United States Government Accountability Office

GAO

Report to Congressional Committees

July 2012

BANKRUPTCY

Agencies Continue Rulemakings for Clarifying Specific Provisions of Orderly Liquidation Authority

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Highlights

Highlights of GAO-12-735, a report to congressional committees

BANKRUPTCY

Agencies Continue Rulemakings for Clarifying Specific Provisions of Orderly Liquidation Authority

Why GAO Did This Study

The Dodd-Frank Act created OLA for resolving failed, systemically important financial companies. Since the act was passed in 2010, regulators have been developing regulations to implement this authority and avoid disorderly resolutions that create substantial losses for the financial system. In July 2011, GAO issued the first of its statutorily mandated reports on the effectiveness of the Bankruptcy Code for resolving or liquidating complex, internationally active financial companies. Among the topics examined in this second report, GAO reviewed: (1) federal rules or regulations relating to OLA and the resolution of financial institutions, including living wills; and (2) status of efforts to improve coordination on international resolutions, data collection efforts, and the outcomes of financial institutions that were in the bankruptcy process.

To address these objectives, GAO reviewed agencies' draft and final rules related to OLA and comment letters submitted. GAO continued to monitor developments related to the Lehman Brothers and Washington Mutual bankruptcies, and began monitoring a recent bankruptcy filing by MF Global. GAO also studied available data on the number of financial company bankruptcies and met with relevant agency and court officials.

GAO makes no new recommendations in this report. GAO provided a draft for comment to AOUSC, the Department of the Treasury, and federal financial regulators. None provided written comments and technical comments have been incorporated, as appropriate.

View GAO-12-735. For more information, contact Alicia Puente Cackley at (202) 512-8678 or cackleya@gao.gov.

What GAO Found

The federal financial regulators have issued certain final rules for resolving large, complex financial companies under the Dodd-Frank Wall Street Reform and Consumer Protection Act's (Dodd-Frank Act) established Orderly Liquidation Authority (OLA). Under OLA, the Federal Deposit Insurance Corporation (FDIC) could serve as receiver of a failing financial company instead of the company entering the bankruptcy process. Regulators continue to address a number of issues related to FDIC's new authority, including how creditors will ensure that they receive no less than they would under a Chapter 7 bankruptcy liquidation; how certain assets and liabilities would be treated in a new company created by FDIC under OLA; and what role the Securities Investor Protection Corporation would play in the resolution of a broker-dealer under OLA. Regulatory officials reported that they were continuing to draft rules to clarify how OLA would be used. FDIC and the Board of Governors of the Federal Reserve (Federal Reserve) also have issued final rules requiring certain financial companies to file resolution plans or "living wills" that must detail how companies would resolve their operations through an orderly bankruptcy. Regulators told GAO that the plans also would help FDIC plan for the exercise of its resolution authority, including OLA. The filing dates for these plans are phased in over the next year and a half, with the first group of financial companies filing their first plans on July 1, 2012. However, "nonbank financial companies" that also will need to provide plans have yet to be designated.

International coordination remains a critical component in resolving the failure of a large, complex financial company and regulators have been taking steps to address this and are testing new data collection efforts. Specifically, efforts are under way to develop a universal legal entity identifier that allows companies to identify and manage risks from companies with which they are engaged in financial transactions. This additional information could help regulators in resolving internationally active financial companies. Data to identify financial institutions filing for bankruptcy protection as well as their outcomes are limited. Since neither FDIC nor federal judicial agencies have a database that tracks financial companies in bankruptcy, the Administrative Office of the U.S. Courts (AOUSC) and the Federal Judicial Center have begun a new effort to track financial company bankruptcies, but reported court data are untested for this purpose. Several large financial institution bankruptcies are still in progress. Two of the largest financial company bankruptcies, Lehman Brothers Holdings Inc. (Lehman Brothers) and Washington Mutual, Inc.—both of which filed in September 2008—recently had their reorganization plans confirmed by creditors and approved by the courts. However, these cases are not yet fully resolved. In the Lehman Brothers case, international litigation could take several years to resolve. The October 2011 bankruptcy of MF Global Holdings Ltd., a holding company with a securities and commodities broker, has raised concerns about how commodity customers are treated under a liquidation regime and also involves international litigation over customer property. These financial company bankruptcies highlight the challenges FDIC and other regulators would face in resolving large, complex financial companies under the OLA process.

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Abbreviations

AOUSC	Administrative Office of the U.S. Courts
CFTC	Commodity Futures Trading Commission
DIP	debtor-in-possession
FDIC	Federal Deposit Insurance Corporation
FSOC	Financial Stability Oversight Council
LBIE	Lehman Brothers International, Europe
LEI	Legal Entity Identifier
OLA	Orderly Liquidation Authority
SEC	Securities and Exchange Commission
SIFI	systemically important financial institutions
SIPA	Securities Investor Protection Act
SIPC	Securities Investor Protection Corporation

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Congressional Committees

The 2008 financial crisis and the failures of large, complex financial institutions led some experts to question the effectiveness of the United States Bankruptcy Code (Code) for resolving or liquidating these institutions without causing further harm to the financial system.[1] In response, Congress created the Orderly Liquidation Authority (OLA) as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[2] Under OLA, the Secretary of the Treasury may appoint the Federal Deposit Insurance Corporation (FDIC) as a receiver for certain insolvent financial companies that pose a risk to the financial stability of the United States. The Dodd-Frank Act requires FDIC to liquidate certain financial companies to maximize the value of the companies' assets, minimize losses, mitigate systemic risk, and minimize moral hazard. OLA created a new process for resolving large, complex financial companies, but policymakers, academic experts, and industry participants have raised questions about whether this process would achieve the stated goals more effectively than the established bankruptcy process.

As well as creating OLA, the Dodd-Frank Act requires financial companies to file periodic resolution plans describing how they could be resolved in an orderly manner in the event of material financial distress or failure. These "living wills" are intended to allow companies and regulators to anticipate possible challenges to their resolution under the Code.[3] Some policymakers and other experts have questioned the usefulness of the resolution plans because of the range of scenarios that could lead to a financial institution's failure.

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[1]Insured depository institutions and insurance companies may not file for debtor protection under the U.S. Bankruptcy Code, and broker-dealers qualify for liquidation, but not reorganization.

[2]Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[3]Pub. L. No. 111-203, Title I, § 165 (d). 123 Stat. 1376, 1426-1427 (2010), codified at 12 U.S.C. § 5365(d).

In July 2011, we issued the first of our statutorily mandated reports on the effectiveness of the Code for resolving or liquidating complex, internationally active, financial institutions.[4] Although OLA has not been invoked, we have been monitoring the development of rules and regulations related to OLA as well as the bankruptcies of large financial institutions. Specifically, this report examines: (1) actions the U.S. District Court for the District of Columbia (D.C. District Court) has taken in response to the judicial review provision of OLA, including any revisions to local civil rule 85; (2) federal rules or regulations relating to OLA and efforts to improve international coordination, including living wills, in resolving financial companies; and (3) data collection efforts and outcomes of financial institutions that were in the bankruptcy process.

To address these objectives, we monitored the promulgation of rules through agency websites, legal journals, and legal searches. We examined comment letters on draft rules, attended webinars from law firms, and reviewed academic articles discussing the key challenges related to OLA and resolution plan rules.[5] We continued to review court and regulatory documents to follow developments of two large financial company bankruptcies (Lehman Brothers Holdings, Inc. and Washington Mutual, Inc.) that we began tracking as case studies in our 2011 report. We also began tracking the more recent bankruptcy of MF Global Holdings Ltd. We analyzed available data on U.S. bankruptcies and determined that they were sufficiently reliable to provide some background information on the number of bankruptcies of large financial

[4]See GAO, *Bankruptcy: Complex Financial Institutions and International Coordination Pose Challenges*, GAO-11-707 (Washington, D.C.: July 19, 2011) for the first study reported under this mandate. We must report on the judicial review for OLA and the effectiveness of the Code annually for 3 years after the passage of the act and every 5 years after the date of enactment. Dodd-Frank Act § 202(e); 12 U.S.C. § 5382(e). The Administrative Office of the United States Courts also must conduct a study of bankruptcy and the process for orderly liquidation for financial companies. The Board of Governors of the Federal Reserve System has a similar requirement. Dodd-Frank Act § 216.

[5]We also studied the reports related to the section 202(e) and section 216 mandates. See Administrative Office of the United States Courts, *Report Pursuant to Section 202(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* (Washington, D.C.: July 2011) and Board of Governors for the Federal Reserve System, *Study of the Resolution of Financial Companies Under the Bankruptcy Code* (Washington, D.C.: July 2011). Pursuant to Dodd-Frank Act § 215, the Financial Stability Oversight Council (FSOC) in July 2011 published *Report to Congress on Secured Creditor Haircuts*, which examined allowing regulators to treat a portion of fully secured creditors' claims as unsecured in a resolution proceeding.

institutions from January 1, 2010, through December 31, 2011. Finally, we met with officials from the Administrative Office of the U.S. Courts (AOUSC), D.C. District Court, the Commodity Futures Trading Commission (CFTC), FDIC, the Board of Governors of the Federal Reserve System (Federal Reserve), Federal Judicial Center, Department of Justice (Justice), Securities and Exchange Commission (SEC), Securities Investor Protection Corporation (SIPC), and the Department of the Treasury (Treasury), including the Office of Financial Research. See appendix I for more information on our scope and methodology.

We conducted this performance audit from August 2011 to July 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Bankruptcy is a federal court procedure conducted under the Code. The goal of bankruptcy is to give individuals and businesses a "fresh start" by eliminating or restructuring debts they cannot repay and help creditors receive some payment in an equitable manner. The filing of a bankruptcy petition operates as an "automatic stay" that stops most lawsuits, foreclosures, and most other collection activities against the debtor. Under the Code, secured creditors—those with liens or other secured claims against the debtor's property—are more likely to get some debt repaid than unsecured creditors. Creditors typically receive payment of their debts before shareholders receive any return of their equity in the failed company.

Bankruptcy Proceedings

Business debtors that are eligible for protection under the Code may qualify for liquidation, governed primarily by Chapter 7 of the Code, or reorganization, governed by Chapter 11. Proceedings under both Chapters 7 and 11 can be voluntary (initiated by the debtor) or involuntary (generally initiated by at least three creditors).[6]

[6]Voluntary cases are permitted under 11 U.S.C. § 301. Involuntary cases are permitted under 11 U.S.C. § 303.

- A liquidation proceeding—under Chapter 7—is a court-supervised procedure by which a trustee takes over the assets of the debtor's estate, reduces them to cash, and makes distributions to creditors in accordance with the Code's priority scheme.
- A reorganization proceeding—under Chapter 11—allows debtors that are commercial enterprises to continue to operate some or all of the debtor's operations as a way to satisfy creditor claims. The debtor typically remains in control of its assets under a Chapter 11 proceeding, and is called a debtor-in-possession (DIP). However, if the court determines that there is cause or it is in the best interest of creditors, the court can direct the U.S. Trustee to appoint a Chapter 11 trustee to take over the affairs of the debtor. A debtor (or other interested party) may file a reorganization plan, which ultimately may be confirmed by the court. The plan includes details on the operations of the reorganization, including disposition or retention of property, mergers, and issuance of securities.[7] The plan also divides creditors into classes and directs how the creditor classes will be paid. The debtor can terminate burdensome contracts and leases, recover assets, and rescale its operations to return to profitability. To continue operations, a debtor may obtain additional financing, which could be paid before other debts.[8] A debtor also may file a plan of liquidation under Chapter 11 or transfer to a Chapter 7 liquidation, which may provide a greater return to creditors.

The U.S. bankruptcy system involves multiple federal entities. While bankruptcy courts are located in 90 federal judicial districts, the Southern District of New York (which includes Manhattan) and the District of Delaware adjudicate a majority of larger corporate or business bankruptcy cases, many of which constitute "megacases."[9] The Judicial Conference of the United States recommends national policies and legislation for all aspects of federal judicial administration. AOUSC serves as the central administrative support entity for the Judicial Conference and the federal

[7]See 11 U.S.C. § 1123.

[8]This is known as DIP financing and is available under 11 U.S.C. § 364.

