A Creditor's Guide to the FDIC's Orderly Liquidation Authority

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- Overview of the FDIC's Orderly Liquidation Authority
  - Purpose
  - Process for Invoking
  - FDIC as Receiver
  - Funding Sources
- Orderly Liquidation Authority vs. Bankruptcy Code
  - What's Thought to be Wrong with the Bankruptcy Code
  - Certain Key Differences in Creditor Treatment
- Select Concerns with Orderly Liquidation Authority
  - Issues Requiring Additional Rulemaking
  - General Concerns
  - Can it Work and Will it Be Used?
- Select Questions to Ask Yourself as a Creditor of a Potential SIFI

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Overview of the Orderly Liquidation Authority

PURPOSE

- The central focus: resolution of a failing systemically important "non-bank" financial institution without a "bailout"
- General dissatisfaction with the way Lehman and AIG were handled
  - Failure = Loss of Value (Lehman)
  - Preservation = Taxpayer Bail-Out (AIG)
- Restructurings/Liquidations of non-bank financial institutions are generally conducted pursuant to the Bankruptcy Code and/or SIPA (in the case of broker-dealers)
  - Two alternatives — reorganization under Chapter 11 (for non-broker-dealers) or liquidation under Chapter 7 or SIPA
  - Administered by a court with the active involvement of constituent parties, substantial transparency, due process, judicial oversight and distributional equality of treatment
- After Lehman's failure, there was a governmental consensus that the Bankruptcy Code process is unworkable for large, complex interconnected financial institutions
  - *e.g.*, AIG, Lehman, Bear Stearns, bank holding companies and hedge funds

Overview of the Orderly Liquidation Authority

PURPOSE

- Orderly Liquidation Authority ("**OLA**") permits the government to invoke a new form of **resolution authority** for **non-bank financial institutions** instead of the Bankruptcy Code, if the Treasury Secretary makes certain **financial distress** and **systemic risk determinations**
- OLA is modeled largely on Sections 11 and 13 of the Federal Deposit Insurance Act, but also adopts certain concepts from the Bankruptcy Code
- OLA addresses the competing public policy objectives of systemic protection and protection of **creditors' rights**
- Three principal purposes:
  - Preserve financial stability by:
    - Maintaining the continuity of systemically critical operations
    - Allowing the payment of systemically critical obligations
  - Maximize creditor recoveries
  - Insure that public funds are not used to "bail out" private creditors or equity

Overview of the Orderly Liquidation Authority

PROCESS FOR INVOKING

- To What Institutions Could it Apply?
  - Must Be A "Financial Company"
    - "Financial Companies" may include non-banks that are "predominantly engaged in financial activities" (*i.e.*, 85% or more of consolidated annual gross revenues are attributable to financial activities)
    - "Financial Companies" not limited to systemically important firms, but requires finding that use of normal insolvency laws would have a serious adverse affect on "financial stability in the United States"
    - GSEs and certain other types of institutions are excluded
    - Special treatment for insurance companies
    - Special provisions for broker-dealers
- Invocation of OLA is Discretionary
  - Impact of resolution on "financial stability in the United States" determined at the time of failure
  - Could apply to any sizeable financial company
  - Creates uncertainty regarding whether the financial problems of a particular financial institution would be "resolved" through conventional bankruptcy proceedings or pursuant to OLA

Overview of the Orderly Liquidation Authority

PROCESS FOR INVOKING

- **The so-called “Three Keys”:** Subject to certain exceptions, a **financial company** will be designated as a **covered financial company**, and the FDIC will be appointed as its receiver if:
  - The Treasury Secretary, in consultation with the President, finds, among other things, that:
    - (i) such financial company is “**in default or in danger of default**”;
    - (ii) use of normal insolvency laws to resolve entity “would have **serious adverse effects on financial stability in the United States**”; and
    - (iii) the effect on creditors is “appropriate” in light of the dangers to financial stability
  - Such action is recommended by 2/3 of the Federal Reserve Board
  - Such action is recommended by 2/3 of the FDIC Board (except as described below)
- Broker-Dealers
  - The designation must be approved by 2/3 of the Securities and Exchange Commission and 2/3 of the Federal Reserve Board, and the FDIC must be consulted
- Insurance Companies
  - The designation must be approved by the Director of the new Federal Insurance Office and 2/3 of the Federal Reserve Board, and the FDIC must be consulted

Overview of the Orderly Liquidation Authority

PROCESS FOR INVOKING

- Limited judicial review only of “default” and “financial company” determinations
  - Only if the board of directors of the financial company refuses to consent to receivership
  - If the board of directors consents to receivership, directors will be absolved of liability for making such determination
  - If no consent, confidential court review must take place within 24 hours
  - Arbitrary and capricious standard of review of two determinations
- OLA does not automatically replace the Bankruptcy Code/SIPA/Other Law
  - Procedural hurdles and presumption against its applicability
  - Intended to be reserved for extreme cases during severe financial conditions
  - Nevertheless, strong incentive to invoke where no other workable options
- While there are substantial hurdles before a company can become subject to OLA, once those hurdles have been satisfied, company is likely to consent, eliminating opportunity for *ex ante* judicial review

Overview of the Orderly Liquidation Authority

PROCESS FOR INVOKING

- **What happens if invoked?**
  - FDIC is appointed as receiver
    - Acts under OLA, not under the Bankruptcy Code/SIPA/Other Law
    - Supersedes any existing or future bankruptcy filing
    - Has the discretion to act as receiver of subsidiaries (other than a bank subsidiary, though the FDIC may separately become receiver of a bank subsidiary under the Federal Deposit Insurance Act)
    - Splits its authority over broker-dealers with SIPC (which must be appointed trustee)
      - Any assets not transferred to a bridge company are administered in a conventional SIPA liquidation (*see Appendix II–"Overview of Bridge Financial Companies Under Orderly Liquidation Authority"* for background information on bridge companies)
    - Exception for insurance companies
      - Resolution conducted by state regulators pursuant to applicable state insurance insolvency law or, if the state regulator declines to act, the FDIC

Overview of the Orderly Liquidation Authority

FDIC AS RECEIVER

- **Authority of Receiver to Transfer Assets and Liabilities**
  - The FDIC, as receiver, has the power to transfer some or all of the assets or liabilities of a covered financial company to a third party in a quick sale or to a bridge financial company without a creditor's consent or prior court review
  - As long as the statutory minimum recovery requirement is satisfied and subject to an exception for QFCs, the FDIC can cherry-pick liabilities and thereby treat similarly situated creditors differently, including:
    - Treating short-term creditors better than long-term creditors
    - Treating operating creditors better than lenders or bondholders
  - The liens of secured creditors are, however, protected
  - The FDIC administers the claims process for "left behind" creditors and determines what they receive from the liquidation of any "left behind" assets, including any net value received from transferring assets and liabilities to a third party or bridge

Overview of the Orderly Liquidation Authority

FDIC AS RECEIVER

- **Treatment of Similarly Situated Creditors**
  - The FDIC's power to treat similarly situated creditors differently by transferring claims to a bridge or making additional payments is predicated on the FDIC determining that such action is necessary to:
    - maximize the value of the assets of the covered financial company;
    - initiate and continue operations essential to implementation of the receivership or any bridge financial company;
    - maximize the present value return from the sale or other disposition of the assets of the covered financial company; or
    - minimize the amount of any loss realized upon the sale or other disposition of the assets of the covered financial company
- **Additional Payments**
  - The FDIC, with approval from the Treasury Secretary, has the authority to make additional payments or credit additional amounts to any claimant, with no obligation to make any payment to any other claimant as a result, if the FDIC determines such payments are necessary or appropriate to minimize losses to the FDIC as receiver

Overview of the Orderly Liquidation Authority

FDIC AS RECEIVER

- **Limitations on the FDIC's Authority**
  - The FDIC has promulgated regulations limiting its discretion, in its capacity as receiver, to make "additional payments" to any of the following creditors to the extent payments result in recovery beyond the priority of payments :
    - Holders of long-term senior debt (*i.e.*, term is more than 360 days);
    - Holders of subordinated debt;
    - Shareholders, members, general partners, limited partners and others at that level; and
    - Other general creditors or holders of senior liabilities unless a majority of the FDIC board approves such additional payments
- **Limited Judicial Review**
  - A creditor can seek after-the-fact judicial review of a disallowed claim

Overview of the Orderly Liquidation Authority

FUNDING SOURCES

- **Orderly Liquidation Fund**
  - A fund established by the Treasury, from which the FDIC may borrow to carry out its OLA responsibilities
    - The fund is not pre-funded by the private sector, but can be created upon the commencement of a receivership
  - FDIC may fund costs by issuing debt securities to Treasury in amounts not exceeding:
    - during the 30-day period immediately following the appointment of the receiver, 10% of the book value of the covered financial company's total consolidated assets; and
    - after such 30-day period, 90% of the fair value of such company's total consolidated assets available for repayment
- **Post-Event Assessments to Repay Borrowings From Treasury**
  - FDIC is required to repay Treasury within 5 years, or longer as approved by Treasury
  - Assessments to be imposed on:
    - **Creditors** that received "additional payments" or excess benefits, including by virtue of having claims transferred to a bridge, but not payments or amounts "necessary to initiate and continue operations essential to implementation" of a receivership or bridge
    - **Financial companies** with total consolidated assets of $50 billion or more and systemically important financial institutions ("**SIFIs**")

