

The Presidential Memorandum on the Orderly Liquidation Authority - Another Look

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President Trump issued a Presidential Memorandum last Friday, April 21, which directed the Treasury Secretary to conduct a review of the Orderly Liquidation Authority (OLA). OLA was established by Title II of the Dodd-Frank Act. Its potential repeal, with or without a new Chapter 14 (or subchapter V of Chapter 11) of the Bankruptcy Code as a replacement, has been the subject of a vigorous public debate for years, which has intensified in recent months. OLA provides regulators with the authority to wind down nonbank financial companies if certain financial distress and systemic risk determinations are made. In particular, OLA can only be legally invoked if a finding is made that the financial company could not be resolved under the Bankruptcy Code without serious adverse effects on U.S. financial stability and that the use of OLA would avoid or mitigate such effects. The provisions of OLA are modeled largely on the bank resolution provisions in the Federal Deposit Insurance Act, subject to several important differences designed to harmonize the provisions defining creditor rights under OLA more closely with their counterparts in the Bankruptcy Code.

On its face, the Presidential Memorandum appears to be neutral and does not appear to pre-ordain any particular outcome. It directs the Treasury Secretary to review and provide a report to the President within 180 days. The review must consider:

- the potential adverse effects of failing financial companies on U.S. financial stability;
- whether OLA is consistent with the Trump Administration's core principles against taxpayer-funded bailouts and in favor of economic growth and vibrant financial markets;
- whether invoking OLA could result in a cost to the general fund of the Treasury;
- whether the availability or use of OLA leads or could lead to excessive risk taking on the part of creditors, counterparties, and shareholders, or otherwise leads market participants to believe that a financial company is "too big to fail"; and
- whether a new chapter to the Bankruptcy Code would be a superior method of resolution for financial companies.

In recent years, legislation has been passed in the House and proposed in the Senate that would add a new Chapter 14 (or subchapter V of Chapter 11) to the Bankruptcy Code. The purpose of this proposed legislation has been to increase the legal certainty that a financial group could be resolved using a single-point-of-entry (SPOE) resolution strategy. Under an SPOE strategy, only the top-tier financial holding company parent would be put into a bankruptcy proceeding. The assets of the parent would be used to recapitalize its operating subsidiaries, which would then continue operating or be wound down in an orderly manner outside of their own insolvency proceedings. The ability to successfully implement an SPOE strategy under the Bankruptcy Code would substantially reduce the risk that the resolution of a large, complex financial group under the Bankruptcy Code would have serious adverse effects on U.S. financial stability. This would in turn substantially reduce the possibility that OLA could be legally invoked.

The bankruptcy reform bill in the House is called the Financial Institutions Bankruptcy Act (FIBA). It first passed the House in 2014 and again in slightly amended form in 2016 and 2017. It has also been included in both versions of the Financial CHOICE Act, which included a repeal of OLA. See our prior [blog post](#) on the CHOICE Act. The bill in the Senate is called the Taxpayer Protection and Responsible Resolution Act (TPRRA), and it was introduced in 2013 by Senators Cornyn and Toomey, and has been coupled with a proposed repeal of OLA.

The proponents of OLA's repeal argue that its Orderly Liquidation Fund (OLF) provision, which gives the FDIC authority to borrow money from the Treasury and use it to provide funding to a financial company in an OLA proceeding, would, or at least could, be misused to provide a taxpayer-funded bailout. The defenders of OLA argue that the FDIC has publicly stated that it will only use the OLF to provide temporary liquidity to recapitalized firms on a fully secured basis at above-market interest rates, and will not misuse the OLF to provide a taxpayer-funded bailout. All of the losses of a failed firm will therefore be imposed on its shareholders, creditors and other stakeholders, and not the taxpayers. The defenders also warn that a complete repeal of OLA would remove an important back-up tool to resolve large financial companies in a crisis.

Given the high level of attention this topic has received from both Congress and the private sector, we expect that the Treasury Secretary will request and receive substantial input on this issue in the coming months. Notably, when asked at a press conference the day before the Presidential Memorandum was formally released as to whether he anticipates ultimately repealing OLA or if he believes there is some middle ground, the Treasury Secretary responded that the Administration would be listening to a variety of views—including regulators' views, the views of people in the previous administration and the views of people impacted by the financial crisis—and would be taking all of them into account in concluding what the Administration believes makes sense.

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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