[9]AOUSC defines a "mega" Chapter 11 case as a single case or set of jointly administered or consolidated cases that involves $100 million or more in assets and 1,000 or more creditors. See GAO, *Federal Bankruptcy Judges: Measuring Judges' Case-Related Workload,* GAO-09-808T (Washington, D.C.: June 16, 2009).

courts, including bankruptcy courts. For example, AOUSC provides administrative, legal, financial, management, and information technology support functions for the federal courts. The Federal Judicial Center, an education and research agency for the federal courts, assists bankruptcy courts with education relating to case administration and management, while the majority of Federal Judicial Center research helps inform policy decisions of the Judicial Conference of the United States. In addition, the Trustee Program at Justice and the Bankruptcy Administrator Program oversee bankruptcy trustees and the administration of bankruptcy estates, respectively.[10]

It is important to note that certain financial institutions may not file as debtors under the Code and other entities face special restrictions in using the Code:

- *Insured depository institutions:* Under the Federal Deposit Insurance Act, FDIC serves as the conservator or receiver for the insured depository institutions placed into conservatorship or receivership under applicable law.[11]

- *Insurance companies:* Insurers generally are subject to oversight by state insurance commissioners, who have the authority to place them into conservatorship, rehabilitation, or receivership.

- *Broker-dealers:* Broker-dealers can be liquidated under the Securities Investor Protection Act (SIPA) or under a special provision of Chapter

[10]The United States Trustee Program covers 84 of the 90 bankruptcy courts and consists of the Executive Office for U.S. Trustees which is led by a director; 21 regions managed by U.S. Trustees; and 95 field offices supervised by Assistant U.S. Trustees. The mission of the U.S. Trustee Program is to promote the integrity of the bankruptcy system. The U.S. Trustee Program oversees the administration of all bankruptcy cases filed by individual and business debtors in every federal judicial district except for Alabama and North Carolina. The U.S. Trustee's specific duties in a case depend on the chapter under which a debtor files and the facts of the case. Bankruptcy Administrators, who are employees of the federal judiciary, perform the functions of the U.S. Trustees in the remaining six bankruptcy courts in Alabama and North Carolina. See http://www.justice.gov/ust/eo/ust_org/index.htm.

[11]12 U.S.C. § 1821(c).

7 of the Code. However, broker-dealers may not file for reorganization under Chapter 11.[12]

- *Commodity brokers:* Commodity brokers, also known as futures commission merchants, are restricted to using only a special provision of Chapter 7 for bankruptcy relief.[13]

Orderly Liquidation Authority under the Dodd-Frank Act

The OLA process could replace the bankruptcy process for certain financial companies. Title II of the Dodd-Frank Act established OLA, which requires a series of regulatory determinations and may involve limited judicial action (see fig. 1). On their own initiative, or at the request of the Secretary of the Treasury, regulators may consider whether to make a recommendation with respect to whether the Secretary should appoint FDIC as receiver for a financial company. Among other factors, regulators first must determine that the company generally falls under one of four categories:[14]

- bank holding companies (defined under the Bank Holding Company Act);[15]

[12]Chapter 7 of the Code contains special provisions for the liquidation of stockbrokers. 11 U.S.C. §§ 741-753. Under SIPA, the SIPC initiates a liquidation proceeding, the primary purpose of which is to protect customers against financial losses arising from the insolvency of their brokers. Once a protective decree has been applied for under SIPA, any other pending bankruptcy proceeding involving the debtor stockbroker is stayed, and the court where the application is filed has exclusive jurisdiction over that stockbroker. SIPC participation can displace a Chapter 7 liquidation pending the SIPA liquidation, but provisions of the Code apply in a SIPA liquidation to the extent they are consistent with SIPA. See 15 U.S.C. §§ 78eee(b)(2)(B), 78fff(b). Because the stockbrokers discussed in this report are also dealers registered with the SEC as broker-dealers, we generally use the term broker-dealer rather than stockbroker in this report.

[13]Chapter 7 of the Code contains special provisions for commodity broker liquidation (11 U.S.C. §§ 753, 761-767), and CFTC's rules relating to bankruptcy are set forth at 17 C.F.R. § 190.01 *et seq*.

[14]Dodd-Frank Act § 201(a)(11); 12 U.S.C. § 5381(a)(11). The company must be incorporated or organized under federal or state law.

[15]Bank Holding Company Act of 1956, 12 U.S.C. § 1841 *et seq*.

- nonbank financial companies supervised by the Federal Reserve;[16]

- any company that is predominantly engaged in activities that the Federal Reserve has determined to be financial in nature or incidental thereto for purposes of section 4(k) of the Bank Holding Company Act (including broker-dealers that are registered with SEC and are members of SIPC); or

- any subsidiary of a company described in the bullets above that is predominantly engaged in activities that the Federal Reserve has determined to be financial in nature or incidental thereto for purposes of section 4(k) of the Bank Holding Company Act (except for insured depository institutions and insurance companies).[17]

In addition to the evaluation of whether the financial company fits within one of the categories described above, federal regulators recommending whether the Secretary of the Treasury should appoint FDIC as receiver must include:

- an evaluation of whether the financial company is in default or in danger of default;

[16]Under the Dodd-Frank Act, Title I, FSOC may require that a nonbank financial company become subject to Federal Reserve Board supervision. The Federal Reserve has issued a proposed rule on criteria for determining whether a company is predominantly engaged in financial activities for purposes of determining whether the company is a nonbank financial company under Title I of the Dodd-Frank Act. See appendix II for further details.

[17]Under the Dodd-Frank Act § 210(a)(1)(E), if FDIC is appointed receiver of a financial company, it has the authority to appoint itself as receiver of any subsidiary of the financial company if FDIC and the Secretary of the Treasury jointly determine that the subsidiary is in danger of default, such action would mitigate serious adverse effects on the financial stability or economic conditions in the United States, and such action would facilitate the orderly liquidation of the financial company. Although this authority does not apply to insurance companies or certain broker-dealers, special provisions may apply in those cases. For example, if the Secretary makes a determination with respect to an insurance company or if an insurance company is a subsidiary or affiliate of a financial company, the liquidation or rehabilitation of the insurance company is to be conducted under applicable state law. However, if the state regulator has not filed the appropriate judicial action within 60 days after the date of the Secretary's determination, then FDIC will have the authority to stand in place of the state regulator and file the appropriate judicial action to place the company into orderly liquidation under state law. Dodd-Frank Act § 203(e); 12 U.S.C. § 5383(e).

- a description of the effect that the default of the financial company would have on the financial stability in the United States;

- a description of the effect that the default of the financial company would have on economic conditions or financial stability for low-income, minority, or underserved communities;

- a recommendation on the nature and extent of actions to be taken under Title II of the Dodd-Frank Act regarding the financial company;

- an evaluation of the likelihood of a private-sector alternative to prevent the default of the financial company;

- an evaluation of why a case under the Code is not appropriate for the financial company; and

- an evaluation of the effects on creditors, counterparties, and shareholders of the financial company and other market participants.

Upon recommendation, the Secretary of the Treasury, must invoke OLA if the Secretary, in consultation with the President, determines that:

- the financial company is in default or in danger of default;

- the failure of the financial company and its resolution under otherwise applicable federal or state law would have serious adverse effects on the financial stability of the United States;

- no viable private-sector alternative is available to prevent the default;

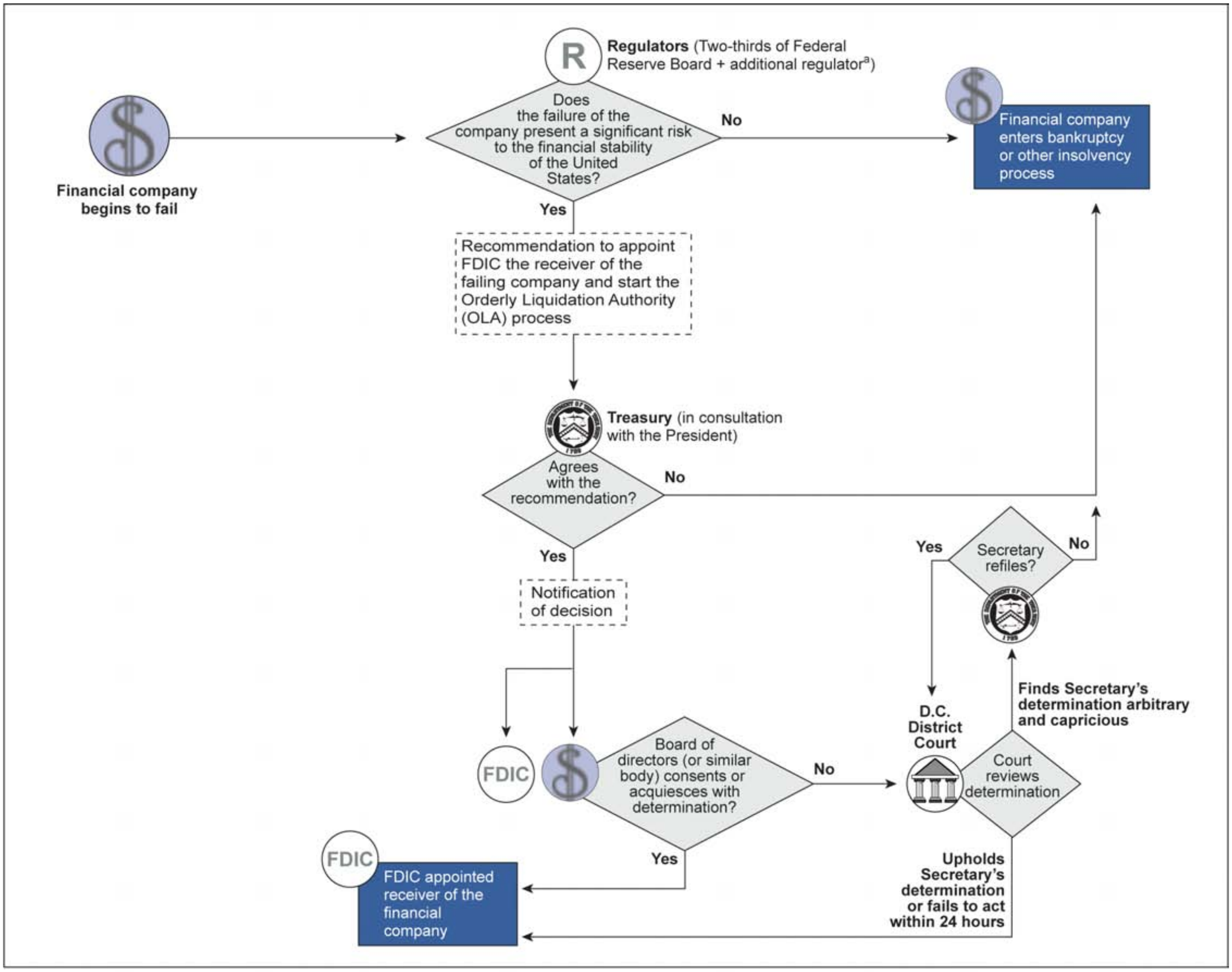
- the effect on the claims or interests of creditors, counterparties, and shareholders of the financial company and other market participants of proceedings under Title II of the Dodd-Frank Act is appropriate, given the impact that any action under Title II would have on the financial stability of the United States;

- an orderly liquidation would avoid or mitigate such adverse effects; and

- the company meets the definition of financial company as described above.[18]

[18]Dodd-Frank Act § 203(b); 12 U.S.C. § 5383(b). The Secretary's determination also must include whether a federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments that are subject to the regulatory order.

Figure 1: Decision Process for Invoking OLA and Appointing FDIC Receiver of a Failing Financial Company



Sources: GAO (data); Art Explosion (images).

[a]If the financial company or its largest U.S. subsidiary is: (1) a broker-dealer, SEC (two-thirds of the commissioners) must approve the recommendation in consultation with FDIC; (2) an insurance company, the Director of the Federal Insurance Office in Treasury also approves the recommendation in consultation with FDIC; or (3) any other financial company, FDIC (two-thirds of the Board of Directors) must approve the recommendation.

By a two-thirds vote, the Federal Reserve and FDIC (or relevant regulator) must agree to make the recommendation to the Secretary of the Treasury to place the financial company into receivership.[19] The Secretary consults with the President and then makes a determination to place the company in receivership, and notifies the company's board of directors (or equivalent). If the company consents or acquiesces to the recommendation, FDIC becomes receiver. If the company does not consent, the Secretary through Justice must petition the D.C. District Court for an order authorizing the appointment of FDIC as receiver.[20] The D.C. District Court has 24 hours to determine whether the Secretary's determination was arbitrary and capricious, in which case FDIC would not become receiver.[21] If the D.C. District Court failed to act within 24 hours, then FDIC would become receiver. The financial company can appeal the D.C. District Court's determination, but the receivership would not be stayed (or postponed) if it did so. If the D.C. District Court did not uphold the Secretary's determination, the Secretary could amend and refile or appeal within 30 days. Upon appointment as receiver, FDIC becomes successor to and legal custodian of the financial company, including assets and operations.[22]

Under authority provided by Title II of the Dodd-Frank Act, when FDIC is appointed receiver of the financial company it may take over and manage the assets of the company. FDIC must liquidate and wind up the affairs of

[19]If the financial company or its largest U.S. subsidiary is a broker-dealer, then two-thirds of SEC Commissioners and two-thirds of the Federal Reserve Board approve the recommendation, in consultation with FDIC. If the financial company or its largest U.S. subsidiary is an insurance company, then the Director of the Federal Insurance Office in Treasury approves the recommendation along with the Federal Reserve. For all other types of companies, two-thirds of the Federal Reserve and two-thirds of the FDIC Board of Directors approve the recommendation in consultation with FDIC. Dodd-Frank Act § 203(a); 12 U.S.C. § 5383(a).