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Orderly Liquidation Authority vs. Bankruptcy Code

WHAT'S THOUGHT TO BE WRONG WITH THE BANKRUPTCY CODE

- The Bankruptcy Code is thought to impede value maximization and is viewed as contributing to systemic risk
  - Inability to fund business in a timely manner
    - Fails to curtail liquidity crisis and market concerns
    - Destructive to preservation of financial assets
  - Inability to treat similarly situated creditors differently
  - Inability to continue or assign QFCs
    - ISDA provisions favorable to non-defaulting counterparty are destructive of value
    - Race to cover unhedged positions increases systemic risk
  - Inability to efficiently prepare filing

Orderly Liquidation Authority vs. Bankruptcy Code

WHAT'S THOUGHT TO BE WRONG WITH THE BANKRUPTCY CODE

- Length of process and uncertainty of outcomes
  - Customer assets trapped for substantial periods of time
  - Distributions delayed by claims determination process and possible litigation
- Multiplication of proceedings (Chapter 11; SIPA; Foreign Proceedings) and lack of international coordination and tools enabling SIFI to preserve non-US assets
  - "Matched" book becomes "unmatched"
  - Non-US assets "go dark"
- Absent OLA, government has few alternatives to take action to avert chaos, contagion, etc., in a financial panic

(See Appendix IV—"2008 Financial Crisis—Lehman Brothers Lessons Learned")

Orderly Liquidation Authority vs. Bankruptcy Code

CERTAIN KEY DIFFERENCES IN CREDITOR TREATMENT

- **Ability to Transfer Assets and Liabilities to Bridge Financial Companies**
  - The FDIC can transfer any assets or liabilities of a covered financial company to a bridge financial company, including making payments that do not treat similarly situated non-QFC creditors equally, should it determine that such action is necessary:
    - to maximize the value of the assets of the covered financial company;
    - to maximize the present value return from the sale or other disposition of the assets of the covered financial company; or
    - to minimize the amount of any loss realized upon the sale or other disposition of the assets of the covered financial company
  - Certain anti-transfer provisions are unenforceable
- **Minimum Distributions to Creditors**
  - Creditors are entitled to receive at least what they would have received in a liquidation under Chapter 7 of the Bankruptcy Code (comparable to the "best interests of creditors" test under the Bankruptcy Code)
    - Leaves difficult issue of determining what creditors would have received, hypothetically, in a liquidation that would have adversely affected "financial stability in the United States"
  - Ability to surcharge large financial institutions and SIFIs if shortfall in claw-backs to repay borrowings from Treasury

Orderly Liquidation Authority vs. Bankruptcy Code

CERTAIN KEY DIFFERENCES IN CREDITOR TREATMENT

- **Setoff Rights**
  - Reflects Bankruptcy Code, with important modifications to permit receiver to transfer liabilities to a third party or a bridge financial company even if it destroys the mutuality of offsetting claims, subject to priority treatment for allowed setoff rights and perhaps full recovery under minimum recovery right
- **Contractual Rights**
  - *Ipso facto* clauses not enforceable
    - Exception to unenforceability for QFCs in receivership, D&O insurance policies, and other very limited exceptions
  - Repudiation of contracts
    - Damages for repudiation are limited to actual direct compensatory damages
    - Damages for repudiated debt obligations are calculated as the face amount of the obligation plus accrued interest

Orderly Liquidation Authority vs. Bankruptcy Code

CERTAIN KEY DIFFERENCES IN CREDITOR TREATMENT

- **Contractual Rights (*cont.*)**
  - Oral contracts unenforceable; compromise on additional requirements for written contracts that otherwise would apply under the FDIA
- **OLA statutory priorities for unsecured creditors**
  - Generally similar to the Bankruptcy Code's order of priority, with some differences as outlined in *Appendix I—"Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code" at 12-13*
- **Post-receivership financing**
  - Provided by the FDIC on behalf of a covered financial company; will rank senior to administrative expenses
    - However, as under Bankruptcy Code, secured creditors' liens must be honored and cannot be "primed" unless adequate protection is provided

Orderly Liquidation Authority vs. Bankruptcy Code

CERTAIN KEY DIFFERENCES IN CREDITOR TREATMENT

- **Special Treatment for Qualified Financial Contracts**
  - **Short Suspension of Close-Outs.** Contrary to Bankruptcy Code, which permits *ipso facto* termination of qualified financial contracts despite the general automatic stay, under OLA *ipso facto* close-outs are suspended for a 1-business day period to allow selection of contracts to transfer to bridge or third party
  - **Preservation and Transfer of QFCs.** During 1-business day stay, the FDIC has the option to preserve and transfer <u>all</u> QFCs with a <u>particular counterparty and its affiliates</u> to a single third-party financial institution or bridge (importantly, no contract-by-contract cherry-picking is permitted)
  - **Damages on Repudiated QFCs.** Calculated as of the date of repudiation, rather than the earlier date of the FDIC's appointment and may include the cost of cover
  - **Secured QFCs.** Generally, perfected security interest securing QFC cannot be set aside
  - **QFCs (and Other Contracts) of Subsidiaries and Affiliates.** Where SIFI is guarantor, no *ipso facto* termination based on cross-default of guarantor's insolvency or financial condition if guarantee and all related assets and liabilities are assumed by a third party transferee or a bridge financial company within 1-business day or if other adequate protection is provided by the receiver

Orderly Liquidation Authority vs. Bankruptcy Code

CERTAIN KEY DIFFERENCES IN CREDITOR TREATMENT

- **FDIC can recoup shortfalls to pay back borrowings from Treasury**
  - “Claw-back” — FDIC can recover “additional payments” or excess benefits beyond the minimum recovery right received by creditors, including by virtue of having claims transferred to a bridge, but not payments or amounts “necessary to initiate and continue operations essential to implementation” of a receivership or bridge
  - If claw-backs are insufficient, can recoup any shortfall through assessments on SIFIs and other large financial institutions
- **Recovery of Compensation from Senior Executives and Directors**
  - The FDIC has the authority to recover from any current or former senior executive or director “substantially responsible” for the “failed condition” of the covered financial company any “compensation” received by such person during the 2-year period preceding the date the FDIC was appointed receiver
  - Standard of care that would trigger a recovery is negligence – “ordinarily prudent person…under similar circumstances”

Orderly Liquidation Authority vs. Bankruptcy Code

CERTAIN KEY DIFFERENCES IN CREDITOR TREATMENT

- **Customers of Covered Broker Dealers**
  - The overall goal is to achieve the same result for customers as in a normal SIPA proceeding, although implementation is subject to further rulemaking
  - SIPC and the FDIC both play a role. The FDIC must appoint SIPC as trustee of the covered broker dealer, but the FDIC as receiver may transfer customer accounts and associated customer name securities and customer property, as well as other assets and liabilities, to a bridge financial company under FDIC control
  - SIPC will have control over the liquidation of whatever remains at the covered broker-dealer. These proceedings will generally be governed by SIPA, except as otherwise provided in OLA
  - Whether their accounts are transferred to the bridge or remain behind, customers are supposed to receive securities or cash in amounts at least as beneficial as would have been the case had the actual proceeds realized from the liquidation been distributed in a straight SIPA proceeding

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Select Concerns with Orderly Liquidation Authority

Select Concerns with Orderly Liquidation Authority

ISSUES REQUIRING ADDITIONAL RULEMAKING

- **Minimum-Recovery Right**
  - Questions remain on how hypothetical Chapter liquidation valuation at the time of a presumptive systemic meltdown (where the FDIC did not step in to act as receiver) would be determined
  - Clarification needed as to whether the minimum-recovery right applies even if in conflict with other specific provisions and the assessments process
- **"Claw-back" powers**
  - The possible claw back of "excess benefits" paid to creditors could defeat the stabilization purpose of OLA, depending on how it is exercised
- **Treatment of Broker-Dealers and Interaction with SIPA and SIPC**
- **Treatment of Futures Commission Merchants**

Select Concerns with Orderly Liquidation Authority

ISSUES REQUIRING ADDITIONAL RULEMAKING

- **Operation and Management of Bridge Entities**
  - FDIC has indicated a draft rule is in the works
- **How recapitalization under OLA would work**
  - Method of valuing and allocating equity among “left behind” creditors based on their respective priorities
  - Treatment of contingent liabilities (holdbacks)
  - Remedies for creditors if valuation or allocation methodology disputed
- **Coordination of multiple proceedings for the SIFI and its affiliates (*e.g.*, multiple OLA proceedings, SIPA, FDIA, Chapter 11)**
- ***But* there is no deadline for rules on these subjects**

Select Concerns with Orderly Liquidation Authority

GENERAL CONCERNS

- Challenge for any governmental agency to deal with a complex financial organization in a crisis situation
- No legal or practical framework exists yet for international cooperation or coordination, and a number of legal and political impediments will have to be surmounted
  - Lack of power or willingness of local authorities to cooperate with the FDIC
  - Potential issues overcoming local law transfer restrictions applicable to local assets
- "Playing back the tape" on the events of October and November 2008 leads to interesting speculation about what might have resulted had the government possessed OLA

Select Concerns with Orderly Liquidation Authority

CAN IT WORK AND WILL IT BE USED?

