

Treasury: Retain but Reform OLA + Add New Chapter 14 to Bankruptcy Code

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In a long-awaited [report to the President](#), the Treasury Department recommended reforming—but not repealing—the orderly liquidation authority (“OLA”) created by Title II of the Dodd-Frank Act (“**Title II**”), while also recommending the addition of a new Chapter 14 to the Bankruptcy Code. Concluding “unequivocally that bankruptcy should be the resolution method of first resort,” the Treasury Department recommended “narrow[ing] the path to OLA by building a more robust, effective bankruptcy process for financial companies.” OLA cannot be lawfully invoked if the Bankruptcy Code would work—*i.e.*, if a failed financial company can be reorganized or wound down under the Bankruptcy Code without destabilizing the U.S. financial system.

Treasury also recommended that the FDIC’s extraordinarily broad discretion under Title II be curtailed to bring this financial emergency legislation back into line with the rule of law. But Treasury ultimately concluded that OLA should be retained “as an emergency tool for use under only extraordinary circumstances.”

The report recommended adding a new reorganization provision to the existing Bankruptcy Code—a new Chapter 14—specifically designed to facilitate a “single point of entry” or “SPOE” reorganization strategy by financial groups that have a parent holding company at the top of their structures. Under an SPOE strategy, only the top-tier parent of a financial group would be put into a bankruptcy proceeding. All of its material subsidiaries would be transferred to a newly organized, debt-free bridge holding company, recapitalized and kept out of their own bankruptcy or similar proceedings to be continued, sold or wound down in an orderly fashion. All of the group’s losses would be borne by the top-tier parent’s shareholders and long-term bondholders, before any losses are borne by the shareholders, depositors or other short-term creditors of the group’s material subsidiaries. Treasury dubbed its recommended new provision “Chapter 14” in honor of a series of proposals by the [Hoover Institution](#), even if implemented in a technically different way such as by adding a new subchapter V to Chapter 11 as in the [Financial Institution Bankruptcy Act of 2017](#), which passed the House last year with strong bipartisan support.

Although the Treasury Department recommended against the wholesale repeal of OLA, it said it “shares many of the concerns raised by critics of OLA.” As a result, the Treasury report recommended making several amendments to the OLA framework to “eliminate opportunities for *ad hoc* disparate treatment of similarly situated creditors, reinforce taxpayer protections, and strengthen judicial review.” It also recommended that the FDIC be required to “explicitly confirm its commitment” to the SPOE strategy by finalizing its December 2013 [notice and request for comments](#) on that strategy and that the tax exemption in OLA for bridge financial companies be repealed as unjustified and anticompetitive.

With respect to similarly situated creditors, Treasury would amend OLA so that only critical vendors and others who would receive favorable treatment under the Bankruptcy Code because it is in the best interest of all creditors could receive favorable treatment under OLA.

With respect to taxpayer protections, the Treasury report recommended various reforms, including specific restrictions on the FDIC’s use of the Orderly Liquidation Fund (“OLF”). The OLF gives the FDIC authority to borrow money from the Treasury in order to provide liquidity to a firm in a Title II receivership. Among other things, Treasury recommended that the FDIC’s use of the OLF to make loans be restricted to fully secured, short-term loans at premium interest rates. Treasury also urged the FDIC to establish a preference for loan guarantees, instead of direct loans, and recommended that the FDIC charge premium guarantee fees.

The report recommended that the FDIC's role be limited to the exercise of core resolution powers—e.g., the quick transfer of assets from a failing firm to a bridge financial company over a weekend. Responsibility for the significantly slower process of adjudicating the claims of creditors and equity holders against the residual value of the failed firm left behind in a Title II receivership would be turned over to a bankruptcy court, which, in Treasury's view, would "improve the fairness and regularity of the process."

The initial reactions to Treasury's recommendations by the critics and defenders of OLA have been mixed. Long-time OLA critic Jeb Hensarling, the House Financial Services Committee Chairman, released a [statement](#) in which he criticized the Treasury report as "inconsistent with the President's core principle" of preventing taxpayer-funded bailouts because it does not recommend repealing OLA altogether. Meanwhile, the [Financial Times](#) reports that Aaron Klein of the Brookings Institution responded to the Treasury report by saying, "some of the changes make sense and some of them don't," and Marcus Stanley of Americans for Financial Reform likewise said the recommendations in the report were a "mixed bag," saying he opposed curtailing the FDIC's discretion through a "completely pre-written rule book."

Professors John Taylor and David Skeel, two members of the Hoover group that developed Chapter 14, co-authored a [blog post](#) in which they praised the report for providing "a practical road map" to enact Chapter 14 and noted that the "'reform rather than repeal' approach to OLA leaves in place international arrangements through which resolution authorities in different countries can coordinate the resolution of large international financial firms. If OLA were repealed, there would be no parallel authority in the United States."

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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