Saul Ewing LLP

BANKRUPTCY AND RESTRUCTURING DEPARTMENT

DODD-FRANK TASK FORCE

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"What keeps you up at night?"

"Orderly Liquidation Process" created for "Too-Big-To-Fail" companies

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SUMMARY

Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") establishes a process for orderly liquidation of non-bank financial companies previously deemed "too big to fail." It seeks to protect taxpayers, who were forced to bail out such companies in the recent recession. Through this legislation, the FDIC is armed with the power to conduct an orderly liquidation of non-bank financial companies–distinct from a reorganization akin to Chapter 11 under the Bankruptcy Code–a power that most likely will be used sparingly, if at all.

Dodd-Frank creates an "orderly liquidation authority," which vests the FDIC with the prerogative to exercise control over a financial entity whose precarious financial health is believed to endanger the national financial system as a whole. Once a receivership under the orderly liquidation authority is commenced, traditional bankruptcy proceedings are no longer an option.

The orderly liquidation authority follows the FDIC structure for ailing depository institutions, with some departures. Only "financial companies" are eligible for liquidation relief, and this means bank holding companies, non-bank financial companies otherwise supervised by the Federal Reserve Board, such companies' subsidiaries, and SEC-registered brokers and dealers. Insurance companies will continue to follow applicable state law if a risk determination is made.

Yet paradoxes exist: the Dodd-Frank legislative history makes clear that "the bankruptcy process will continue to be used to close and unwind failing financial companies, including large, complex ones" unless such companies' perils in turn threaten the national economy as a whole. Similarly, the Securities Investor Protection Corporation remains primarily responsible for liquidation of registered broker-dealers, with limited oversight by the FDIC.

A Dodd-Frank liquidation and receivership begins following a determination of "systemic risk" and a formal recommendation that the financial company be placed into receivership. This means a financial company must be in "default or danger of default" and there must be a determination of systemic risk by the relevant expert community.

Once appointed, the FDIC may act as receiver over all assets, and any existing insolvency or bankruptcy proceedings are immediately dismissed. All assets vest back in the company, for administration by the FDIC, but conversely any orders already entered by a bankruptcy court stay in effect. The sweeping powers of the FDIC include the right to establish a bridge company that will acquire assets, procure liquidation financing and make payments to claimants; act as receiver of related subsidiaries; invoke subpoena powers; and dispose of assets.

Its powers formidable, the FDIC is armed and ready to act as a receiver, if needed, although commentators believe the use of these powers may remain merely theoretical.

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