- **The Biggest Concern:**
  - The fundamental proposition that a run on a systemically significant failing financial institution can be stemmed by the FDIC stepping in under OLA remains to be proven
  - Highly dependent on how discretion is exercised by the FDIC
- **Other Concerns:**
  - Lack of FDIC experience with SIFIs
  - Practical difficulties financing bridge companies and maintaining their operations pending ultimate transfer
  - Cross-border issues cannot be resolved due to incompatible national interests
  - Inability to apply OLA substantive rules to insurance companies
  - *See Appendix III—"Concerns with Orderly Liquidation Authority—Alternatives and Mitigants"* for an overview of potential methods of addressing these concerns

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Select Questions to Ask Yourself as a Creditor of a Potential SIFI

- Are you a creditor of a bank, a broker-dealer, a non-bank financial company or a combination of the above?
  - Banks would be resolved under the FDIA
  - Broker-dealers and other non-bank financial companies could be resolved under OLA or under the Bankruptcy Code/SIPA
- Is your counterparty likely to be subject to OLA?
  - Is there a material risk that the failure of the financial company and its resolution under otherwise applicable insolvency law have serious adverse effects on U.S. financial stability?
- Will your obligations be transferred to a bridge institution or left behind?
  - The FDIC has broad discretion to cherry-pick non-QFC contracts and obligations that will be transferred — obligations could be transferred if transferring them would maximize the value of the assets, maximize the present value return from the sale of the assets or minimize losses realized upon sale of the assets
  - If your obligations are transferred, you should receive the benefit of your bargain from the bridge
  - Do you have claims for set-off that would be disturbed through the bridge institution process?

Select Questions to Ask Yourself as a Creditor of a Potential SIFI

- Are your obligations long-term or short-term? Operating or lending-related?
  - Short-term and operating company obligations might be "preferred" in treatment to long-term and lending obligations
- Are your obligations QFCs?
  - Special treatment rules apply to QFCs under OLA, including a 1-business day stay on termination and a prohibition on "cherry-picking" among contracts
- If your obligation is left behind, what would your minimum-recovery right be?
  - It is possible that left-behind creditors might receive equity in or proceeds from the bridge institution in partial payment of their claims?
- Could you be subject to clawback or after-the-fact assessments?

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Applicability	▪ **Most individuals and business entities with specified connections to the United States are eligible.** ▪ Exceptions: Most banks, credit unions, insurance companies and insured depository institutions	▪ **U.S. bank holding companies, systemically important nonbank financial companies, other companies predominantly engaged in financial activities, and any subsidiaries of the foregoing that are themselves predominantly engaged in financial activities.** ▪ Exceptions: Subsidiaries that are insured depository institutions or insurance companies; government entities ▪ Covered broker-dealers are excluded from the definition of covered subsidiary. ▪ **"Predominantly engaged in financial activities" requires 85% or more of consolidated annual gross revenues to be attributable to such activities.**

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Commence-ment of Proceedings	▪ By debtor (voluntarily) or creditors (involuntarily)	▪ "Three keys" approach: Federal Reserve, Treasury Secretary and FDIC (or SEC for broker-dealers or Federal Insurance Office for insurance companies) must make certain financial distress and systemic risk determinations. ▪ Treasury Secretary must determine that the company falls within the definition of "financial company" and either obtain the consent of the company's board of directors or an order from the U.S. District Court for the District of Columbia authorizing the appointment of the FDIC as receiver. ▪ "Arbitrary and capricious" standard of review ▪ Appellate review available to the D.C. Circuit and then to the U.S. Supreme Court, but no stay is available

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Control of Business	▪ **Debtor in possession or bankruptcy trustee**	▪ **FDIC, as receiver. Receivership is limited to three years, subject to two one-year extensions (for a maximum of five years).** ▪ **Further extension available to complete ongoing litigation (up to 90 days after such litigation is completed)** ▪ **FDIC has no liability for unresolved claims after termination of the receivership.**
Close-Out of Certain Financial Contracts by Counterparties	▪ **Protected financial contracts can be closed-out/netted immediately, and remedies against collateral can be exercised under exceptions to the automatic stay.**	▪ **Close-out/netting of qualified financial contracts (QFCs) by counterparties stayed for 1 business day to allow receiver to determine which QFCs to transfer** ▪ **Must transfer all or none of the QFCs with a particular counterparty and its affiliates**

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Customer Property	▪ **Customer property held by stockbrokers and commodity brokers is treated separately and specific rules govern its distribution.** ▪ **"Customer name" securities to be delivered to customers, with certain exceptions in the case of negative net equity**	▪ **Same rules for customer property held by non-SIPC member stockbrokers and commodity brokers** ▪ **Special provisions for covered broker-dealers:** ▪ FDIC can establish bridge financial companies and transfer thereto all or any portion of the covered broker-dealer's assets and liabilities (including customer accounts and related "customer name" securities and customer property). ▪ FDIC must appoint SIPC as trustee to liquidate the covered broker-dealer and any of its assets or liabilities that are left behind in a liquidation proceeding under SIPA (subject to limited exceptions). ▪ SIPC generally has the same powers and duties as under SIPA, except with respect to assets or liabilities transferred to a bridge financial company. SIPC may not exercise powers under SIPA in a manner that impedes or impairs FDIC's core resolution powers.

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Customer Property (cont.)		▪ Rules governing counterparty rights on QFCs with the covered broker-dealer would be governed by the QFC provisions in OLA rather than those in SIPA. ▪ FDIC cannot exercise its powers with respect to a covered broker-dealer in a manner that would adversely affect the rights of a customer to customer property or "customer name" securities, diminish the amount or timely payment of customer net equity claims or otherwise impair customer recoveries provided under SIPA. ▪ FDIC is required to use the net proceeds from any transfer, sale or disposition of assets of the covered broker-dealer for the benefit of the estate of the covered broker-dealer. ▪ SIPC, the FDIC or the bridge financial company must promptly discharge all obligations of a covered broker-dealer or bridge financial company to a customer relating to, or net equity claims based on, customer property or customer name securities by delivering securities or making payments as would have been the case in a proceeding under SIPA.

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Customer Property (cont.)		▪ **As trustee for a covered broker-dealer, SIPC must allocate customer property and deliver customer name securities in accordance with Section 8(c) of SIPA. SIPC is required to pay all other claims in accordance with OLA priority rules.**
Financial Assistance	▪ **Subject to the requirement of "adequate protection" of existing lien holders, the debtor can obtain post-bankruptcy (DIP)-financing and lenders can receive priming liens and super-priority claims (subject to Bankruptcy Court approval). Such financing can be provided by any source, including the federal government.**	▪ **Emergency Open Assistance: No emergency open assistance.** ▪ **Emergency Closed Assistance: FDIC can provide a wide range of financial assistance to assist in the resolution of the covered financial company. There are some mandatory conditions to providing closed assistance, including:** ▪ unsecured creditors must bear losses; and ▪ the management and board members responsible for the failure must be removed.
Prompt Transfer of Assets and Liabilities to Buyer	▪ **Sale of assets to a third party is permitted after notice and hearing if good business reasons (like declining values) can be demonstrated.**	▪ **FDIC has broad discretion to sell or transfer assets and liabilities to a third party, notwithstanding any otherwise applicable consent requirements, subject to certain limitations in the statute but no meaningful judicial review.**

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Cherry-Picking Powers	**Select assets can be sold free and clear of claims and liens, subject to court approval of the transfer, but limited by close-outs of protected financial contracts and subject to providing for the value of existing liens. Selected liabilities may be assumed by a buyer.**	**FDIC has broad discretion to cherry-pick which assets or liabilities to transfer, even if it results in unequal treatment of similarly situated creditors, subject to three limitations:** ▪ minimum recovery rights of any left-behind claimants; ▪ if the FDIC transfers any QFCs with a particular counterparty or its affiliates, it must transfer all QFCs with that counterparty and its affiliates (and if the FDIC repudiates any such QFCs, it must repudiate all such QFCs); and ▪ all assets are transferred subject to pre-existing liens unless FDIC is able to invalidate the lien pursuant to one of its "super powers" discussed below.
Minimum Recovery Rights	**All impaired creditors are entitled to receive at least what they would receive in a liquidation of the company under Chapter 7 of the Bankruptcy Code.**	**All unsecured creditors are entitled to receive at least what they would have received in a liquidation of the covered financial company under Chapter 7 of the Bankruptcy Code. (Secured creditors would generally receive the collateral or the value thereof.)**

