidation Authority. I hold the Harvey Washington Wiley Chair in Corporate Governance at Seton Hall University School of Law in Newark, where I specialize in chapter 11 of the Bankruptcy Code, but also teach courses on corporate finance and financial institutions. Before academia, I practiced with a leading New York corporate law firm. However, these comments reflect my own opinions, and not those of any current or former employer or client.

The general theme of my comments is that the SPOE proposal is a good start, although it could benefit from much greater specificity. In particular, I urge the Agency to explain how an insolvent operating subsidiary would be dealt with under the proposal. The example of AIG looms large when assessing the credibility of the SPOE proposal.

Holding companies are unlikely to be the direct source of financial distress that would warrant the use of OLA, yet the SPOE proposal as explicated is almost exclusively focused on holding companies. Certainly resolving holding companies is much easier than resolving operating companies, but if the SPOE is to provide a realistic roadmap for future use of OLA, it must engage in a full discussion of a more realistic, and specific scenario.

It has been suggested that operating subsidiaries will be recapitalized by the forgiveness of intercompany debt owed to the parent holding company. Quite obviously such an approach requires sufficient intercompany debt at the specific subsidiary that is the source of the trouble. Supposing that managers and regulators will be lucky enough to predict the exact right place and amount when consigning the debt seems unreasonable.

Thus, plans should be made for recapitalizing an operating subsidiary beyond the forgiveness of intercompany debt. Presumably this would involve the creation of new, post-OLA intercompany debt funded by the parent's own borrowing. Acknowledging that controversial fact and addressing it is key.

Given the FDIC's studied vagueness on how it will value the holding company's assets – which, recall are the equity interests in the sub – there is a natural concern that this lending will become a disguised bailout. After all, if the subsidiary is insolvent, its equity by definition has no value that can support a loan to the parent company. Thus, if the loan is secured at all, it will be by the value of other subsidiaries in the group. But what if even that is not enough to support the liquidity needs of the operating subsidiary?

In short, the discussion to date has focused on the problem of recapitalizing the operating subsidiaries, but recapitalization might well be inextricably linked with liquidity in times of crisis, with each exacerbating the other. How *precisely* would SPOE work in these circumstances?

Similarly, in a situation where financial distress infects the entire group – Lehman provides an example, in that it was not easy to identify a specific part of Lehman that had failed – it would be helpful to know how the FDIC would approach the resolution. In particular, is SPOE still a viable option in such a situation? If not, would it not be better to explain SPOE as something of an ideal, while more realistically resolution might often entail a gradual move along a continuum that starts with SPOE and moves toward a Multiple Point of Entry approach?

That is, in many cases it seems likely that the FDIC might have to conduct receivership proceedings with respect to an offending subsidiary, in addition to the holding company, and that in many such cases it might not be possible to do anything but liquidate that subsidiary to avoid complete devastation of the remaining group. Acknowledging this reality might be more useful than continually suggesting that only the holding company will be affected by OLA. For example, statements like "[t]o implement the SPOE strategy the FDIC would be appointed receiver only of the top-tier U.S. holding company, and subsidiaries would remain open and continue operations," tends to suggest a lack of engagement with a more realistic scenario.

Some more specific comments follow:

On page 76615 of the proposal, FDIC argues that during the financial crisis, policy makers were faced "with the poor choice of bail-outs or disorderly bankruptcy."

Lehman's bankruptcy could have much more orderly if the Lehman board, and the applicable regulators, had both understood the chapter 11 process and made appropriate plans. The failure to do so in 2008 does not mean that all bankruptcy cases must be disorderly or that the choice at that time was inevitably binary. The development of a workable bankruptcy-OLA regime for financial institutions, as Congress has instructed, will require moving past this myth.

On page 76615 of the proposal, FDIC states that SPOE

> would also provide stability to financial markets by allowing vital linkages among the critical operating subsidiaries of the firm to remain intact and preserving the continuity of services between the firm and financial markets that are necessary for the uninterrupted operation of the payments and clearing systems, among other functions.

This appears to be a lot of jargon that obscures the basic idea that counterparties will get paid in full. The proposal would be stronger if FDIC conceded that and explained why that is the best result.