[20]Justice files the petition on behalf of Treasury. See generally 28 U.S.C. § 516.

[21]The D.C. District Court's review is limited to the Secretary's determination that the financial company is (1) in default or danger of default; and (2) satisfies the definition of a financial company.

[22]Title II also establishes additional authorities for FDIC as receiver, such as the ability to set up a bridge financial company, and collect funding for the OLA process from the financial industry after a company has gone through OLA. Dodd-Frank Act, § 210(o); 12 U.S.C. § 5390(o). Under the Dodd-Frank Act, GAO must review and report on the Treasury Secretary's decision to appoint FDIC as receiver. Dodd-Frank Act § 203(c)(5), 12 U.S.C. § 5383(c)(5) discusses these responsibilities in more detail.

the financial company, and may sell or transfer the assets to a bridge financial company, which is a temporary company used to maintain the failed company's operations. A bridge financial company may purchase assets, assume liabilities, and undertake other functions of the financial company. FDIC also has authority to determine the validity of creditor claims against the company and pay creditor claims. The Dodd-Frank Act generally requires that all creditors of a financial company with similar priority be treated similarly; however, in certain circumstances FDIC may treat similarly situated creditors differently. In some cases, FDIC may repudiate contracts to which a financial company is a party or may enforce certain contracts that otherwise could have been terminated because of the financial company's insolvency.

Resolution Plans and Other Financial Stability Provisions under the Dodd-Frank Act

Among its provisions, Title I of the Dodd-Frank Act requires certain financial companies to provide regulators with periodic reports on their plans for rapid and orderly resolution in the event of "material financial distress or failure" under the Code.[23] The resolution plan must include the following:

- information on the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company;
- full descriptions of the ownership structure, assets, liabilities, and contractual obligations of the company;
- identification of the cross-guarantees tied to different securities, identification of major counterparties, and a process for determining to whom the collateral of the company is pledged;[24] and

[23]The Dodd-Frank Act, § 165(d)(1), states that the Federal Reserve and FDIC must review the resolution plans. Resolution plans are often referred to as living wills. The companies that must file reports are: (1) nonbank financial companies designated by FSOC for supervision by the Federal Reserve, (2) bank holding companies with $50 billion or more in consolidated assets, and (3) foreign banking organizations with $50 billion or more in total consolidated assets that are or are treated as bank holding companies. 12 U.S.C. § 5365(d)(1). The resolution plans should not assume an orderly liquidation under Title II.

[24]Cross-guarantees are not specifically defined in the act but refer to contracts and other interconnections the financial company has with other parties.

- any other information that the Federal Reserve and FDIC jointly require by rule or order.[25]

The Federal Reserve and FDIC must review the information in these resolution plans. If they jointly determine and notify a company that its plan is not credible or would not facilitate an orderly resolution under the Code, the financial company would have to submit a revised plan. A revised plan must discuss in detail revisions that address the deficiencies jointly identified by the Federal Reserve and FDIC. The revised plan must also address changes, if any, in its business operations or corporate structure that the company proposes to make to facilitate implementation of the plan. If the company fails to submit a satisfactory revised plan, the Federal Reserve and FDIC could impose stricter requirements such as higher capital or liquidity requirements on the company.[26] If the company fails to submit a satisfactory revised plan within 2 years of the imposition of stricter requirements, the Federal Reserve and FDIC, in consultation with the Financial Stability Oversight Council (FSOC), may jointly direct a company to divest certain assets or operations jointly identified by the Federal Reserve and FDIC as necessary to facilitate an orderly resolution under the Code in the event of failure of the company.[27]

[25]Dodd-Frank Act § 165(d);12 U.S.C. § 5365(d).

[26]*Id*. at § 165(d)(5)(A); 12 U.S.C. § 5365(d)(5)(A).

[27]*Id*. at § 165(d)(5)(B); 12 U.S.C. § 5365(d)(5)(B).

Additional Rulemaking Authorities under the Dodd-Frank Act

The Dodd-Frank Act requires certain regulators to develop and issue rules to implement OLA and resolution plan requirements.[28] For some rules, the regulators must consult with FSOC, a new entity established by the Dodd-Frank Act.[29] FDIC—in consultation with FSOC—has primary responsibility for developing and issuing rules and regulations related to its authority as receiver of a failed financial company. Other sections of Title II of the Dodd-Frank Act also contain specific requirements for FDIC to coordinate with the Federal Reserve, SEC, and other banking regulators on key aspects of OLA. Under Title I, the Federal Reserve and FDIC must issue joint rules on resolution plans. FSOC has the authority to designate nonbank financial companies (including foreign nonbank financial companies) for Federal Reserve supervision if FSOC determines that such companies could pose a threat to the financial stability of the United States.[30] These nonbank financial companies would have to file resolution plans.[31] Appendix II lists the primary rules related to OLA and resolution plans and their status as of May 15, 2012.

[28]Regulatory agencies have authorizing statutes that set out their authority and responsibilities for developing and issuing regulations. An agency's statute can prescribe formal rulemaking. The Administrative Procedure Act establishes procedures and broadly applicable federal requirements for informal rulemaking, also known as notice and comment rulemaking. This act generally requires agencies to publish a notice of proposed rulemaking in the *Federal Register*. After giving interested persons an opportunity to comment on the proposed rule, the agency may then publish the final rule. Agencies also may be subject to additional requirements imposed by other statutes specific to the agency.

[29]FSOC consists of 14 federal and state agency heads and an independent member with insurance expertise. The council was created to (1) identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside of the financial services marketplace; (2) promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the U.S. government will shield them from such losses in the event of failure; and (3) respond to emerging threats to the stability of the U.S. financial system.

[30]Dodd-Frank Act § 113; 12 U.S.C. § 5323.

[31]Dodd-Frank Act § 165(d); 12 U.S.C. § 5365(d)(1).

D.C. District Court Revised Its Rule for Judicial Review under OLA

As we previously reported, the D.C. District Court issued Local Civil Rule 85 on January 19, 2011, to implement its judicial review requirements under OLA. Generally, the rule reiterated the procedural requirements in the Dodd-Frank Act. It provided for a 24-hour review, and the financial company has the right to oppose the Secretary's petition to invoke an FDIC receivership under OLA. If the court did not rule on the petition within 24 hours, or ruled in favor of the Secretary, the receivership would proceed immediately. As the rule was originally written, the Secretary of the Treasury would have had to notify the D.C. District Court under seal at least 48 hours before the filing of a petition, which would give the court time to prepare for the review. In addition, the original rule did not specifically address Rule 6 of the Federal Rules of Civil Procedure regarding the 24-hour period. Rule 6 states that if a time period ends on a weekend or holiday, the period would be extended to the next business day. Court officials told us that they included the original 48-hour notice because they were concerned about receiving advance notice before an OLA filing. Court officials also told us that the D.C. District Court was a smaller court that did not hear many business cases and few large bankruptcies and therefore they needed the advance notice.

In letters dated March 2011, FDIC and Treasury objected to notification requirements in the rule that required Treasury to provide an additional 48-hour notification to the court before filing a petition to invoke OLA. In addition, they were concerned about the possible use of Rule 6 of the Federal Rules of Civil Procedure to extend the 24-hour period for the court to rule and the 48-hour notification period. The agencies said that Treasury may not always be able to provide the 48-hour notice because of the speed with which a financial company could become insolvent. FDIC and Treasury were concerned that the use of Rule 6 to calculate the timing of filings and decisions effectively would expand the court's 24-hour time frame to rule on the petition and the 48-hour notice period. For example, if the Secretary's 48-hour notice period or the court's 24-hour review period ended on a weekend or holiday, Rule 6 calculations would move the ends of those periods to the next business day. According to agency officials, this delay could have serious adverse effects on U.S financial stability. As a result, the agencies thought the court should be prepared to make rulings over the weekend.

On July 6, 2011, the court issued a revised final rule, which added "to the extent feasible" to the requirement that the Secretary of the Treasury notify the court 48 hours before filing a petition. In addition the revised rule added a section stating that the 48-hour notice period and the 24-hour decision period were not subject to Rule 6, meaning that the time limit would apply without regard to whether the time periods ended on a weekend or holiday. FDIC and Treasury officials told us that the revisions to the court's rule addressed their concerns. The court has not yet tested the effectiveness of the rule because, as of May 1, 2012, the Secretary had not sought the appointment of FDIC as receiver in an OLA proceeding.

Although Regulators Have Issued Rules Related to OLA, Some Clarifications Remain Outstanding

Federal regulators have issued separate final rules for OLA and resolution plans, as required by the Dodd-Frank Act. FDIC plans to issue additional rules to clarify its use of OLA, such as a joint rule with SEC for the resolution of broker-dealers. Because the first financial companies will not begin filing resolution plans until July 2012, it is too soon to determine the effectiveness of the plans. Despite the issuance of rules, academics and other experts have questioned FDIC's ability to resolve large, systemically important financial institutions under OLA because of the complexity of the firms involved and challenges relating to international coordination. Regulators have reported progress on developing a universal identifier for financial companies that would help them identify and manage companies' counterparty exposures.

Federal Regulators Have Issued Final Rules for OLA and Resolution Plans

Final Rules for OLA. On July 15, 2011, FDIC published a final rule (referred to as the Orderly Liquidation Authority Final Rule) under rulemaking authority provided by Section 209 of the Dodd-Frank Act. In its discussion of the final rule, FDIC noted that the rule represented the results of its initial phase of rulemaking for its OLA authority. FDIC staff also told us that this final rule included topics addressed in an earlier interim final rule and two notices of proposed rulemakings.[32]

More specifically, the final rule covers topics under three broad categories: (1) the definition of terms in a receivership under OLA and other general provisions of an FDIC receivership; (2) the priority of payments, including those for administrative expenses and to unsecured creditors; and (3) the process for administering claims against the failed financial company. The rule also covers other aspects of the receivership. For example, the final rule addresses FDIC's ability to recover

[32]FDIC published a notice of proposed rulemaking on October 19, 2010, an interim final rule on January 25, 2011, and a notice of proposed rulemaking on March 23, 2011. See appendix II for a complete list of rules and other actions.

compensation from a current or former senior executive who is found substantially responsible for the failure of the financial company. In addition, the rule addresses the payment for services performed under personal service agreements after FDIC is appointed receiver or for the acceptance of services by a bridge financial company. FDIC's final rule also discusses the distribution of assets in the liquidation of a noninsurance company subsidiary of an insurance company. FDIC has indicated that it believes it now has in place the regulations necessary to accomplish a resolution under OLA, even though it intends to adopt several additional regulations over the next year.

In addition, FDIC published a final rule (the Mutual Insurance Holding Company Treated as Insurance Company Rule) concerning the treatment of mutual insurance holding companies on April 30, 2012. Mutual insurance holding companies are owned by policyholders, not stockholders, and generally have been subject to state insurance insolvency regimes. In its final rule, FDIC sought to make the resolution of mutual insurance companies conform to state insurance statutes for the resolution of such companies.

Proposed Rules Related to OLA. FDIC, in consultation with FSOC, also has issued two proposed rules related to OLA to clarify certain technical issues. First, FDIC and Treasury jointly issued a notice of proposed rulemaking on November 25, 2011, governing the calculation of the maximum obligation FDIC could incur as receiver under OLA, as required by the Dodd-Frank Act.[33] The proposed rule (the Maximum Obligation Limitation Rule) outlines a calculation that limits the total outstanding obligations that FDIC can incur in connection with the liquidation of a financial company under OLA and defines terms such as "obligations."[34] FDIC issued a second proposed rule on March 20, 2012, which relates to its enforcement of subsidiary and affiliate contracts as the receiver of a covered financial company. The proposed rule (Enforcement of Subsidiary and Affiliate Contracts by the FDIC as Receiver of a Covered

[33]The Dodd-Frank Act expressly prohibits "bailouts" to a specific firm. Under OLA, FDIC must maximize the value of the assets of the financial company under receivership in the context of liquidation. However, the Dodd-Frank Act allows FDIC as receiver of a failed company to borrow funds from Treasury to carry out the orderly liquidation.