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Minimum Recovery Rights (cont.)	▪ **In a Chapter 7 liquidation, secured creditors generally receive their collateral or the value thereof, and all remaining assets are then distributed first to administrative creditors, then to certain priority general unsecured creditors, and then to non-priority general unsecured creditors.**	▪ **No express, practical remedy for creditors who do not receive their minimum recovery rights.** ▪ **FDIC is required to make periodic reports while acting as receiver on the extent to which creditors will receive this minimum recovery amount**
Damages for Rejected or Repudiated Contracts	▪ **Breach of contract damages generally allowed for rejected contracts. Administrative expense claims generally allowed to the extent the debtor accepted benefits under the contract after the petition date.**	▪ **Damages for repudiation or disaffirmance are limited to "actual direct compensatory damages," resulting in smaller damage claims than for rejection under the Bankruptcy Code, determined as of the date of the appointment of the receiver, with the exception of QFCs, for which damages are calculated as of the date of disaffirmance or repudiation and are measured in accordance with market custom (cost of cover included).**

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Damages for Rejected or Repudiated Contracts (cont.)		▪ **Damages for repudiated debt obligations are calculated as the face amount of the obligation plus accrued interest and accreted original issue discount, determined as of the date of the receiver's appointment.** ▪ **Similar to "post-petition" interest provisions of the Bankruptcy Code for secured claims, accrued interest is calculated through the date of repudiation, to the extent that such allowed secured claim is secured by property greater in value than the amount of such claim.**
Enforceability of Ipso Facto Clauses	▪ **Generally unenforceable, with exceptions for financing contracts, protected financial contracts and other protected agreements**	▪ **Unenforceable in any contracts other than QFCs in receivership, D&O insurance policies, and other very limited exceptions**
Oral contracts	▪ **In some cases, oral agreements can form the basis of a claim.**	▪ **Although agreements against the interest of the receiver or a bridge financial company have to be in writing and meet certain other special enforceability requirements, any written agreement that is duly executed or confirmed in the ordinary course of business is enforceable.**

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Contingent Claims	▪ Contingent claims, such as under undrawn guarantees or letters of credit, loan commitments or unused portions of committed lines of credit, are provable and estimated by the Bankruptcy Court.	▪ Contingent claims in the form of guarantees, letters of credit, loan commitments and other similar claims would be recognized as provable claims equal to their estimated value as of the date of the receiver's appointment, similar to estimation under the Bankruptcy Code if FDIC so prescribes.
Partially Secured Creditors	▪ Partially secured claims are divided into secured and unsecured portions based on the value of the collateral. The secured portion generally must receive the value of the collateral; the unsecured portion receives distributions comparable to other general unsecured claims.	▪ Portion of claim that exceeds the value of the collateral considered unsecured. No payments may be made with respect to unsecured claims other than in connection with the disposition of all unsecured claims.
Guaranteed Subsidiary Contracts	▪ None	▪ FDIC given power to enforce subsidiary contracts (including QFCs) guaranteed by a covered financial company in receivership notwithstanding any cross-default in the underlying contract based solely on the insolvency of the guarantor, if the guarantee and all related assets/liabilities are transferred to a bridge financial company or a third party.

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Clearing Organizations	▪ None ▪ Protected financial contracts can be closed-out/netted immediately, and remedies against collateral may be exercised under exceptions to the automatic stay.	▪ Receiver required to use best efforts to meet margin, collateral and settlement obligations with respect to any QFCs of covered financial company with a clearing organization. ▪ If the receiver defaults on these obligations, the clearing organization may exercise rights and remedies immediately with respect to such QFCs despite an otherwise applicable stay on the exercise of close-out or other rights.
Setoff Rights	▪ Allows for setoff of mutual debts between the debtor and a creditor under certain circumstances.	▪ Respected as under the Bankruptcy Code, with qualifications to permit receiver to transfer liabilities to third party or bridge financial company even if it destroys the mutuality of offsetting claims.
Haircut on Secured Creditors	▪ Fully secured creditors receive the value of their security interest in bankruptcy.	▪ No authority to impose secured creditor haircuts. On July 18, 2011 the Financial Stability Oversight Council released a Dodd-Frank mandated report on the topic to Congress. The report's findings supported the view that market discipline and taxpayer protection could be achieved under Dodd-Frank in the absence of secured creditor haircuts.

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Post-Insolvency Interest	▪ **Generally disallowed, except (i) where the debtor is solvent and (ii) to the extent the value of a secured creditor's collateral exceeds its principal claim.**	▪ **Generally not payable because damages are calculated as of the date receiver is appointed, but exceptions for QFCs (where damages are calculated as of date of repudiation or disaffirmance) or as the FDIC may provide by regulation, policy statement or staff interpretation.** ▪ **Also, post-appointment interest is available on repudiated debt obligations through the date of repudiation to the extent that the allowed claim is secured by property with a value greater than the claim.**

Priority of Unsecured Claims	▪ **Tax claims and certain allowed unsecured claims (including those based upon any commitment by the debtor to a federal depository institution's regulatory agency, or the predecessor to such agency, to maintain the capital of an insured depository institution) have priority junior to administrative expenses, but senior to other unsecured creditors.**	▪ **The following unsecured claims generally have priority over the claims of general unsecured creditors:**
		  ▪ Claims by the FDIC for administrative expenses as receiver;
		  ▪ Amounts owed to the U.S.;

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Priority of Unsecured Claims (cont.)		▪ Wages, salaries or commissions to those other than senior executives and directors (up to $11,725 each) and certain contributions to employee benefit plans; and ▪ Claims of creditors with otherwise enforceable setoff rights where the FDIC destroys the mutuality of their offsetting claims by **transferring** one of the otherwise offsetting claims to a third party or bridge financial company. ▪ **The following unsecured claims generally rank junior to general unsecured creditors and subordinated debt, and senior only to the claims of shareholders:** ▪ Wages, salaries or commissions to senior executives and directors.
Choice of law rules	▪ **Noninsolvency choice of law rules determine which noninsolvency law governs the perfection of security interests and the creation and enforcement of security entitlements.**	▪ **Same.**

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Preferential Transfers	▪ **"Preferential" transfers made on account of antecedent debt within 90 days before bankruptcy (or 1 year for insiders) while debtor was insolvent may be avoided under Section 547, but defenses include transfers for "new value" and transfers made in the ordinary course of business. Certain protected financial contracts are exempt from preference risk.**	▪ **Legally enforceable or perfected security interests and other transfers of property are avoidable as preferential transfers only if preferential under the Bankruptcy Code. Bankruptcy Code defenses are available and spelled out.** ▪ **Security interests taken to secure QFCs are avoidable only if taken with actual intent to hinder, delay, or defraud.**
Fraudulent Transfer	▪ **Pre-bankruptcy transfers made or obligations incurred on or within two years prior to the petition date (i) with actual intent to hinder, delay or defraud creditors or (ii) for less than "reasonably equivalent value" and while the debtor was insolvent or that rendered the debtor insolvent, are generally voidable, subject to certain defenses.**	▪ **Legally enforceable or perfected security interests and other transfers of property are avoidable as fraudulent transfers as provided for under the Bankruptcy Code. Bankruptcy Code defenses are available and spelled out.**

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Fraudulent Transfer (cont.)	▪ **State law fraudulent conveyance laws also apply. Certain protected financial contracts are exempt from constructive fraudulent transfer risk.**	

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Funding the Insolvency Proceeding	▪ **Administrative creditors of the debtor are granted priority over pre-bankruptcy creditors with respect to estate assets, and trustees and professionals receive compensation subject to approval of the Bankruptcy Court.**	▪ **No pre-funded dissolution fund.** ▪ **FDIC's resolution expenses are funded by borrowings from Treasury up to certain maximum amounts equal to certain percentages of the book or fair value of the covered financial company's assets.** ▪ **Borrowings must be repaid within 5 years, first, by making assessments on claimants that received "additional payments" or other "amounts" from the FDIC in order to recover any excess benefits they received in the liquidation (i.e., amounts in excess of their minimum recovery rights) and, second, by making assessments for any shortfall on large financial companies with assets of $50 billion or more and any systemically important nonbank financial company.**

Appendix I: Comparison of Orderly Liquidation Authority with U.S. Bankruptcy Code

TOPIC	BANKRUPTCY CODE	ORDERLY LIQUIDATION AUTHORITY
Monitoring and Oversight	▪ Office of the United States Trustee (component of the Department of Justice) oversees the administration of bankruptcy cases. ▪ Judicial supervision of the claims process by the Bankruptcy court.	▪ Various Inspectors General and regulatory agencies provide oversight and investigative authority over the resolution process. ▪ Periodic reports required by FDIC related to the receivership of a covered company. ▪ Monitoring and studies by GAO, the Federal Reserve and Administrative Office of the United States Courts. ▪ Narrows the gap between the due process protections of the Bankruptcy Code and those provided under the bank resolution statute, for example by including gatekeeping role of the U.S. District Court for the District of Columbia, additional opportunity for judicial review of the claims process and certain notice and hearing rights.