On page 76616 of the proposal, it is noted that

> During the resolution process, measures would be taken to address the problems that led to the company's failure. These could include changes in the company's businesses, shrinking those

> businesses, breaking them into smaller entities, and/or liquidating certain subsidiaries or business lines or closing certain operations. The restructuring of the firm might result in one or more smaller companies that would be able to be resolved under bankruptcy without causing significant adverse effect to the U.S. economy.

The FDIC should consider whether this will be possible without any stay or other protection against creditor runs at the subsidiary level. At the very least, preparing subsidiaries for liquidation or closure is apt to reduce the value of the subsidiaries, and thus the recovery in the broader OLA proceeding, where the holding company's primary assets will be the equity in the subsidiaries.

On the same page, the proposal states that "the company's subsidiaries would remain open and operating" during an SPOE proceeding against the parent. How precisely would this have worked in a case like AIG? Would AIG FP really keep performing on its CDS contracts? That would seem to require much more support from the U.S. parent that the proposal contemplates. More specificity is required to make the proposal plausible.

More specifically, throughout the proposal it would be more helpful if FDIC expressly stated that it only intends to keep *solvent* subsidiaries open.

On page 76617, the proposal explains that

> As required by the statute, the FDIC would identify and remove management of the covered financial company who were responsible for its failed condition.

What if the employees in question are not employed by the holding company? Indeed, the development of SPOE would seem to encourage the assignment of employees to specific operating subsidiaries to the greatest extent possible. Removing the CEO might be symbolic, but presumably FDIC wants to actually remove the directly responsible manager too.

On page 76618, the proposal states that

> The transfer [from the holding company to the bridge] would also likely include secured claims of the holding company because the transfer of fully secured liabilities with the related collateral would not diminish the net value of the assets in the receivership and would avoid any systemic risk effects from the immediate liquidation of the collateral.

How and when will it be determined that a claim is "fully secured?" What process will be invoked if the secured status of a claim is in dispute? For example, what if a claim is "fully secured" by assets of uncertain value? These points need greater specificity.

The hypothetical on pages 76619 to 76620 illustrates my point about the need for greater specificity. The reader is told that the institution failed "following a loss on assets and subsequent liquidity run." Presumably that happened at the subsidiary level, yet the hypothetical provides no information on how that problem was solved.

On page 76620, the FDIC states that

> the FDIC may determine to pay claims in cash or deposit securities into a trust for prompt liquidation for those portions of certain creditors' claims that would result in the creditors owning more than 4.9 percent of the issued and outstanding common voting securities of NewCo (or NewCos).

The FDIC should further explain this provision and perhaps consider what effect it will have on the market for a distressed financial institution's securities.

This provision also creates a significant gap between resolution under the Bankruptcy Code and resolution OLA. A distressed debt buyer might acquire a significant position in a financial institution's debt as part of a "loan to own" strategy, only to have its recovery converted into cash when and if OLA is invoked. Presumably any gap between bankruptcy and OLA should be well considered and justified.

Admittedly ownership of financial institutions is more heavily regulated than ownership of real economy companies, but a general presumption against "loan to own" seems unwarranted if the creditor otherwise qualifies as an appropriate owner of the debtor's equity.

On page 76623 of the proposal, FDIC explains that

> if there are circumstances under which the losses cannot be fully absorbed by the holding company's shareholders and creditors, then the subsidiaries with the greatest losses would have to be placed into receivership, exposing those subsidiary's creditors, potentially including uninsured depositors, to loss.

On the one hand, I applaud this discussion as one of the few points at which the SPOE proposal engages with a realistic scenario that involves the holding company's operating subsidiaries. On the other hand, does this statement not undermine much of the SPOE proposal?

The language in question makes SPOE sound like a "we'll do this if it works, but it may not work" kind of thing. And that is apt to make creditors of the operating companies, and foreign regulators, quite uneasy.

Which brings us back to my initial point about the need for specificity. Realism is good, but specificity is also required to provide comfort that the SPOE idea will actually work.

Hypotheticals based on the notion that the debtor's assets are easily valued in times of financial stress do not comport with the reality of modern financial institutions.

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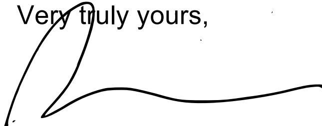
Thank you for considering these comments. Please do not hesitate to contact me if I can be of further assistance.

Very truly yours,



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