[34]FDIC's Board of Directors approved a final Maximum Obligation Limitation Rule on April 23, 2012. After we completed our analysis, Treasury approved the final rule in June 2012 and the rule was published in the *Federal Register* on June 22, 2012.

Financial Company Proposed Rule) clarifies FDIC's authority to preserve the value of a failed financial company's assets and business lines by enforcing certain contracts of subsidiaries and affiliates of the financial company. FDIC as receiver has authority to enforce contracts guaranteed by the financial company even though the counterparty has the contractual right to terminate or accelerate the contract based on the insolvency of the financial company. FDIC must transfer the guarantee and all related assets to a bridge financial company or third party or provide adequate protection for the obligations. According to FDIC, this authority will help enable it to place a financial company at the holding company level into receivership without placing solvent subsidiaries into receivership, while also helping to mitigate systemic risk and maintain financial stability.

Final Rule on Resolution Plans. On November 1, 2011, FDIC and the Federal Reserve published a final rule (the Resolution Plans Final Rule) implementing the Dodd-Frank Act requirement under section 165(d). Under this requirement, bank holding companies with at least $50 billion in total consolidated assets (including foreign banking organizations that are treated as bank holding companies) and nonbank financial companies supervised by the Federal Reserve must periodically submit resolution plans.[35] Although this rule requires these types of financial institutions to submit plans describing how they would be resolved through the bankruptcy process, regulators reported that having companies file resolution plans would help FDIC in planning for the exercise of the possible use of its resolution authorities, including OLA. Regulators anticipate the plans also would provide additional insights on these companies' structure and complexity, including funding sources and counterparties. In addition, the Federal Reserve noted that the plans will assist in its supervisory efforts to ensure that companies operate in a manner that is both safe and sound and do not pose risks to financial stability generally. The final rule addresses information required in the plans, steps for submitting the plans, requirements for updating plans, and steps regulators may take for addressing inadequate plans.[36] Under

[35]FDIC also has issued a rule requiring resolution plans for depository institutions with total assets of $50 billion or more. These rules were promulgated under the Federal Deposit Insurance Act.

[36]Federal Reserve staff also made some technical changes in the final rule to clarify how companies with large depository institution subsidiaries should prepare plans when their largest asset would be resolved outside of the bankruptcy process.

the rule, a company's resolution plan must take into account different economic scenarios provided to the company by the Federal Reserve; the scenarios will be developed in the Federal Reserve's rules on stress testing. As shown in table 1, the deadlines for resolution plans are staggered by company size. Plans for the largest bank holding companies are due in July 2012.

Table 1: Deadlines for Submissions of Initial Resolution Plans, by Size of Financial Company

Size of bank holding company or nonbank financial company (dollars in assets)[a]	Deadline for first resolution plan
Large (greater than $250 billion)	July 1, 2012
Medium ($100-$250 billion)	July 1, 2013
Small (less than $100 billion)	December 31, 2013

Sources: Federal Reserve and FDIC.

[a]The rule determines a U.S. company's size by reviewing total nonbank assets as reported to the Federal Reserve (or for foreign-based companies, total U.S. nonbank assets).

Regulators Plan to Issue Additional Rules to Clarify OLA

FDIC and other regulators noted in our discussions that although they completed a final rule for OLA and drafted several other rules, regulators are working on, but have not yet issued, certain mandated rules. In addition, the final rule does not address a number of important issues. Most of the outstanding rules related to OLA are required under the Dodd-Frank Act. Three of these are rules FDIC must issue jointly with other regulators:

- Orderly liquidation of broker-dealers (no statutory deadline);

- Recordkeeping for qualified financial contracts (due July 21, 2012);[37] and
- Source of strength (due July 21, 2012).[38]

FDIC officials reported that each of these three rules was in a different stage of development, with the recordkeeping rule for qualified financial contracts closest to being issued, potentially as an interim rule before the statutory deadline in July.

Joint Rule Development

Besides addressing the complexity of OLA, regulators told us that coordination and reaching consensus with different regulators represented a challenge in drafting and issuing OLA-related rules, particularly given the number of rulemakings required of some regulators and resource constraints. As part of the OLA rule development process, FDIC must consult with different members of FSOC and in some cases is statutorily mandated to work with specific regulators or agencies.[39] Regulators also have had to address how certain rules would avoid conflicts with other rules and help ensure consistency with other requirements mandated under the Dodd-Frank Act.

For example, under the Dodd-Frank Act, FDIC and SEC must, after consultation with SIPC, develop a rule for the orderly liquidation of broker-

[37]Qualified financial contracts are financial agreements including securities and commodities contracts, forward contracts, and repurchase and swap agreements. Certain counterparties to these agreements are exempt from the automatic stay under the Code and other bankruptcy provisions. The automatic stay is designed to prevent creditors from taking action against or collecting assets from the debtor before approval from the bankruptcy court, but the exemption allows the counterparty to the qualified financial contract to close out the contract when the debtor files for bankruptcy and seize collateral if the company has an obligation to the counterparty. Under OLA, qualified financial contracts are subject to a 1-day stay and counterparties cannot terminate their contracts until 5:00 p.m. of the day after FDIC begins its receivership. During this time, FDIC may have transferred the contract to a bridge financial company or repudiated (rejected) it.

[38]Dodd-Frank Act § 616(d); 12 U.S.C. § 1831o-1.

[39]Agency officials told us that potential rules are discussed among FSOC members through the Orderly Liquidation Authority, Resolution Plans Committee. FDIC staff told us that there are protocols under which draft rules are provided to FSOC members and the committee. FSOC members can put forth suggestions for rules. For example, FDIC and Treasury obtained feedback on the draft Maximum Obligation Limitation proposed rule through this process.

dealers that are subject to OLA.[40] Under OLA, FDIC, as receiver of a failed broker-dealer, or in a case in which the largest U.S. subsidiary of a financial company is a broker-dealer, would appoint SIPC as trustee for the liquidation. However, in our earlier discussions with FDIC, SEC, and SIPC officials, they noted that the Dodd-Frank Act did not clearly delineate SIPC's role in a broker-dealer resolution under OLA, which may pose challenges in such a case. For instance, if FDIC as the receiver of a broker-dealer put the broker-dealer into a bridge institution, the agencies would need to determine what SIPC's role would be and how creditor and customer claims would be handled.[41] FDIC officials told us that this rule would govern the relationship between FDIC and SIPC. Although there is no statutory deadline for this rule, SIPC officials emphasized the importance of the rule to clarify SIPC's participation so as to avoid confusion in any future resolution under OLA. FDIC and SIPC officials told us that they met together with SEC for the first time on May 3, 2012, to discuss developing this rule. FDIC officials reported that they anticipate issuing a final rule by the end of 2012.

SEC officials told us that other Dodd-Frank requirements were a complicating factor in the development of the required rule on recordkeeping for qualified financial contracts. Under FDIC's proposal, financial companies would have to provide FDIC with information on swaps and other contracts similar to the information that they would provide regulators under other Dodd-Frank requirements.[42] FDIC officials told us that they are actively working with other regulators on the rule, which is due in July 2012. In another example, Federal Reserve staff told us that rulemaking related to the source of strength rule involved significant policy decisions, including to which bank holding companies the rule would apply, and how this requirement relates to other

[40]Dodd-Frank Act § 205(h).

[41]SIPC uses its fund, established by SIPA, to make advances to satisfy customer claims for missing cash and securities, including notes, stocks, bonds, and certificates of deposit. The fund is financed through annual assessments of SIPC member firms. 15 U.S.C. § 78aaa *et seq*.

[42]Swaps are contracts in which two parties agree to exchange periodic interest payments, especially when one payment is at a fixed rate and the other varies according to the performance of a reference rate, such as the prime rate.

requirements for bank holding companies.[43] FDIC officials told us that they have reached out to the Federal Reserve and Office of the Comptroller of the Currency to start developing this rule (also due in July 2012) but do not have an estimated issuance date.

Development of other OLA-Related Rules

FDIC officials told us that other OLA-related rules—either mandated by the Dodd-Frank Act or recommended by others—detailing key aspects of FDIC's authority as receiver, as well as the treatment of creditors, were still in the design phase or had not been drafted. First, the final rule on FDIC's general authority under OLA does not fully define the universe of financial companies for which FDIC could be receiver.[44] In an earlier proposed rule, FDIC included a definition of financial companies (under its authority under Title II of the Dodd-Frank Act) but in the final rule, the agency deferred finalizing this definition until the Federal Reserve issued its final rule on the definition of nonbank financial companies (under its authority for enhanced supervision under Title I of the Dodd-Frank Act). The Federal Reserve has issued two proposed rules on the definition of financial companies and officials from FDIC and the Federal Reserve told us that they have been coordinating to make their definitions consistent.[45] FDIC officials told us that they anticipated issuing a final rule defining financial companies by the end of 2012.

Second, the final rule on FDIC's general authority also has not defined how creditors under an OLA proceeding would receive no less than they would under a Chapter 7 bankruptcy proceeding, as mandated under the Dodd-Frank Act. In using this authority, FDIC would have to quickly assess the valuation of the company under Chapter 7. In comments on

[43]The Dodd-Frank Act § 616(d) amended the Federal Deposit Insurance Act to require any company that controls an insured depository institution to serve as a source of financial strength for that insured depository institution. This provision applies to bank holding companies, savings and loan holding companies, and any other company that controls an insured depository institution. Section 616(d) provides that "source of financial strength" means the ability of the company to provide financial assistance to the subsidiary insured depository institution in the event of its financial distress. 12 U.S.C. § 1831o-1.

[44]As discussed earlier, FDIC's authority under OLA would extend to those companies "predominantly engaged in activities that the Federal Reserve has determined are financial in nature or incidental thereto for purposes of section 4(k) of the Bank Holding Company Act." The final OLA rule did not define how FDIC would make this determination.

[45]See appendix II for a complete list of the proposed rules and their timelines.

the proposed rule, industry groups and a federal regulator called for greater clarification about how FDIC would do its assessment.[46] FDIC officials told us that they have started to develop a “minimum recovery” rule to respond to these concerns and clarify how creditors would receive no less than they would under a Chapter 7 bankruptcy proceeding.

Third, FDIC plans to clarify through rulemaking how it would establish and maintain a bridge financial company. FDIC, as receiver of a failed financial company, may organize a bridge financial company to merge the failed financial company with another company, or to transfer any assets and liabilities of the failed company to the bridge financial company, without obtaining approval or consent from creditors. In the OLA final rule, FDIC also recognized that the treatment of assets and liabilities transferred to a bridge financial company needed additional clarification. FDIC officials told us that they expected to issue a rule by the end of 2012 clarifying the use of bridge financial companies. In January 2012, FDIC discussed the role of the bridge financial company and said in its view, a bridge entity would help preserve continuity of operations for the failed financial company and would provide time for FDIC to develop resolution options, including merger with another company, conversion into a recapitalized company, a stock sale, or a purchase and assumption transaction, much as the agency does when it sells failed banks to another institution. More recently, FDIC’s Acting Chair discussed the use of a bridge financial company as part of FDIC’s resolution strategy.[47] Under this strategy, FDIC, as receiver, initially would own the bridge financial company. As owner, FDIC would (1) create a capital base by effectively converting some of the debt from the former parent company into equity in the new bridge company, (2) obtain any necessary liquidity from the Orderly Liquidation Fund in Treasury, and (3) appoint a new board of directors and chief executive officer from the private sector. The

[46]Although the Dodd-Frank Act does not provide authority for FDIC to treat a portion of secured creditors’ claims as unsecured (or take a “haircut” on recoveries), FSOC in its study of this topic did not find that haircuts were needed to promote market discipline or protect taxpayers. See *Report to the Congress on Secured Creditor Haircuts* (Washington, DC: July 18, 2011).

[47]Martin J Gruenberg. “Remarks to the Federal Reserve Bank of Chicago Bank Structure Conference” (Chicago, Ill.: May 10, 2012).