Appendix II: Overview of Bridge Financial Companies Under Orderly Liquidation Authority

Appendix II: Overview of Bridge Financial Companies Under Orderly Liquidation Authority

- Federally chartered
- Operational control will be assumed by the FDIC or its designees and:
  - the business will be transferred, in whole or in pieces, to other institutions; and/or
  - the bridge will continue as an ongoing entity and a recapitalization or “bail-in” will be effected with some or all of the pre-failure creditors of the systemically important financial institution receiving equity in the bridge in satisfaction of some or all of their claims
- Upon transfer, liabilities may not exceed assets
- May operate without capital
- May obtain superpriority financing, secured by a senior or equal lien on property of the bridge financial company, only if there is adequate protection for pre-receivership secured creditors and only after notice and hearing before a federal court
- May issue and offer stock and other securities for sale
- Must terminate upon earlier of 2 years, sale of 80% or more of its capital stock, or sale of all or substantially all assets, subject to FDIC extension for up to 3 additional years
- Exempt from federal, state and local taxes

Appendix III: Concerns with Orderly Liquidation Authority—Alternatives and Mitigants

Davis Polk

Alvarez & Marsal

Appendix III: Concerns with Orderly Liquidation Authority

ALTERNATIVES AND MITIGANTS

- Contingent convertible securities
- Bail-ins (mandatory debt conversion programs) — similar to pre-packaged bankruptcies
- New FDIC resolution methods – *e.g.*, recap within resolution
- Amendments to the Bankruptcy Code to add, in the case of certain financial institutions:
  - A short stay of close out of QFCs and power to create creditworthy bridge, to permit the debtor to assume and assign such contracts to a bridge
  - Regulatory involvement and cross-border regulatory coordination
  - An ability for the government to provide liquidity support to facilitate resolution if needed
  - An ability to offer more favorable treatment to runable debts
  - An ability to make quick transfers of key businesses to third parties or to a bridge entity
- Living Wills – Can Mitigate Risks By Improving Pre-planning for Resolution

Appendix III: Concerns with Orderly Liquidation Authority

ALTERNATIVES AND MITIGANTS – LIVING WILLS

- A blueprint for how to resolve a financial institution
  - Pre-planning required of a SIFI to document how an institution could be wound-down with minimum disruption to the overall economy
  - For each SIFI, a top-down plan that includes the legal planning, information, and other elements, that would allow a resolution or sale of an institution over a 50-hour weekend.
- Assumes that the SIFI will be resolved under the Bankruptcy Code or applicable insolvency regime and not under OLA
  - Failure to submit a credible resolution plan may result in regulators imposing more stringent capital, leverage or liquidity requirements or restrictions on growth, activities or operations
  - After two years, if the institution fails to cure deficiencies, regulators have the power to mandate divestitures
  - For the initial submission, regulators have stated that they will not be making credibility determinations
- The living wills are expected to inform resolution plans prepared by the FDIC under OLA

Appendix IV: 2008 Financial Crisis—Lehman Brothers Lessons Learned

2008 FINANCIAL CRISIS

LEHMAN BROTHERS LESSONS LEARNED

EXECUTIVE SUMMARY

Key Lessons Learned & Regulatory Remediation.

- Key Lessons Learned

1. Unprepared filing of a SIFI creates chaos and value destruction
2. Risk assessment has to be entity focused
   - Non US legal entities go "dark" in a default situation
   - Entanglement of global financial institutions is highlighted by a default situation
3. Bad things happen to derivatives in a default situation
4. Long term assets funded with short term capital are conducive to liquidity crisis

- Regulatory Remediation

1. Living wills provide regulators with a "roadmap" avoiding an unprepared filing
2. Living wills / OLA require an entity based risk assessment
   - Living wills / OLA are "light" on international bankruptcy/cooperation rules
   - Living wills should ensure some group simplification and improvement in legal documentation thereby reducing group entanglement risk
3. OLA will allow FDIC to temper value destruction from derivatives
4. Volker rule attempts to address mismatch of assets and funding

Conclusion: regulatory remediation will temper value destruction but does not deal with "too big to fail", begs the question of reintroduction of Glass-Steagall and unlikely to result in a "97%" recovery rate

SITUATION OVERVIEW

Lehman Brothers was in the top 5 U.S. dealers with $650 billion in assets and thousands of entities in 40+ countries.

- 9/15/08 Lehman Filing
  - Bryan Marsal (Alvarez & Marsal) appointed as Chief Restructuring Officer of Lehman Brothers Holdings and its affiliates
  - PwC appointed as administrators of LBIE
  - KPMG appointed as administrators of Lehman Hong Kong

- 9/19/08
  - Giddens appointed as SIPC trustee to LBI
  - Sale of capital markets and IB division to Barclays through 363 sale

- Existing regulations resulted in multiple proceedings for a SIFI:
  - Non Regulated US Entities (LBHI et al): Chapter 11 Proceeding
  - Commercial Bank: FDIC Receivership (note: Lehman's banks were able to avoid receivership)
  - Broker Dealer (LBI): SIPA Proceeding
  - International: 75+ local proceedings with 15+ administrators

SITUATION OVERVIEW

The Lehman Chapter 11 proceedings can be divided in four phases.

- Phase I: Chaos from the unprepared filing
  - Lack of liquidity and lack of visibility on liquidity
    - counterparties hoarding debtor liquidity (deposits, collateral, margin calls all slowed down)
  - Lack of asset inventory – challenge from “melting” assets and assets gone “dark”
  - Loss of resources – people jumping ship (sale of businesses to Barclays / Nomura)
  - Lack of entity mapping – international entities going “dark”
  - Loss of operational support – systems shut down

- Phase II: Fact Finding, Control & Stabilization
  - Salvage “melting” assets and make protective investments to preserve long term assets
  - Inventorying of assets and legal entities and mapping of “control” chain
  - Secure control of legal entities and underlying assets
  - Secure resources
  - Secure systems

SITUATION OVERVIEW

The Lehman Chapter 11 proceedings can be divided in four phases.

- Phase III: Business Plan Development
  - Design a front-to-back technology platform to manage wind-down
  - Recruit and incentivize 450+ FTEs
  - Organize asset teams along five primary asset classes
    - real estate
    - private equity and principal investments
    - corporate loans
    - derivatives
    - regulated banks
  - Develop business plans on an asset by asset basis
  - Develop first multiparty international protocol among foreign administrators (including cooperation, data sharing, preservation of assets, non aggression, proceeding coordination, claims reconciliation and settlement)
  - Design and implement a two phase resolution strategy (pre-Dodd Frank Living Wills) for Insured Depositories (banks):
    - Stabilization Phase (near-term plan) to address immediate Capital and Liquidity needs
    - Resolution Phase (long-term plan) performed robust stress testing to establish Capital and Liquidity adequacy

SITUATION OVERVIEW

After 3+ years in bankruptcy Lehman US expects to be the first major proceeding to make distributions to creditors.

- Phase IV: Exit Strategy
  - Execute on asset disposition strategy
  - Claims management (67k claims over $1 trillion)
    - Expect to reduce by 2/3 through mitigation and negotiation process
    - Settlement of most intercompany claims by using last accounting close as a baseline and for trading activity end of day close, mid screen pricing at termination date
  - Develop a plan to distribute funds to creditors and settle the following issues:
    - Substantive consolidation vs. separateness of legal entities
    - Equitable, statutory or contractual subordination of intercompany claims
    - Validity and legal enforceability of affiliate guarantee claims
    - Ownership of certain assets
    - Framework for settling huge derivative claims from largest global financial institutions on an equitable basis (reducing filed claims by 50% on average)
    - Valuation methodology of +3k complex structured notes

KEY CHALLENGES FACED IN LEHMAN

Splintering of Group into Multiple Legal Entities and Proceedings.

- Absence of prepared filing results in chaos

- Lack of international rules results in value destruction
  - Entity grab by foreign administrators - unless separately capitalized, foreign entities are "lost"
  - Conflicting agendas between proceedings - US (hold strategy) and foreign (liquidation strategy)
  - Dependency on foreign group services / resources

- "Group interest" shifts to "entity centric interests"
  - Notwithstanding consolidated US proceedings, fiduciary duties of management are entity centric

- Transfer of risk between legal entities: bankruptcy creates a "break" in pass-through of "risk" from one legal entity to another as a result of:
  - Different bankruptcy dates for different legal entities
  - Different trade termination dates for "street" and "intercompanies"
  - Ineffective "back-to-back" documentation/process

- ***Lehman Solution: Consolidated US Proceedings, Transition Services Agreements, Global Protocol Among Lehman Administrators***

KEY CHALLENGES FACED IN LEHMAN

Group entanglement.

