GAO
Highlights

Highlights of GAO-15-299, a report to congressional committees

March 2015

FINANCIAL COMPANY BANKRUPTCIES

Information on Legislative Proposals and International Coordination

Why GAO Did This Study

The challenges associated with the bankruptcies of large financial companies during the 2007-2009 financial crisis raised questions about the effectiveness of the U.S. Bankruptcy Code and international coordination for resolving complex financial institutions with cross-border activities.

The Dodd-Frank Act mandates that GAO report on an ongoing basis on ways to make the U.S. Bankruptcy Code more effective in resolving certain failed financial companies. GAO has issued three reports on this issue. This fourth report addresses (1) recent changes to the U.S. Bankruptcy Code and (2) efforts to improve cross-border coordination to facilitate the liquidation or reorganization of failed large financial companies under bankruptcy.

GAO reviewed laws, court documents, regulations, prior GAO reports, and academic literature on financial company bankruptcies and regulatory resolution. GAO also reviewed documentation from foreign financial regulators and international bodies such as the Financial Stability Board. GAO interviewed officials from the Administrative Office of the United States Courts, Department of Justice, Department of the Treasury, and financial regulators with a role in bankruptcy proceedings.

GAO makes no recommendations in this report. The Department of the Treasury, Federal Reserve, FDIC, and the Securities and Exchange Commission provided technical comments on a draft of the report that GAO incorporated as appropriate.

View GAO-15-299. For more information, contact Cindy Brown Barnes at (202) 512-8678 or brownbarnesc@gao.gov.

What GAO Found

The U.S. Bankruptcy Code (Code) chapters dealing with the liquidation or reorganization of a financial company have not been changed since GAO last reported on financial company bankruptcies in July 2013. However, bills introduced in the previous Congress would, if re-introduced and passed, make broad changes to the Code relevant to financial company bankruptcies. The Financial Institution Bankruptcy Act of 2014 (H.R. 5421) and Taxpayer Protection and Responsible Resolution Act (S.1861) would have expanded to varying degrees the powers of the Board of Governors of the Federal Reserve System (Federal Reserve) and Federal Deposit Insurance Corporation (FDIC) and would have imposed a temporary stay on financial derivatives (securities whose value is based on one or more underlying assets) that are exempt from the automatic stay under the Code. That stay would prohibit a creditor from seizing or taking other action to collect what the creditor is owed under the financial derivative. The bills also would have added to the Code processes for the resolution of large, complex financial companies similar in some ways to provisions currently in the Orderly Liquidation Authority (OLA) in Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which grants FDIC the authority to resolve failed systemically important financial institutions under its receivership. For example, each bill would have allowed for the creation of a bridge company, in which certain assets and financial contracts of the holding-company would be transferred, allowing certain subsidiaries to continue their operations. The 21st Century Glass-Steagall Act of 2013—a bill introduced in the House of Representatives (H.R. 3711) and the Senate (S. 1282)—would have repealed safe-harbor provisions that allow most counterparties in a qualifying transaction with the debtor to exercise certain contractual rights even if doing so would otherwise violate the automatic stay. As of March 12, 2015, these legislative proposals had not been re-introduced in Congress.

In the United States, the presumptive mechanism to resolve a failed large financial company with cross-border operations is through the judicial bankruptcy process. Since GAO's 2013 report, no changes have been made to the chapter of the Code that relates to coordination between U.S. and foreign jurisdictions in bankruptcy cases in which the debtor has foreign operations. Some structural challenges remain, such as conflicting regulatory regimes related to the treatment of financial contracts between parties in different countries when a firm enters bankruptcy, but efforts are underway to address them. Regulators have implemented a Dodd-Frank Act provision that requires certain large financial firms to submit a resolution plan to assist with an orderly bankruptcy process, which regulators expect to help address potential problems with international cooperation, among others. However, in 2014, FDIC and the Federal Reserve identified shortcomings with the plans for a number of large financial companies that those firms are to address in their 2015 submissions. Further, international bodies, such as the Financial Stability Board—an international body that monitors and makes recommendations about the global financial system—have focused on having countries adopt a regulatory approach to resolutions. Other recent actions include a January 2015 stay protocol for derivatives contracts developed by the International Swaps and Derivatives Association that is intended to give regulators time to facilitate an orderly resolution of a troubled firm.