Dodd-Frank Act allows for a bridge financial company to be established for 2 years, with the ability to extend it for 1 year (up to three times).[48]

Furthermore, FDIC must issue rules related to its ability to impose assessments on financial companies to pay for any losses or obligations incurred while taking a failed company into receivership. Under the Dodd-Frank Act, FDIC first must use the proceeds from the sale of assets from the failed company to cover any losses. However, FDIC may borrow Treasury funds to finance operations with the requirement that FDIC later assess financial companies covered under OLA to pay for any losses not covered by asset sales.[49] (The Maximum Obligation Limitation Rule discussed earlier determines the maximum amount that FDIC can borrow from Treasury.) FDIC, in consultation with Treasury, must develop rules to clarify its authority to impose assessments. FDIC also must establish a risk matrix for imposing assessments after taking into account recommendations from FSOC.[50] However, FDIC and Treasury officials told us that FDIC had not started drafting this rule and there is no statutory deadline to do so.

The Dodd-Frank Act also requires FDIC to issue rules about records retention for a financial company under OLA and purchaser eligibility

[48]The same limitation applies to bridge banks under receivership of FDIC under the Federal Deposit Insurance Act. 12 U.S.C. § 1821(n)(9). Under the Dodd-Frank Act, FDIC's receivership appointment has a limit of 3 years with two possible 1-year extensions. Dodd-Frank Act § 202(d); 12 U.S.C. § 5383(d).

[49]The Dodd-Frank Act specifically states OLA is not a bailout to individual firms. Section 214 provides that all financial companies put into OLA must be liquidated and all funds expended in the liquidation shall be recovered through disposition of assets or assessments on the financial sector. 12 U.S.C. § 5394, Section 1101 amended the section 13(3) of the Federal Reserve Act to prohibit the Federal Reserve Board from authorizing direct loans for the purpose of assisting a single and specific company to avoid bankruptcy, as it did in the 2008 financial crisis. 12 U.S.C. § 343.

[50]FDIC would first assess creditors in the liquidation that received additional payments as defined in the Dodd-Frank Act. If assessments imposed on claimants are insufficient, FDIC may assess any bank holding company with total consolidated assets of at least $50 billion, any nonbank financial company supervised by the Federal Reserve Board, and other financial companies with total consolidated assets of at least $50 billion. The universe of companies that may be required to pay for an assessment also depends on the definition of financial company, which has not yet been finalized. Dodd-Frank Act § 210(o)(1)(D), 12 U.S.C. § 5390(o)(1)(D).

under OLA.[51] FDIC faces no statutory deadline for completing these rules, and FDIC officials told us that they considered them to be of lower priority. Lastly, FDIC may issue additional rulemakings through its general authority under Title II of the Dodd-Frank Act, in consultation with FSOC.[52] FDIC plans to issue a rule about the orderly liquidation of a commodity broker, but officials told us that they would coordinate any rulemaking with changes CFTC might make to its rule related to commodity broker bankruptcies.[53]

Concerns Have Been Raised about FDIC's Limited Experience with Resolving Large, Complex Institutions

Although FDIC and other regulatory officials noted that resolution plans could help prepare for the possible failure of a large financial company, not enough time has passed to determine the effectiveness of the living will requirement in assisting financial companies to prepare for bankruptcy (as discussed earlier) as well as aiding FDIC in the use of its Title II authority. As mentioned previously, the largest bank holding companies are required to submit resolution plans by July 1, 2012. As of May 2012, FSOC had not yet designated the systemically important nonbank financial companies, and the resolution plan final rule states that these companies do not have to file earlier than 270 days from their date of designation.[54] Federal Reserve and FDIC staff told us that they anticipated that 9 or 10 bank holding companies would file in the first wave of submissions. Federal Reserve officials told us that they have been in discussions with the largest bank holding companies since the rule was finalized.[55] Although entities commenting on the draft rule for resolution plan requirements brought up concerns about the definition of government support to financial companies and the confidentiality of

[51]For regulations regarding records retention, see § 210(a)(16)(D), and for purchaser eligibility, see §210(r). FDIC may issue rules on termination of a receivership; see Dodd-Frank Act § 202(d)(5).

[52]Dodd-Frank Act § 209; 12 U.S.C. § 5389. FDIC has developed the Office of Complex Financial Institutions for carrying out its Title II responsibilities and has begun to track potential circumstances under which OLA would be warranted.

[53]17 C.F.R. § 190.01 *et seq.*

[54]Financial Stability Oversight Council, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21637 (April 11, 2012),12 C.F.R. §§ 243.3(a)(2), 381.3(a)(2).

[55]The resolution plans rule was published in November 2011. See appendix II for further details.

proprietary data, regulatory officials believe that they have largely addressed these issues in the final rule. As of May 2012, details on the credit exposure reporting requirements had not been specified. Federal Reserve officials told us that the requirement for credit exposure reports will be included in a separate rulemaking related to single-party credit exposure limitation.[56]

In the bankruptcy process, the resolution or liquidation of large, complex, internationally active financial firms involves multiple challenges. As we discussed in our 2011 report, these challenges include identifying funding sources and counterparties and dealing with complex corporate structures across international jurisdictions.[57] Financial and legal experts have noted that resolution plans might not be as helpful as hoped during times of financial distress because of the need for current information—much of a company's contracts, assets, and liabilities could change dramatically from day to day. The final rule for resolution plans under Title I requires financial companies to stress test their portfolios under multiple scenarios to identify the financial firm's risks. However, the scenarios may not anticipate the type of financial crisis that could eventually lead to a firm's insolvency. Because of these challenges and the reported burden associated with developing the plans, some industry and academic experts have questioned the merits of the plans. FDIC noted their expectation that the plans, when complete, would provide important information for its advance planning to facilitate any necessary liquidation of a firm, irrespective of the cause of the firm's failure.

Furthermore, although FDIC has been working to further clarify its authority under OLA, several academic and other experts have raised concerns about FDIC's overall ability to effectively initiate the resolution of

[56]Under the Dodd-Frank Act, the Federal Reserve must issue regulations that prohibit each nonbank financial company supervised by the Federal Reserve and bank holding company with at least $50 billion in assets from having credit exposure to any unaffiliated company that exceeds 25 percent of the capital stock and surplus. Dodd-Frank Act § 165(e)(1); 12 U.S.C. § 5365(e)(1). The Dodd-Frank Act also requires that the Federal Reserve require supervised nonbank financial companies and bank holding companies to file credit exposure reports that generally would include (1) the nature and extent to which the company has credit exposure to other significant nonbank financial companies and significant bank holding companies, and (2) the nature and extent to which other significant nonbank financial companies and significant bank holding companies have credit exposure to that company. Dodd-Frank Act § 165(d)(2); 12 U.S.C. § 5365(d)(2).

[57]See GAO-11-707.

large and complex firms without causing broader market disruption. As we discussed in our 2011 report, FDIC has issued an analysis of how it would have handled the failure of Lehman under OLA; some criticized the analysis for its assumptions about Barclays Capital Inc.(Barclays)'s ability to obtain regulatory approval to purchase Lehman's distressed assets at a time of widespread weakness in the financial markets.[58] According to Lehman's bankruptcy examiner, Barclays was interested in acquiring Lehman prior to Lehman's bankruptcy and did purchase certain assets of Lehman's following bankruptcy. According to FDIC, its willingness to absorb the first $40 billion in Lehman's losses would have addressed concerns of Barclays' U.K. regulators. FDIC officials told us that they have been given sufficient powers to resolve such firms in order to limit further market disruption. FDIC officials reported that having access to funding would allow the receiver to make payments to creditors shortly after the time of failure and would help to maintain financial stability. In addition, they noted that the receiver would be able to establish a bridge financial company, as discussed earlier, to maintain the operations of the company without engaging in a bailout of stockholders of the failed firm. FDIC reported it received strong support for its proposals under OLA during a public forum with academic experts in January 2012.[59]

Others have noted FDIC's lack of experience in resolving financial companies as complex as Lehman with multiple international subsidiaries. As one SIPC official told us, Lehman collapsed within 24 hours—a much shorter planning period than that to which FDIC is accustomed when resolving failed banks. In response, FDIC officials noted that they likely would have reviewed a firm's resolution plan and been kept abreast of actions taken by the firm's supervisor. As FDIC notes in its paper on the hypothetical liquidation of Lehman under OLA, FDIC would have been engaged for months prior to the failure of the firm. In addition, we noted in our 2011 report, there have been few large scale bankruptcies of complex, internationally active financial firms.

However, others have noted that today's largest financial companies have structures and asset sizes that dwarf those of Lehman, which remains the largest Chapter 11 debtor in U.S. history. FDIC also could be limited in its

[58]See GAO-11-707 and FDIC, "The Orderly Liquidation of Lehman Brothers Holdings Inc. under the Dodd-Frank Act," *FDIC Quarterly*, vol. 5, no. 2 (May 2011).

[59]FDIC Systemic Resolution Advisory Committee meeting, January 2012.

ability to manage the failure of an internationally active financial institution because it would be responsible for resolving the domestic subsidiaries of a failed company. Certain subsidiaries, assets, and creditors would be subject to separate insolvency regimes in various countries.[60]

International Coordination Remains a Key Challenge, Although Regulators Have Made Progress on a Universal Identifier

International Coordination Efforts

As discussed in our 2011 report, cross-border resolutions of internationally active financial institutions such as Lehman Brothers remain a challenge, due to the manner in which different countries' insolvency proceedings interact. In comments on the proposed resolution plan rules, several entities called for international coordination on the submission and approval of resolution plan requirements, as many internationally active financial institutions will be subject to resolution regimes in multiple countries. U.S. and international regulators have recognized this challenge and in July 2011 the Financial Stability Board issued a consultative document that proposed a requirement to mandate that all designated global systemically important financial institutions (SIFI) have recovery and resolution plans.[61] In addition, the document called for cross-border cooperation agreements to enable countries' resolution authorities to act collectively to resolve internationally active financial institutions in an orderly and less-costly way.

[60] FDIC could maintain certain subsidiaries, assets, and relationships with certain creditors in other countries in order to avoid insolvency regimes in those countries and maintain the value of the failed U.S. company. As we discuss later in this report, international insolvency regimes have created challenges for those resolving Lehman and MF Global.

[61] The Financial Stability Board brings together central bank officials, finance and treasury officials, and financial institution regulators as well as representatives from the International Monetary Fund and the World Bank to address issues related to global financial stability. In November 2011, the Financial Stability Board defined SIFIs as "financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity." The Financial Stability Board identified 29 companies as global SIFIs in the November 2011 statement and plans to update the list each year.

After receiving comments on its proposal, the Financial Stability Board released an updated list of key attributes of effective regimes for resolving failed SIFIs in October 2011.[62] These attributes addressed issues such as the scope and independence of the country's resolution authority, the essential powers and authorities of the resolution authority, and how jurisdictions can facilitate cross-border cooperation in resolutions of SIFIs. Members of the G20 endorsed the attributes in November 2011.[63] FDIC and Federal Reserve officials report that the Dodd-Frank Act's Title II authority for FDIC to resolve systemically important financial institutions and its Title I requirement for these institutions to file periodic resolution plans follow the key attributes designated by the Financial Stability Board. Federal Reserve staff told us that the United States was ahead of some jurisdictions in adopting these provisions. In a November 2011 update (the latest available), the Financial Stability Board wrote that many jurisdictions had not implemented adequate legal frameworks for resolving global SIFIs and substantial further work on recovery and resolution plans as well as cross-border cooperation was needed.

FDIC, the Federal Reserve, and other international regulators that are members of the Financial Stability Board have formed "crisis management groups" to review the recovery and resolution plans for global SIFIs. Officials from both U.S. agencies told us that the crisis-management groups for five of the U.S. global SIFIs have met with their international regulatory counterparts during the past year. In particular, they discussed progress for the planning efforts of these institutions. FDIC also has reported starting bilateral discussions with the foreign regulators of U.S.-based global SIFIs to identify any impediments to orderly resolution and implement any changes to address those challenges. FDIC noted that these discussions have led to the drafting of several memorandums of understanding with international regulators. FDIC further reported in January 2012 that their analysis has shown that in a crisis the U.S.-based global SIFIs would have a limited number of international regulators with which to work. For these financial institutions, more than 90 percent of the "total reported foreign activity" was located in

[62]Financial Stability Board, "Key Attributes of Effective Resolution Regimes for Financial Institutions" (October 2011).

[63]The G20 or Group of Twenty includes representatives of nations with major economies. During its summits, heads of state, financial ministers, and heads of central banks consult and coordinate on issues related to the international financial system.

from one to three foreign jurisdictions and more than 80 percent of this activity came from legal entities in the United Kingdom.