- Parent guarantees result in multiplication of liabilities to parent (50K+ claims for $800B+ filed against parent)
  - Transaction specific guarantees (ISDAs, Repos)
  - Entity specific guarantees to creditors generically
  - Generic authority to issue guarantees to cover affiliates' obligations
- Intercompany entanglement
  - Intercompany claims reconciliation and settlement has potential to result in years of litigation as a result of:
    - Complexity (funding, trading)
    - Number (10K I/C bookings per month; 300K+ live trades between affiliates)
    - Documentation
    - Qualification: equitable, statutory or contractual subordination; avoidance actions
  - Multiple Guarantee Documents
  - Substantive consolidation vs separateness of legal entities
- Uncertainty around customer asset ownership
  - Prime brokerage accounts allowing for the re-hypothecation of assets
  - Affiliate liens or rights against said assets
  - Counterparty securities collateral postings to debtor which are held by debtor affiliates (under separate administration)
- ***Lehman Solution: Intercompany Settlement Guidelines & Economic Compromise Plan***

KEY CHALLENGES FACED IN LEHMAN

Bad things happen to derivatives in a bankruptcy.

- "Matched books" become "unmatched"
  - Two sides of a trade within different legal entities / jurisdiction (via intercompany pass-through of risk from one entity to another)
  - Securities collateral (broker dealer / foreign jurisdictions) held in separate entities vs from derivative entities
  - Some contracts terminated, while others are live at counterparty's option
- Live portfolios require attention
  - Monitoring of performance payments and credit default notices
  - Hedging and risk management: motion to hedge derivative risk through new ISDAs
  - Trade valuations – booking, pricing and reporting
  - Contract assignments are challenging
- Street termination option is destructive of value
  - Termination date and time at counterparty's option
  - Non vanilla portfolio valuations and related charges (potentially wide range of reasonable values)
  - Adverse contractual provisions, e.g. walk-aways, subordination, set-off

KEY CHALLENGES FACED IN LEHMAN

Bad things happen to derivatives in a bankruptcy.

- ISDA close out methodologies inadequate in Lehman type situation, especially for large trade populations

- ***Lehman Solution: Derivative unwind blue print (200+ derivative organization), Big Bank Settlement Framework, Motion to Assign ISDAs & to Hedge Open Positions, Stepping Stone Legal Strategy***

KEY CHALLENGES FACED IN LEHMAN

Proprietary Investments – private equity and commercial real estate investments require access to significant capital and liquidity.

- Funding long term/ less liquid assets through short term funding sources can result in a liquidity crunch
- A proprietary investment needs to be matched with a corresponding long-term source of funding – the investment should be backed by sufficient equity
- Risk of "eradication" of existing investments due to significant unfunded LP capital commitments, $4.4B as of Lehman's filing
- Large/illiquid GP stakes, are subject to limited/restrictive transferability of ownership
- During periods of extreme "market stress" substantial liquidity discounts to NAVs represent significant haircuts to underlying marks
- Regulated institutions (banks) represent a substantial portion of consolidated capital, leaving little equity "cushion" for non regulated activities
  - Lehman's banks held only $13.6B or 2% of consolidated assets but represented $2.0B or 7.8% of Lehman's consolidated equity
- ***Lehman Solution: hold & protect investment through "storm"***

ORDERLY LIQUIDATION AUTHORITY

The advent of the FDIC's Orderly Liquidation Authority ("OLA") will address some, but not all, of the challenges faced by the Lehman collapse.

- Bridge Bank eliminates a fair amount of uncertainty and should have calming effect on market
  - Once "salvageable" assets are transferred into Bridge Bank, certainty around "going concern" business and continuation of qualified financial contracts should have calming effect on market
  - On the flip side, market will be uneasy as a result of:
    - » FDIC having little experience with SIFIs
    - » "Rules of engagement" being unclear
    - » Different treatment of creditors
    - » Assets / liabilities left behind

- Living Wills: potential answer to unprepared filings
  - Living Wills will provide FDIC with the tools to avoid unprepared wind-down and a roadmap to manage the Bridge Bank (asset inventory, systems, key personnel)
  - FDIC will need to convince talent to work for FDIC entity and will need to convince workforce of "going concern"

ORDERLY LIQUIDATION AUTHORITY

The advent of the FDIC's Orderly Liquidation Authority ("OLA") will address some, but not all, of the challenges faced by the Lehman collapse.

- Conflicts between US legal entities not fully resolved: three competing proceedings – FDIC, Chapter 11 and SIPA proceedings

- Non-US businesses still likely to be "lost": OLA does not provide for any international coordination / cooperation
  - Local regulators will not be able to resist protecting creditors of their jurisdiction
  - FDIC is unlikely to have "political" capital to fund non-US entities

- OLA tempers value destruction from derivative contracts tempered by (i) providing one business day stay for the close-out/netting of qualified financial contracts by counterparties and (ii) allowing the FDIC to transfer contracts to a Bridge Bank without approval of the counterparty
  - Determination seems too short
    - » Winding down of exotic trades, use of clearing houses and Living Will roadmap will likely facilitate this determination
  - Criteria for determination of book to be transferred:
    - » Going concern: matched book
    - » Maximization of value of Bridge Bank: counterparties with a net receivable position
    - » Systemic risk avoidance: Counterparties with large net positions

ORDERLY LIQUIDATION AUTHORITY

The advent of the FDIC's Orderly Liquidation Authority ("OLA") will address some, but not all, of the challenges faced by the Lehman collapse.

- Determination to factor in:
  - Market direction as collateral will need to be posted on a continued basis
  - Counterparty credit will need to continue to perform
- Determination will need to be made on a "net counterparty" basis:
  - Status of counterparties with affiliates subject to foreign jurisdictions
  - Status of counterparties with ISDAs subject to foreign jurisdictions

Biographies

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PARTNER

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Bar Admissions

- State of New York

Mr. Bernstein, who heads Davis Polk's Insolvency and Restructuring Practice, is globally recognized as among the small group of leading insolvency lawyers in the world. He has received numerous honors, including being elected by his peers as the Chair of the National Bankruptcy Conference, the most prestigious professional organization in the field. Mr. Bernstein's practice includes representing debtors, creditors, liquidators, receivers and acquirers in major corporate restructurings and insolvency proceedings, as well as advising financial institutions and other clients regarding credit risks involved in derivatives, securities transactions, and other domestic and international financial transactions.

WORK HIGHLIGHTS

Representations

- Companies in restructurings and reorganizations, including Ford Motor Company, U.S. Industries, LTV Steel, Lomas Financial, Liberte Investors, Allis-Chalmers and Johns-Manville
- Agent banks, major lenders or official creditors' committees in restructurings and bankruptcy proceedings, including those of Tribune Companies, Delphi, Syncora, Lehman Brothers, Refco, C-BASS, Centro Properties, Enron, Conseco, Adelphia, Bethlehem Steel, McLeodUSA, Dow Corning, Memorex Telex, R.H. Macy, Morrison-Knudsen, Drexel Burnham Lambert, Crown Paper, U.S. Office Products and Toshoku America
- Liquidators or receivers in international insolvency proceedings, including those of L.J. Hooker and Princeton Economics/Cresvale International

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- U.S. District Court, E.D. New York
- U.S. District Court, S.D. New York

Professional History

- Partner, 1986-present
- Associate, 1978-1986

- Global financial institutions, such as JPMorgan Chase, Bank of America, Citibank, Goldman Sachs and Morgan Stanley, on credit exposures and global credit risk management

RECOGNITION

Listed as a leading lawyer in numerous legal industry publications, including:

- *Chambers Global: The World's Leading Lawyers for Business*
- *Chambers USA: America's Leading Lawyers for Business*
- Practical Law Company's *Cross-border Restructuring & Insolvency Handbook*
- Legal Media Group's *Expert Guide to the World's Leading Lawyers – Best of the Best* and *Expert Guide to the World's Leading Insolvency & Restructuring Lawyers*
- Law Business Research's *Who's Who Legal – International Who's Who of Business Lawyers* and *Who's Who Legal – International Who's Who of Insolvency and Restructuring Lawyers*
- American Lawyer Media's *Corporate Counsel: Annual Guide to the Bankruptcy and Creditor-Debtor Rights Law*
- *IFLR1000: The Guide to the World's Leading Financial Law Firms*

In addition, Mr. Bernstein's distinguished practice has earned him the following distinctions:

- Selected by *Turnaround & Workouts* as an Outstanding Restructuring Lawyer

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- Named a leading insolvency and restructuring lawyer in 2010 by Euromoney's *Expert Guide to the World's Leading Insolvency and Restructuring Lawyers*
- Named "Dealmaker of the Year" by *The American Lawyer* in April 2010 for his lead role in Ford's restructuring
- Named *Best* Lawyers' 2010 New York Bankruptcy and Creditor-Debtor Rights Lawyer of the Year
- Named one of the top 100 lawyers in New York in the *Super Lawyers* survey
- Named *Who's Who Legal Insolvency and Restructuring Lawyer of the Year*
- Selected by the Advisory Board of the K&A Restructuring Register as one of "America's Top 100 Restructuring Professionals"