However, Federal Reserve staff told us developing plans for cross-border resolution under the Bankruptcy Code remains a challenge. While the United States is requiring companies to file resolution plans that must detail how companies would resolve themselves under the Code, in some countries, regulators complete a resolution plan that discusses resolving the company without further market disruptions. In contrast, financial companies in those countries only have to complete a recovery plan that discusses ways to restore strength to a company under financial stress. Therefore, foreign banking organizations, which must file resolution plans in the United States, could face a different set of requirements in their home countries.

Development of Global Legal Entity Identifier

U.S. and international regulators have cited the development of the Legal Entity Identifier (LEI) as a code for financial institutions and regulators to better identify and manage institutions' relationships with other institutions—allowing them to more effectively measure and monitor systemic risk. In addition, FDIC officials told us that the use of an LEI should help regulators in resolving a financial company during the OLA process because its adoption would allow large, systemically important financial companies to identify their many component entities, which generally are organized along business rather than legal lines. As we discussed in our 2011 report, the resolution of these companies involves unwinding the complex interrelationships among the entities in order to address creditor claims.[64]

Currently, a single financial institution may be identified or coded in different ways by a firm doing business with that institution. For example, JP Morgan Chase, Inc. may be referred to as JPMC, Chase, and JPMorgan. Regulators have cited a universal identifier for financial institutions as particularly helpful in the identification of parties in transactions involving over-the-counter derivatives.[65] When Lehman collapsed in 2008, other financial institutions struggled to determine their counterparty exposure to the firm, causing further market disruptions.

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[64]See GAO-11-707.

[65]Over-the-counter derivatives refer to derivatives not traded on a formal exchange.

The financial industry has been exploring a universal identifier for decades, but recently regulators have pushed for a global mandate. The Dodd-Frank-created Office of Financial Research issued a policy statement in 2010 seeking comment on the development of an LEI.[66] Since then, the Office of Financial Research and the Financial Stability Board have held roundtables and the financial industry has convened panels on the development of an LEI. In January 2012, the Financial Stability Board convened an expert group of regulators (supported by an industry advisory panel of experts) to provide recommendations on the governance framework for the LEI with a goal of endorsement by the G20 summit in June 2012. On May 30, the Financial Stability Board endorsed the expert group's recommendations for a governance and operational framework for an LEI. In addition, the Financial Stability Board's specification for an LEI standard is derived from the technical standard for a 20-digit alphanumeric code published in May 2012 by the International Organization for Standardization.

Global acceptance of an LEI requires determining its governance and regulatory oversight. An Office of Financial Research official told us that the Financial Stability Board's LEI Expert Group has broken into committees to discuss issues including governance, operating model, reference data and confidentiality, funding, and implementation. The official said that the governance committee also has been considering a model in which a nonprofit entity would administer the process. According to Treasury, the Financial Stability Board published a report in mid-June 2012 including recommendations for the appropriate governance framework for a global LEI. U.S. regulators reported that the first iteration of LEI structure will be limited to the code itself and a minimal set of reference data, not information about ownership hierarchies, because of confidentiality concerns. In its commodity swap reporting rule (which goes into effect July 16, 2012), CFTC became the first U.S. regulator to require financial companies to use LEIs.[67] SEC also has published a proposed securities swap reporting rule that requires the use of an LEI provided by

[66]The Office of Financial Research supports the Financial Stability Oversight Council and member agencies by collecting and standardizing financial data, performing applied and essential long-term research, developing tools for risk measurement and monitoring, performing other related services, and making the results of the activities of the office available to financial regulatory agencies. The office operates as part of Treasury.

[67]CFTC has clarified its rule that financial institutions may use an interim identifier if the LEI was not adopted by July 16, 2012. See 77 Fed. Reg. 2136 (Jan. 13, 2012).

an international organization when available.[68] The Financial Stability Board has recommended a target for global implementation of the LEI standard by March 2013.

Financial Company Bankruptcies Remain Difficult to Track and Several Major Cases Move Forward

In the 2011 report, we found that comprehensive data on the number of financial companies in bankruptcy are not readily available. Bankruptcy data are collected for provisions relevant to the Code and for management of cases. While federal agencies currently do not collect information to identify certain bankrupt entities, the Federal Judicial Center is starting to assemble a specialized database of financial company bankruptcies from the past 10 years. Two large cases we began tracking in our 2011 report, Lehman Brothers and Washington Mutual, are moving forward, but these cases along with the more recent bankruptcy of MF Global illustrate the challenges in resolving large, complex financial institutions.

Data on Financial Company Bankruptcies Are Limited

As we reported last year, tracking financial company bankruptcies is difficult because data are limited. Specifically, data on the number of financial company bankruptcies and their outcomes have been difficult to obtain. Neither AOUSC, the Trustees' Office in Justice, nor FDIC collect information on the number of financial companies in bankruptcy. We previously reported that AOUSC collects some data on bankruptcy outcomes, such as the closing date for large cases. However, AOUSC does not specifically include information on bankruptcy cases involving financial institutions, or track outcomes such as the value of creditor returns or the value of firms emerging from bankruptcy. The bankruptcy courts only collect data on the type of business in which an institution is engaged if the data are pertinent to provisions of the Code (for example if the business was a broker-dealer subject to a SIPA proceeding) and these data are used for case processing rather than overall study. AOUSC officials told us they have been considering having the bankruptcy courts include the North American Industry Classification

[68]See 75 Fed. Reg. 75208 (Dec. 2, 2010) for the proposed securities swap reporting rule. In addition, an SEC official told us that under a form all SEC-registered investment advisers must file with SEC, they are requested to include an LEI for either themselves or their fund. Similarly private funds (hedge funds) also will be requested to list an LEI. Under a proposed rule, SEC would provide stock exchanges with the option of using LEIs to identify broker-dealers and all entities with which the broker-dealer executes trades. 75 Fed. Reg. 32556 (June 8, 2010).

System code when a company files for bankruptcy. However, AOUSC and Federal Judicial Center officials told us that this new requirement would require a modification to the Official Bankruptcy Forms. These officials told us that this process generally takes 2 years and follows the process for amending the Federal Rules of Bankruptcy Procedure, except the process does not require approval by the Supreme Court or an opportunity for review by Congress.

AOUSC provides the Trustee Program's bankruptcy filing data. Officials told us these data include whether the debtor is a person or a corporation, whether it is a small business, the case number, the name and address of the debtor, and the status of the case (that is, whether a plan has been filed or if the case has been dismissed), and other types of information. However, officials told us they do not flag financial companies and cannot track them separately. FDIC officials told us that although they track individual cases of bank holding companies in bankruptcy, such as Washington Mutual, Inc. and Colonial Bank, they do not have a database that aggregates these case records.

Although AOUSC officials told us that they currently were not routinely collecting any data that would allow the identification and tracking of financial company bankruptcies, AOUSC and the Federal Judicial Center have undertaken a collaborative effort to create a specialized database of financial companies that have filed for bankruptcy protection from 2000 to 2010, but they have concerns about the reliability of these data as they are untested for this purpose.[69] According to a Federal Judicial Center official, the purpose of the database is to compile information useful in understanding the effectiveness of Chapter 7 and Chapter 11 of the Code in facilitating the orderly liquidation or reorganization of financial companies. Officials told us developing such a database has been challenging, due to the resources needed and coding concerns.[70] A Federal Judicial Center official told us they had developed an online coding form to document more information about each case and held a training session for the student coders. One of the items researchers

[69]AOUSC officials told us the reported court data are reliable for the purpose of reporting required statutory case statistics.

[70]Because of the time needed to review individual court dockets, AOUSC and Federal Judicial Center staff have recruited University of Maryland law students to assist in the initial coding effort.

must code is the type of financial company, which is not information the courts currently collect. Some outcomes included in the database, such as details about the sale of all assets, are more difficult to find in court dockets. In addition, the official told us determining the level of detail on each case to include in the database has been a challenge. For example, the official told us they attempted to limit the complexity of information for staff to code, while still documenting the necessary data for further study. To address this issue, the official told us that the Federal Judicial Center is undertaking various data verification processes, including a process by which two independent coders will code the same information and a third, more experienced researcher will reconcile any differences between them.[71] Despite these efforts, AOUSC officials told us that they currently are not able to determine how effective this database will be in allowing them to track large financial company bankruptcies, partly because of concerns over using data reported by the companies filing for bankruptcy.

As in our 2011 report, to examine the number of large financial companies filing for bankruptcy protection, we matched AOUSC data on Chapter 11 megacases with data from a private firm on financial company bankruptcies to determine the number of financial companies in bankruptcy during the past decade. Table 2 describes both the total megacase filings and those megacases that are financial companies.

Table 2: Chapter 11 Mega-Bankruptcy Filings, by Total Filings and Financial Institution Filings, 2000 through 2011

	Chapter 11 mega-case filings	
Year	Total number of filings	Number of financial institution filings
2000	63	2
2001	101	1
2002	88	2
2003	73	1
2004	54	0
2005	31	2
2006	25	0
2007	13	4

[71]This process is also known as "double-coding for inter-rater reliability."

Year	Chapter 11 mega-case filings: Total number of filings	Number of financial institution filings
2008	79	4
2009	118	6
2010	40	1
2011	35	1
Total	**720**	**24**

Sources: GAO analysis of AOUSC and New Generations data.

Three Major Financial Institution Bankruptcy Cases Continued to Move Forward

We continued to monitor two financial megacases, Washington Mutual, Inc. (Washington Mutual) and Lehman Brothers Holdings, Inc. (Lehman) and began monitoring a third, MF Global Holdings Ltd. (MF Global). Washington Mutual and Lehman are making progress in their bankruptcy proceedings, with several issues outstanding. Both financial institutions filed for Chapter 11 protection in September 2008. A new case involves MF Global, a holding company with a broker-dealer and commodity broker, which filed for Chapter 11 protection in October 2011. Each case illustrates the complexities of liquidating large financial institutions.

Washington Mutual. As we discussed in our 2011 report, the parties to the bankruptcy had agreed to a revised settlement report in late 2010, but confirmation of that plan was delayed due to various claims by shareholders and some creditors. These delays continued throughout 2011 because of additional hearings to discuss allegations of insider trading by hedge funds. Shareholders alleged that several hedge funds had access to discussions about the settlement plan through their attorneys and later bid on creditor claims. The parties entered mediation in October 2011 and reached a settlement and submitted a plan on December 12, 2011. A Delaware bankruptcy court judge confirmed the plan on February 17, 2012. As discussed in the 2011 report, the plan set forth the allocation of the tax refund among all of the parties: up to $2.2 billion to Washington Mutual's holding company; up to $2.2 billion to J.P. Morgan Chase, Inc. (the new owner of the depository bank); up to $850 million to FDIC; and $335 million to the bank's bondholders. As of May 2012, the judge told us that she had been advised that the majority of the claims had been resolved. Further payouts will be distributed through a liquidating trust. Washington Mutual, Inc. is being reorganized as a reinsurance company that will be funded by capital contributions from new bondholders, not by the creditors from the original debtor.

Lehman Brothers. On June 29, 2011, Lehman filed a disclosure statement that set out the plan for distribution of assets to the creditors of 23 Lehman debtor entities. This plan was made after extensive negotiations with representatives of major creditor groups, including those that supported substantive consolidation and those that did not. This plan represents a compromise between the parties by providing for adjustments in payments to creditors. In November 2011, creditors approved Lehman's reorganization plan. The bankruptcy court confirmed the plan in December 2011. The plan included numerous settlements between the holding company and other counterparties, including a series of bilateral settlements with foreign affiliates and creditors. As a result, creditors reduced the amount of claims asserted against Lehman by more than $295 billion. According to Lehman, distributions to creditors totaling $22.5 billion began on April 17, 2012. A second distribution is planned for September 2012.

The resolution of Lehman's broker-dealer, Lehman Brothers Inc., continues through the SIPC process. According to SIPC officials, almost all of the 100,000 claims had been satisfied as of May 2012. However, some of the remaining claims are among the largest and involve complex litigation over who meets the definition of "customer" under SIPA.[72] According to the SIPA Trustee, there are over 2,100 claims with a total value of nearly $42 billion that are still unresolved. One of the largest of these claims involves Lehman's overseas affiliate—Lehman Brothers International, Europe (LBIE)—which is pursuing two types of claims against Lehman Brothers Inc.[73] The first is an "omnibus customer claim" on behalf of approximately 1,100 LBIE clients against Lehman Brothers Inc., of which $6 billion in claims for securities and $2 billion in claims for cash have been allowed by the SIPA Trustee. A remaining $6.7 billion remains under dispute.[74] The second is a "house claim" on its own behalf against Lehman Brothers Inc., of which $8.9 billion remains under dispute. The trustee said he does not recognize LBIE as a "customer" of Lehman Brothers Inc. because it does not meet the definition of

[72]Under SIPA, customers generally receive their distribution before any other group. Generally, a "customer" means any person who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of business. 15 U.S.C. § 78lll(2).