OF NOTE

Current Public Service

- Chair and Conferee, National Bankruptcy Conference, a group of 60 leading lawyers, law professors and judges that advises Congress on bankruptcy legislation
- Chair, Advisory Committee, Program on Law and Public Affairs, Princeton University
- Fellow and Former Director, American College of Bankruptcy
- Founding Director, International Insolvency Institute
- Member, Financial Stability Board, IMF Legal Advisory Panel
- Official U.S. Delegation to the Insolvency Working Group of the United Nations Commission on International Trade Law (UNCITRAL)

Past Public Service

- Treasurer and Member of the Executive Committee, New York City Bar Association
- Adjunct Professor of Law, New York University School of Law

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- Chair, TriBar Opinion Committee
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- Director, New York County Lawyers Association
- Chair, Visiting Advisory Committee, University of Chicago Law School

Current Memberships

- American Bar Association, including Business Bankruptcy Committee and the Committee on Legal Opinions
- National Bankruptcy Conference
- American College of Bankruptcy
- American Bar Foundation
- New York City Bar Association
- New York County Lawyers Association
- INSOL International
- American Bankruptcy Institute
- International Insolvency Institute

EDUCATION

- A.B., Princeton University, 1975
  - *cum laude*
- J.D., University of Chicago Law School, 1978

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Bar Admissions

- State of New York
- District of Columbia
- State of Georgia

Professional History

- Partner, Davis Polk, 2009-present

Mr. Douglas is a partner in Davis Polk's Financial Institutions Group, heading the firm's bank regulatory practice and focusing on bank restructuring and resolutions and other issues arising from the current banking and financial crisis. He has been involved in some of the most difficult and sensitive matters during the crisis, including advising the boards of directors of Indymac and Bank United, counseling Citigroup with respect to FDIC matters, advising various parties on the fallout from the failure of Washington Mutual and advising various private equity firms on proposed investments in troubled or failed banks.

Mr. Douglas was appointed General Counsel of the Federal Deposit Insurance Corporation in 1987 and continued in that capacity through 1989. This was a period of unprecedented stress on the financial system, and he was involved in the major bank failures and restructurings of the late 1980s, participated in the landmark Financial Institutions Regulatory Reform and Restructuring Act of 1989 and assisted in the organization of the Resolution Trust Corporation.

Mr. Douglas is regarded as one of the leading bank insolvency lawyers in the nation.

WORK HIGHLIGHTS

- Led the recapitalization of Sterling Bank ($725 million in new capital infused by Warburg Pincus and TH Lee) and Synovus ($1.1 billion in new capital)
- TH Lee in the $525 million recapitalization of First Banc Corp of Puerto Rico, and assisted in the acquisition of Alostar Bank of Commerce by four private equity funds
- Wachovia Corporation in its acquisition of CoreStates Financial Corp, First Fidelity Bancorporation and Westcorp

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Education

- B.A., Economics, Davidson College, 1972
  - cum laude
- J.D., University of Georgia School of Law, 1977
  - magna cum laude
  - Order of the Coif
  - Notes Editor, *Georgia Law Review*

WORK HIGHLIGHTS (*cont.*)

- Management, placement agents or investors in most of the so-called "shelf charters" and "platform banks" formed for the purpose of engaging in bank roll-up strategies during the current crisis, including SJB Escrow Corp ($1.1 billion committed); NAFH ($1 billion committed); Blue Ridge Holdings ($500 million committed); Community and Southern ($300 million committed); State Bank and Trust ($300 million committed); Community Bank Partners ($250 million committed); and Strategic Bank Partners ($350 million committed).
- Bank of America in a strategic alliance and outsourcing venture to provide electronic bill payment and presentment, involving a $500 million equity investment
- A consortium of 18 of the nation's largest banks and a technology company to form the largest provider of home banking services
- Six major international banks and a card association in the formation of a major global payments processing company
- CheckFree Corporation in obtaining direct access to the major funds transfer systems, allowing it to move over $2 billion each business day
- One of the world's largest asset management companies in the formation and subsequent acquisition of a series of national trust banks

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RECOGNITION

Mr. Douglas has been listed in numerous guides to the world's leading business lawyers, including:

- *Chambers USA: America's Leading Lawyers for Business*
- Woodward/White's The Best *Lawyers in America*
- Euromoney's *Expert Guide to the World's Leading Banking Lawyers*
- Law Business Research's *Who's Who Legal–International Who's Who of Banking Lawyers*
- The Financial Times' *Who's Who Legal* International (Banking)
- The "BTI Client Service All-Star Team," a group of 113 lawyers recognized for exceptional service to Fortune 100 clients.

OF NOTE

Memberships

- Director, Financial Services Volunteer Corp., a non-profit organization assisting countries as they work to develop strong banking and capital markets systems; in that capacity, he has advised the governments of Russia, Indonesia and Egypt, among others
- Member, Financial Markets Tribunal, Dubai Financial Services Authority
- Member, Executive Committee, University of North Carolina Law School's Banking Law Institute
- Member, Executive Committee, Rising Star Outreach, a non-profit organization assisting those affected by leprosy in India

Marshall S. Huebner

PARTNER

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Bar Admissions

- State of New York
- U.S. Supreme Court
- U.S. Court of Appeals, Second Circuit
- U.S. District Court, E.D. Michigan
- U.S. District Court, E.D. New York
- U.S. District Court, S.D. New York

Mr. Huebner is co-head of Davis Polk's Insolvency and Restructuring Group. He is widely recognized as one of the country's leading practitioners, and is one of only five U.S. lawyers to have been twice-named a "Dealmaker of the Year" by The American Lawyer. He routinely *represents both financial* institutions and companies in major restructurings and bankruptcies, and has advised on several of the largest and most complex of such matters yet done.

WORK HIGHLIGHTS

- Lead counsel to the Federal Reserve Bank of New York and to the United States Department of the Treasury with respect to their $150 billion in multiple financings and 79.9% equity stake in the American International Group; AIG has over $1 trillion in assets, and the Federal Reserve and Treasury AIG financings are the largest ever extended to a corporate borrower
- U.S. counsel to the joint administrators and liquidators of Lehman Brothers International (Europe) and its U.K. Lehman affiliates, including in connection with the tens of billions of dollars of claims that such companies have against Lehman's U.S. entities
- Lead bankruptcy and restructuring counsel to Delta Air Lines, in one of the largest and most successful restructurings in U.S. history; Davis Polk assisted Delta in, among other things, securing the then-largest DIP financing, successfully defending against a $10 billion hostile takeover attempt, and expeditiously emerging from Chapter 11 with one of the largest equity capitalizations on record

Marshall S. Huebner *(cont.)*

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Professional History

- Partner, 2002-present
- Associate, 1999-2002
- Law Clerk, Hon. Pierre N. Leval, U.S. Court of Appeals, Second Circuit 1993-1994

- Lead counsel to Citibank, as bank agent, in Lyondell, including advising with respect to the largest private DIP financing ($8.5 billion) in U.S. history and successfully resolving a $23 billion fraudulent transfer litigation
- Counsel to the Ford Motor Company in connection with its $10 billion balance sheet restructuring and various developments with respect to the U.S. auto industry
- Lead counsel to Frontier Airlines and The Star Tribune Company in their Chapter 11 proceedings
- Counsel to the DIP agent in Enron ($1.5 billion), Adelphia Communications ($1.5 billion) and Federal Mogul ($1.1 billion), and counsel to the Exit Financing agent in Federal Mogul ($3.5 billion)
- Lead counsel to Citibank on its $1 billion pre-purchase of AAdvantage Miles from American Airlines
- Counsel to the DIP agent in the A&P restructuring ($800 million)
- Counsel to the agents or other major parties in numerous other cases, including Loral, Polaroid, Citation, Crown Paper, Ntelos, Collins & Aikman and Magellan Health Services

Mr. Huebner has also routinely advised purchasers, companies and boards of directors in many non-public distressed matters, and provides risk management and bankruptcy advice on derivatives products and other complex transactions to clients such as Morgan Stanley, J.P. Morgan, Citibank, Credit Suisse and Bank of America Securities.