[73]LBIE was Lehman's principal European broker-dealer.

[74]See SIPA Trustee report.

"customer" under SIPA. According to SIPC officials, Lehman Brothers Inc. never held reserves on behalf of LBIE. These issues remain in litigation and may go to trial in 2013.

The SIPA Trustee for Lehman Brothers Inc. has initiated litigation against other counterparties over payment distribution, which also remains ongoing. In the first case, the SIPA Trustee is in litigation with Barclays involving issues surrounding its purchase of assets of Lehman Brothers Inc., immediately after Lehman filed for bankruptcy. According to the SIPA Trustee's report, the dispute centers on competing interpretations of the Asset Purchase Agreement (defining the terms of the sale of certain Lehman Brothers Inc. assets to Barclays) between Lehman, Barclays, and Lehman Brothers, Inc. and involves contested claims to approximately $7 billion of "disputed assets."[75] This case is currently on appeal.[76]

In a second case, SIPC officials told us the SIPA Trustee has filed an adversary proceeding against Citibank seeking the return of a $1 billion deposit Lehman Brothers Inc. made with Citibank during Lehman Brothers Inc.'s last week in operation. The case involves Citibank's setoff of Lehman Brothers Inc.'s obligations against Lehman Brothers Inc.'s deposits at Citibank and affiliated entities.[77] Citibank claims it set off the deposit shortly before Lehman Brothers Inc.'s SIPA liquidation process began in September 2008. The SIPA Trustee also has been seeking the turnover of approximately $300 million deposited in Lehman Brothers Inc. accounts at various Citibank locations around the world. According to the SIPA Trustee, Citibank has been attempting to set off these deposits against a component of the Lehman Brothers Inc. obligations

[75]The "disputed assets" consist of assets in Lehman Brothers Inc.'s Rule 15c3-3 customer reserve accounts (the "Rule 15c3-3 Assets"), margin used to support derivatives trading (the "Margin Assets"), and certain assets in LBI's clearance boxes at the Depository Trust and Clearing Corporation (the "Clearance Box Assets").

[76]According to the SIPA Trustee, both he and Barclays appealed portions of the bankruptcy court's opinion to the U.S. District Court for the Southern District of New York. On June 5, 2012, the District Court issued its order, and the SIPA Trustee has filed an appeal to the Second Circuit.

[77]Setoff is essentially the right to balance and cancel mutual claims between parties.

(approximately $1.26 billion) that are related to a settlement service provided by Citibank.[78]

In addition, the SIPA Trustee has been pursuing claims against LBIE on behalf of the broker-dealer's customers. The SIPA Trustee alleges that LBIE has assets that belong to Lehman Brothers Inc. customers. According to the SIPA Trustee, due to the hundreds of thousands of transactions between Lehman Brothers Inc. and LBIE, the final outcome and amounts available for SIPC's customer distribution are heavily dependent on LBIE's own resolution in the United Kingdom. The SIPA Trustee has filed claims against LBIE totaling almost $16 billion. According to the SIPA Trustee, he and his advisers have been engaged in discussions with LBIE about the extent to which LBIE will allow the SIPA Trustee's claim. The SIPA Trustee said the result of this process will have a major impact on the resolution of the U.S.-based Lehman Brothers Inc. estate and the SIPA Trustee's ability to satisfy claims of customers and other creditors of the broker-dealer.

MF Global. MF Global has been in the bankruptcy process since October 31, 2011, and has faced challenges due to missing customer funds and property. MF Global was a large, globally active company with a commodity and securities broker-dealer. The firm was based in the United States, with operations in multiple countries, including Australia, Canada, Hong Kong, India, Japan, Singapore, and the United Kingdom. As of mid-2011, the holding company had total assets of almost $46 billion. MF Global's stock price declined during 2011, falling from about $8 a share at the start of the year to below $4 in early October and below $2 by late October. According to the SIPA Trustee, MF Global's exposure to European debt and poor earnings reports led to credit downgrades and increased demands for collateral from MF Global's counterparties. This in turn led to an increased loss of confidence in MF Global as customers began to close their accounts and withdraw funds.

According to CFTC, the failure of the MF Global commodity broker (MF Global Inc.) is unprecedented in the size and scope of missing customer funds. Ordinarily, the designated self-regulatory organization, in coordination with CFTC, would have arranged for the sale of a failed

[78]Specifically, the settlement service related to payments for foreign exchange transactions through the Continuous Linked Settlement system.

commodity broker to another commodity broker, but in the case of MF Global Inc., the missing customer funds and possible fraud prevented this from occurring, according to CFTC officials. These officials said they increased their involvement in the MF Global case after the company was downgraded by credit rating agencies on October 27, 2011. Despite repeated inquiries, MF Global Inc. was not able to provide supporting records for its calculations of segregated customer accounts. Because CFTC lacks authority to put the commodity broker into bankruptcy, when customer money was found missing, SEC and CFTC determined that a SIPC-led bankruptcy was the appropriate course of action to protect customer accounts and assets.

The MF Global bankruptcy has highlighted issues related to resolving an international broker-dealer and commodity broker and the effect on customer payments. According to SIPC officials, for the securities estate, the SIPA Trustee is using SIPA, and for the commodities estate, the Trustee is applying subchapter IV of Chapter 7 of the Code to the extent consistent with SIPA, as well as applicable commodities law.[79] While a SIPA proceeding and the bankruptcy process for a commodity broker are similar, there are important differences. Under the bankruptcy process for a commodity broker, to the extent that the debtor's general estate is insufficient to pay for the estate's administrative expenses, these expenses are paid from customer property ahead of the claims of customers. However, under the SIPA process, customer property is used to pay customers, and is available to pay estate expenses only if all customers have been satisfied in full. These differences could have a distinct effect on the funds available to customers, depending on the amount of the administrative expenses being paid compared to the amount of the general estate and the amount of the customer claims. In addition, SIPC may advance up to $500,000 for each customer holding securities (and a maximum of $250,000 for customers holding cash) while the liquidation is ongoing, which enables the trustee to provide some relief to securities customers relatively quickly. SIPC has no authority to make advances to satisfy commodities claims and the liquidation process for a commodity broker has no such provision. In MF Global, more than 30,000 commodity customer claims were filed compared with approximately 300 securities customer claims.

[79] 15 U.S.C. § 78fff-1(b).

Because different customer estates are available to securities and commodity customers, each type of customer is receiving a different recovery percentage. CFTC officials told us they have been working to identify customer property for these estates, and SIPC officials told us the CFTC has closely cooperated with the SIPA Trustee. [80] However, SIPC officials said the CFTC's regulations that implement bankruptcies for commodity brokers have been cumbersome to follow. In addition, according to SIPC officials, the SIPA Trustee's authority to conduct bulk transfers from the insolvent commodity broker-dealer to other broker-dealers is vague.

According to the SIPA Trustee, a large volume of transactions occurred in the final week of MF Global's operations. The SIPA Trustee's report stated that the company's information technology system could not handle this increased volume, leading to transactions that were not recorded or recorded incorrectly. The report estimated that "fail transactions" (in which a counterparty fails to deliver cash or securities) were five times the normal volume in the final week. Following the bankruptcy filing, the SIPA Trustee conducted an investigation examining 840 cash transactions in excess of $10 million that totaled $327 billion and 20,000 cash transfers below $10 million that totaled $9 billion. In addition the SIPA Trustee has been examining securities transactions valued at more than $100 billion. The SIPA Trustee has sought to connect cash transfers from counterparties to the transfers of securities from MF Global to locate more customer funds.

The resolution of MF Global Inc. also has been hampered by differences in laws of various jurisdictions and the location of foreign assets. According to the SIPA Trustee, differences in insolvency laws and a lack of legal precedent have contributed to significant gaps in commodity customer protection between the United States and foreign jurisdictions. SIPC officials and the SIPA Trustee said customers who had accounts for trading on domestic exchanges and customers who had accounts to take physical delivery of commodities received an 80 percent return on their account from the first interim distribution; however, the customers with accounts for trading on foreign exchanges will receive only a 10 percent return from this distribution. The officials explained that most of the

[80]Commodity customer property includes property unlawfully converted that is still part of the estate, 17 CFR § 190.08(a)(ii)(F), and received by margin that was withdrawn and recovered by avoidance powers of the trustee.17 CFR § 190.08(a)(ii)(D).

property for customers on foreign exchanges is in the United Kingdom and according to the SIPA Trustee, these assets are now under the control of foreign bankruptcy trustees, similar to other international bankruptcies. The SIPA Trustee said that recovery of foreign assets was uncertain and would take time, adding that these issues were usually the last to be resolved and only after litigation.[81] At a June 1, 2012, hearing, a target date of April 9, 2013, was set by the U.K. court.

The recent bankruptcy cases involving large complex financial institutions illustrate the potential challenges FDIC will have in an OLA proceeding, including resolving a securities and commodity broker, a company with significant international presence, and cases involving complex litigation. As described previously, MF Global customer property may be located in other countries, complicating the trustee's efforts to obtain it. The trustee for Lehman's broker-dealer has been involved in litigation with one of Lehman's foreign affiliates for several years. Because OLA will only apply to domestic entities, international coordination and voluntary cooperation with foreign regulators will be essential for the resolution of a global company. As discussed earlier, FDIC and other regulators have been taking steps to improve international coordination of the resolution of large, systemically important financial institutions but challenges remain. Regulators have yet to clarify the roles and responsibilities of FDIC and SIPC during the liquidation of a broker-dealer under OLA, including the treatment of securities customers, commodity customers, and general creditors. On May 3, 2012, FDIC conducted an exercise with SEC and CFTC simulating a hypothetical failure of a systemically important financial institution with both a securities broker and commodity broker to better understand gaps in the OLA process and assist in their rulemaking process.

Agency Comments and Our Evaluation

We provided a draft of this report to AOUSC, CFTC, Departments of Justice and the Treasury, FDIC, Federal Judicial Center, Federal Reserve, National Association of Insurance Commissioners, SEC, and

[81] As noted in GAO-11-707, regulators and legal officials have mechanisms to coordinate the bankruptcies of international companies, such as the United Nations Commission on International Trade Law's Model Law on Cross-Border Insolvency (adopted in the United States as Chapter 15 of the Bankruptcy Code), insolvency protocols, and memorandums of understanding, but these are not comprehensive. Commodity brokers and entities subject to SIPA proceedings are outside Chapter 15. 11 U.S.C. § 1501(c).

SIPC for review and comment. The National Association of Insurance Commissioners did not provide comments. We received technical comments from the remaining agencies, which we incorporated as appropriate.

We are sending copies of this report to the appropriate congressional committees, the Director of the Administrative Office of the U.S. Courts, the Chairman of the Commodity Futures Trading Commission, the Assistant Attorney General for Administration at the Department of Justice, the Secretary of the Treasury, the Chairman of the Federal Deposit Insurance Corporation, the Director of the Federal Judicial Center, the Chairman of the Board of Governors of the Federal Reserve System, the Chief Executive Officer of the National Association of Insurance Commissioners, the Chairman of the Securities and Exchange Commission, and the Chairman of the Securities Investor Protection Corporation, and other interested parties. The report also is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff members have any questions about this report, please contact Alicia Puente Cackley at (202) 512-8678 or cackleya@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors to this report are listed in appendix III.

Alicia Puente Cackley
Director, Financial Markets and
Community Investment

List of Committees

The Honorable Tim Johnson
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Patrick Leahy
Chairman
The Honorable Charles E. Grassley
Ranking Member
Committee on the Judiciary
United States Senate

The Honorable Spencer Bachus
Chairman
The Honorable Barney Frank
Ranking Member
Committee on Financial Services
House of Representatives

The Honorable Lamar Smith
Chairman
The Honorable John Conyers, Jr.
Ranking Member
Committee on the Judiciary
House of Representatives

Appendix I: Objectives, Scope, and Methodology

As required under section 202 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), this report examines: (1) actions the U.S. District Court for the District of Columbia (D.C. District Court) has taken in response to the judicial review provision of Orderly Liquidation Authority (OLA), including any revisions to Local Civil Rule 85; (2) federal rules or regulations relating to OLA and efforts to improve international coordination, including living wills, in resolving financial companies; and (3) data collection efforts and the outcomes of financial institutions that were in the bankruptcy process.

Generally to address our objectives, we reviewed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) of 2010 and its rulemaking requirements. We also conducted interviews with officials at the Administrative Office of the U.S. Courts (AOUSC); Commodity Futures Trading Commission; Federal Deposit Insurance Corporation (FDIC); Board of Governors of the Federal Reserve System (Federal Reserve); Federal Judicial Center; Securities and Exchange Commission; Securities Investor Protection Corporation; Department of the Treasury (Treasury); and the U.S. District Court for the District of Columbia (D.C. District Court). We reviewed relevant literature and reports issued since our last report, including those written by AOUSC and the Federal Reserve in response to mandates in the Dodd-Frank Act.

Specifically to address the first objective on actions the D.C. District Court took in response to the judicial review provision of the OLA, we monitored the website for the D.C. District Court for changes in Local Civil Rule 85. We interviewed the Chief Judge and other officials from the court to discuss how the rule would be implemented in case of a petition under OLA and the changes made to the rule in response to comments from FDIC and Treasury. We also discussed these changes with officials from FDIC and Treasury to obtain their views on the amended rule and how they expected the rule to be implemented.

To address the second objective on federal regulations relating to OLA and the resolution of financial institutions, we searched the *Federal Register* and monitored the websites of FDIC and the Federal Reserve to determine if relevant rules related to FDIC's authority under Title II and resolution planning had been issued. We also monitored the development of other related rules, including the Federal Reserve's rule related to the definition of nonbank financial companies and the Financial Stability Oversight Council's designation of systemically important financial institutions. We reviewed proposed, interim final, and final rules under these authorities; they are presented in appendix II. We reviewed comment letters on the rules, testimonies by regulatory officials, roundtable discussions held by FDIC, legal opinions and law firm client updates, and seminars conducted by law firms on FDIC's new authority under Title II. We reviewed updates from the Financial Stability Board on international coordination of related resolution and recovery planning and monitored the websites of the Financial Stability Board and Treasury's Office of Financial Research for developments on the Legal Entity Identifier. We also participated in financial industry presentations on the development and challenges of adoption of the Legal Entity Identifier.

To address the third objective on data collection and the status of financial institutions in the bankruptcy process, we spoke to officials from AOUSC, the Federal Judicial Center, and the Trustee Program at the Department of Justice to learn more about potential sources of financial company bankruptcy data. However, as discussed in our report, we found that no single source for financial company bankruptcy data is available. To provide some background information on the number of bankruptcies of large financial institutions from January 1, 2010, through December 31, 2011, we used data (as we did for last year's report) on Chapter 11 megacases collected by AOUSC and compared these cases with bankruptcy data from New Generations Research, Inc. New Generations, Inc., is a private company that takes data from U.S. bankruptcy filings and augments it with industry-specific data, including the type of industry of the debtor. We spoke with federal officials familiar with New Generations, Inc., and they consider it to be reliable for tracking bankruptcy cases. We also spoke to representatives from New Generations, Inc. regarding their data collection and reliability methods. We concluded that the data were reliable for tracking bankruptcy cases. AOUSC provided lead case data on megacases (involving assets of more than $100 million and more than 1,000 creditors) that included date and location of filing and some information on how closed cases were concluded (such as by sale, liquidation, or reorganization). By matching data on bankruptcies of financial institutions from New Generations with the AOUSC-provided megacase data, we were able to provide some context on the number of Chapter 11 megacases that represented financial institutions. We decided the data were sufficiently reliable for that purpose because there was a reasonable match between cases in the two data sets. As with our previous report, AOUSC provided only data on Chapter 11 cases and not Chapter 7. According to AOUSC officials, virtually all megacases were originally filed as Chapter 11 cases.

In addition to our general tracking of financial institution bankruptcies, we continued to monitor two major financial company bankruptcies—Lehman

Brothers Holdings, Inc. and Washington Mutual, Inc.—on which we reported as case studies in 2011.[1] We also began monitoring a new major financial company bankruptcy, MF Global Holdings, Inc., that filed for Chapter 11 protection in October 2011. For each of these cases, we reviewed court documents such as court orders, trustee reports, and reorganization plans. We also interviewed federal officials on their involvement in these cases. We reviewed these data to provide illustrative examples of some of the challenges and complexities of financial company megacases; for example, challenges in resolving an internationally active company or cases involving complex legal issues. We verified information about these cases with federal officials. We concluded that the information in these sources was sufficiently reliable for our purposes.

We conducted this performance audit from August 2011 to July 2012, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[1]We also reported on the bankruptcy of CIT Group in our 2011 report, but this case was completed.

Appendix II: Status of Selected Rules Related to the Orderly Liquidation Authority and Resolution Planning under the Dodd-Frank Act

The following are rules either mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) or initiated by the Federal Deposit Insurance Corporation (FDIC) or other agencies. As discussed in the report, FDIC has been considering additional rules under its Title II authority. Table 3 includes a list of rules and actions that have been completed by the regulators and the courts related to the orderly liquidation authority (OLA), resolution planning, or bankruptcy.

Table 3: Selected Final Rules and Actions Completed, as of May 15, 2012

Agency/ court	Section of Dodd-Frank Act	Rule	Status
FDIC and the Board of Governors of the Federal Reserve System (Federal Reserve)	Section 165(d)	Resolution Plans Final Rule.	FDIC and the Federal Reserve published the final rule on November 1, 2011 (76 Fed. Reg. 67323).[a] The first plans are due in July 2012. The final rule was based on a proposed rule from April 2011 (76 Fed. Reg. 22648). FDIC also issued a resolution plans rule for depository institutions with $50 billion in total assets effective April 1, 2012 (77 Fed. Reg. 3075, published January 23, 2012). The April rule supercedes the interim final rule effective January 1, 2012 (76 Fed. Reg. 58379, published September 21, 2011).
U.S. District Court for the District of Columbia	Section 202(b)	Local Civil Rule 85: Outlines the court's judicial review of a petition from the Secretary of the Treasury to allow FDIC to act as a receiver for a potentially insolvent financial company.	The court issued the rule January 19, 2011, and amended the rule on July 6, 2011, after receiving comments from FDIC and the Department of the Treasury (Treasury).
FDIC		Establishment of the FDIC Systemic Resolution Advisory Committee.	Office was established. Signed April 28, 2011 (76 Fed. Reg. 25352, May 4, 2011).
FDIC	Section 209	Orderly Liquidation Authority Final Rule: Final rule to implement certain provisions to resolve covered financial companies, including (i) recoupment of compensation from senior executives and directors; (ii) the clarification of power to avoid fraudulent or preferential transfers; (iii) the priorities of expenses and unsecured claims; and (iv) the administrative process for initial determination of claims.	FDIC issued this final rule on July 15, 2011, and it became effective August 15, 2011 (76 Fed. Reg. 41626). This final rule incorporates aspects of earlier rulemakings: • A notice of proposed rulemaking from October 19, 2010, described as "Phase I" (75 Fed. Reg. 64173). • An interim final rule on Phase I issued January 25, 2011 (76 Fed. Reg. 4207). • A proposed rulemaking from March 23, 2011 ("Phase II") (76 Fed. Reg. 16324).
FDIC	Section 209	Mutual Insurance Holding Company Treated as Insurance Company Final Rule.	FDIC issued the final rule on April 30, 2012 (77 Fed. Reg. 25349).

Sources: Dodd-Frank Act, D.C. District Court, FDIC, Federal Reserve, and Treasury.

[a]We have listed the dates published in the *Federal Register*, rather than the date the agencies published on their websites.

See table 4 for the status of various rules that have yet to be finalized.

Table 4: Selected Proposed Rules and Actions in Progress, as of May 15, 2012

Agency/ court	Section of Dodd-Frank Act	Rule	Status
Treasury-Office of Financial Research	Sections 151-154	Global Initiative to Establish a Legal Entity Identifier (LEI) for Financial Institutions.	Treasury issued a proposed policy statement for comment on November 30, 2010. Comments were due January 31, 2011 (75 Fed. Reg. 74146). The Financial Stability Board (an international body of regulators that addresses issues related to global financial stability) has created an LEI Expert Panel with the goal of introducing a global proposal for adoption by the G-20 summit in June 2012.[a]
Federal Reserve	Section 102(b)	Definition of Company "Predominantly Engaged in Financial Activities."	The Federal Reserve published a Supplemental Notice of Proposed Rulemaking and Request for Comment on April 10, 2012 (77 Fed. Reg. 21494). Comments are due May 25, 2012. This was based on an earlier proposed rule that was published on February 11, 2011 (76 Fed. Reg. 7731).
FDIC	Section 209	Definition of Company Predominantly Engaged in Activities That Are Financial in Nature.	As part of a proposed rule on OLA, FDIC proposed criteria for this definition (76 Fed. Reg. 16324). However, in the final rule on OLA, FDIC stated that it would wait to finalize the criteria until the Federal Reserve issued its rule defining nonbank financial companies under Title I (76 Fed. Reg. 41626).[b] The Federal Reserve's proposed rule is not yet final (see above).
FDIC and Treasury	Section 210(n)(7)	Calculation of the Maximum Obligation Limitation under OLA.	Proposed rule published November 25, 2011, for 60-day comment period ending January 24, 2012 (76 Fed. Reg. 72645). FDIC approved a final rule on April 23, 2012, but Treasury has not given final approval.[c]
FDIC	Section 210(c)(16)	Enforcement of Subsidiary and Affiliate Contracts by FDIC as Receiver of a Covered Financial Company.	Proposed rule published March 27, 2012, for a 60-day comment period ending May 29, 2012 (77 Fed. Reg. 18127).

Sources: Dodd-Frank Act, FDIC, Federal Reserve, and Treasury.

[a]Treasury reported delivering global LEI governance recommendations for endorsement by the G20 in June 2012.

[b]After we completed our analysis, FDIC published an amendment to the proposed criteria on June 18, 2012, that clarified the activities that would be considered financial in nature or incidental thereto for the purposes of Title II (77 Fed. Reg. 36194).

[c]Treasury approved the rule, and it was published on the June 22, 2012 (77 Fed. Reg. 37554).

Finally, table 5 provides the status of selected required rules that have yet to be proposed or had any action taken.

Table 5: Selected Required Rules That Have Not Yet Been Proposed or Had Action as of May 15, 2012

Agency/ court	Section of Dodd-Frank	Rule	Status
FDIC/Securities and Exchange Commission (SEC)	Section 205(h)	Orderly Liquidation Procedures for Broker-Dealers: Issue joint rules, in consultation with Securities Investor Protection Corporation (SIPC), establishing procedures for FDIC, SEC, and SIPC to implement orderly liquidation for covered brokers and dealers.	Rule has not been proposed. No mandated timeline.
FDIC/Primary Financial Regulators[a]	Section 210(c)(8)(H)	Joint Rulemaking on Recordkeeping for Qualified Financial Contracts: The Dodd-Frank Act requires the primary financial regulatory agencies to adopt rules regarding recordkeeping requirements for qualified financial contracts of financial companies necessary or appropriate to assist FDIC in the event of an orderly liquidation. If no rule is in place by July 21, 2012, then the chairperson of the Financial Stability Oversight Council (Secretary of the Treasury), in consultation with FDIC, shall develop a rule.	According to interviews with agency officials, FDIC has circulated a draft for review among regulators, but it has not been publicly released. A final or interim rule is required to be finalized by July 21, 2012.
FDIC/Treasury	Section 210(o)(6)	Risk-Based Assessment: The Dodd-Frank Act requires FDIC to issue rules to carry out risk-based assessments of covered financial companies to cover obligations incurred by FDIC in becoming receiver of a failed financial company.	Treasury officials told us that they had not been consulted on the drafting this rule. There is no statutory deadline.
FDIC/Federal Banking Agencies	Section 616(d)	Source of Strength Proposed Rule: The Dodd-Frank Act requires the appropriate federal banking agencies to jointly issue rules requiring bank holding companies, savings and loan holding companies, and other companies that control insured depository institutions to serve as sources of financial strength for their subsidiary depository institutions.	FDIC and Federal Reserve staff told us that they are working with the Office of the Comptroller of the Currency on this rule, which is required by July 21, 2012.

Sources: Dodd-Frank Act, FDIC, Federal Reserve, and Treasury.

[a]Primary Financial Regulators are defined in Section 2 of the Dodd-Frank Act.

Appendix III: GAO Contact and Staff Acknowledgments

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Staff Acknowledgments

In addition to the individual named above, Debra Johnson, Assistant Director; Nancy Barry; Rachel DeMarcus; Katherine Bittinger Eikel; William R. Chatlos; Dean P. Gudicello; Jonathan M. Kucskar; Marc W. Molino; Barbara M. Roesmann; and Jessica Sandler made major contributions to this report. Technical assistance was provided by JoAnna Berry and David Martin.

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