Marshall S. Huebner *(cont.)*

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RECOGNITION

Mr. Huebner has repeatedly been recognized as a leader in his field, including being named:

- One of the “500 Leading Lawyers in America” by *Lawdragon* magazine (2011)
- A BTI Client Service All-Star
- A leading lawyer in *IFLR1000: The Guide to the World’s Leading Financial Law Firms* (2011)
- A leading insolvency and restructuring lawyer in 2011, 2010 and 2009 by Euromoney’s *Expert Guide to the World’s Leading Insolvency and Restructuring Lawyers*
- “Dealmaker of the Year” by *The American Lawyer* in April 2009 for his lead role in AIG and April 2007 for his role on Delta Air Lines
- An Outstanding Restructuring Lawyer of 2010, 2009 and 2008 by *Turnarounds and Workouts*
- One of the top 100 lawyers in New York in the *Super Lawyers* survey

He was also:

- Ranked in the 1st tier in *Chambers USA: America’s Leading Lawyers for Business* and *Chambers Global: The World’s Leading Lawyers for Business*
- Selected by the Advisory Board of the *K&A Restructuring Register as one* of “America’s Top 100 Restructuring Professionals”
- Selected by American Lawyer Media’s *Best Lawyers in America* as one of the “New York Area's Best Lawyers” (2012)

Mr. Huebner’s work as bankruptcy counsel for Frontier Airlines earned a “Highly Commended” ranking in the *Financial* Times’ “U.S. Innovative Lawyers 2010” special report, which cited his efforts as “critical in saving the airline from liquidation.”

Marshall S. Huebner *(cont.)*

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OF NOTE

On December 16, 2009, Mr. Huebner testified by invitation before Congress on how to restructure the Bankruptcy Code to strike a better balance between debtors' needs for reorganization tools and the needs of and issues facing employees of companies in Chapter 11. The hearing was held before the House Judiciary Subcommittee on Commercial and Administrative Law.

- Presently writing *Restructuring the Troubled Company*, a full-length book that will be published by the Oxford University Press in 2010
- Author of numerous articles on bankruptcy law
- Contributing Editor, *Collier Bankruptcy Practice Guide*
- Guest lecturer at Yale, Harvard and Columbia Law Schools
- Faculty, New York University Advanced Bankruptcy Workshop
- Key Note Speaker, Corporate Counsel Institute, New York State Bar Association

Current Memberships

- Board of Advisors, Yale Law School Center for the Study of Corporate Law
- National Bankruptcy Conference
- American College of Bankruptcy

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Past Membership

- Chair, Courts Subcommittee of the Committee on Bankruptcy and Corporate Reorganization, New York City Bar

EDUCATION

- A.B., Princeton University, 1988
  - Fulbright and Rotary Scholarships
  - *magna cum laude*
- J.D., Yale Law School, 1993
  - Ford Foundation Fellowship
  - Senior Editor, *Yale Law Journal*

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Daniel Ehrmann

Daniel Ehrmann

Managing Director

Turnaround and Restructuring

- Daniel Ehrmann is a Managing Director with Alvarez & Marsal in New York, where he focuses on developing and implementing operational turnarounds as an adviser or in an interim management capacity. He has led companies through significant change by developing and implementing operating improvement plans across industries including apparel, retail, consumer products, professional and financial services.
- Currently, Mr. Ehrmann is the Co-Head of the derivatives unwind group and the leader of international operating companies unwind for the Lehman Brothers estate.
- Over the past decade, Mr. Ehrmann has operated in various C-level roles. Most recently, he served as CFO and Senior Vice President of Business Planning & Development with Spiegel Brands, a $350 million tri-channel, direct marketing, women's apparel business. Previously, Mr. Ehrmann served as Restructuring Officer of Spiegel Group, a leading tri-channel specialty retailer that offered merchandise through its three subsidiaries: Eddie Bauer, Spiegel Catalog and Newport News Catalog. At Spiegel, he streamlined, formulated and oversaw the carve-out from Eddie Bauer and integration of the Spiegel and Newport News catalogs through the consolidating of organization's logistics, distribution and call center operations. He negotiated the sale of the catalog companies and assisted the company in a rebranding and renegotiation of paper, printing and credit card processing contracts. Additionally, Mr. Ehrmann assisted the company in a business model shift from a catalog-centric to a Web-centric tri-channel business model.
- Some of Mr. Ehrmann's previous adviser assignments have included serving as financial adviser to Quaker Fabrics, a $225-million designer and manufacturer of residential furniture fabrics; financial adviser to OCA, a $400-million non-clinical business services provider to doctors; financial adviser to Communications Corporation of America, a TV broadcaster; and as assistant restructuring officer of Arthur Andersen.
- Earlier in his career, Mr. Ehrmann spent five years as a mergers and acquisitions attorney with Cleary Gottlieb Steen & Hamilton.
- Mr. Ehrmann earned a law degree from University Panthéon-Assas, a master's degree in corporate law and economic science from the University of Paris-Sorbonne, and a law degree (LL.M.) in corporations from New York University, School of Law. He is a member of the Paris and New York Bar Associations, and sits on the Board of Directors of Free Arts NYC.

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Douglas Lambert

Douglas Lambert

Managing Director

Turnaround and Restructuring

- Douglas Lambert, a Managing Director with Alvarez & Marsal, brings 30 years of diverse financial and operational restructuring experience. His primary areas of expertise include the formulation and implementation of restructuring and operational improvement plans for underperforming businesses, and managing companies and their creditor constituents through the restructuring process.
- Mr. Lambert has led financial and operational management teams across a broad spectrum of industries, including financial services, aviation, healthcare, manufacturing and consumer products. He has advised boards of directors and creditor groups in various capacities ranging from financial adviser to interim CRO, CEO and CFO.
- Mr. Lambert currently serves as CEO of Legacy Asset Management Company (LAMCO), a wholly owned subsidiary of Lehman Brothers Holdings, Inc. Post-petition, Lehman established a premier international workforce of approximately 450 financial professionals organized along five principal asset classes – commercial real estate, residential mortgages, private equity and principal investments, corporate loans and derivatives and designed a fully scalable front-to-back technology platform to effectively manage and wind-down Lehman's remaining long-term distressed and illiquid assets. He also has direct responsible for managing all of Lehman's commercial and thrift banking operations, including Lehman's Aurora Mortgage Servicing platform, and has led all post-petition negotiations with federal banking regulators pertaining to various complex regulatory and bankruptcy matters.
- Mr. Lambert's other recent assignments have included serving as pre- and post-Katrina interim CFO for the New Orleans Public School System where he led the operational and financial restructuring efforts; HealthSouth Corp., the largest healthcare fraud in U.S. history, where he successfully directed and managed a team of 350 professionals responsible for completing the company's post-fraud financial restatement and audit; and served as interim CFO for the successful out-of-court debt restructuring and corporate reorganization of Oreck Corp.
- Prior to joining A&M, Mr. Lambert was a Senior Vice President for Wexford Capital LLC, where he focused on distressed debt and special situation private equity investing. He has participated in numerous interim financial and operational management roles resulting in the successful restructuring and disposition of various distressed companies. He has directed pre- and post-reorganization management teams and has served as CRO and interim CFO during several financial transitions. He also served as President and CEO of the post-reorganized Integrated Resources Equipment Leasing division, where he successfully managed the liquidation of a multibillion dollar equipment portfolio. He began his career in the accounting and auditing services group of a Big Five accounting firm.
- Mr. Lambert earned a bachelor's degree in public accounting from Hofstra University. He is a member of the American Institute of Certified Public Accountants (AICPA) and the New York State Society of Certified Public Accountants (NYSSCPA).

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Ralph Schipani

Ralph Schipani

Senior Director

- Ralph Schipani is a Senior Director with Alvarez & Marsal in New York. He has over 11 years of professional experience in the consumer products, food, manufacturing, chemicals, and technology sectors. His primary areas of focus include the development and evaluation of strategic business plans and cash flow projections, assessment of bankruptcy planning and strategy, assistance in the procurement of debtor-in-possession financing, preparation of liquidation analyses, and the development and negotiation of recapitalization strategies and refinancing plans, as well as Plans of Reorganization.
- Most recently, Ralph has been working with a large U.S. financial institution assisting in the development of the Company's "Living Will", pursuant to section 165(d) of Dodd-Frank Act.
- Ralph worked with a U.S. based medical technology Company where he managed key work streams in finance and treasury. He was responsible for the implementation of processes for management reporting, 13 week cash flow forecasting and working capital improvements.
- Prior, Ralph worked at Chemtura Corporation, a $3 billion global specialty chemical company and manufacturer of BioGuard Pool Chemicals, which successfully emerged from bankruptcy after paying all creditors in full, along with providing a return to the pre-petition equity. At Chemtura he developed detailed income statement and cash flow projections, managed the reduction of legacy pension, OPEB, and environmental liabilities, and worked with the executive management team and Board of Directors to craft a reorganization strategy.
- Prior, Ralph served in various interim management and officer roles at Hostess Brands, Inc. (formerly Interstate Brands Corporation), identifying and executing upon a comprehensive operational restructuring, including profitability analyses, suggested rationalization of territories, brands, channels and assets. Ralph also implemented organizational improvements, forming a supply chain function, developing roles, responsibilities and identifying and hiring candidates.
- Ralph began his career in the Supply Chain Strategy practice at Accenture, where he focused on assisting clients in various industries with supply chain optimization, SKU rationalization, operational improvements, and cost reduction.
- Ralph earned a Bachelor of Arts in Business and Economics from Lafayette College.