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Big Banks Will Now Be Resolved Without Bailouts*

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“In my view, we are at a point today that if a systemically important financial institution in the United States were to experience severe distress, it would be resolved in an orderly way under either bankruptcy or the public Orderly Liquidation Authority.”

- Chairman Gruenberg, April 21, 2016, Amsterdam, The Netherlands.

This statement should clarify that failed big banks no longer will be kept alive with financial assistance in times of crisis. Those who want to break up the big banks because otherwise they would not be permitted to fail must therefore look for other reasons to do so.

Chairman Gruenberg update on resolution of large banks

Martin Gruenberg, Chairman of the FDIC, delivered an important message in a speech in April before the High Level Seminar sponsored by Eurofi in Amsterdam, The Netherlands (***Text of the speech***). He systematically discussed the progress made by the FDIC and other U.S. regulators in addressing the dilemma posed in 2008 when the financial crisis found jurisdictions around the world unprepared to deal with the failure of a global, systemically important financial institution yet were faced with just that in the form of a few such institutions in different countries. The option chosen at that time was to provide financial assistance to a broad spectrum of institutions, some very large and many not so large and, in fact, rather small. In the Dodd-Frank Act, the U.S. government vowed not to let itself be placed in that position again, and since then arguments have focused on the assistance provided to the very large institutions.¹

The loudest voices heard since then are those that say big banks should be dismembered, broken into smaller pieces in some way and sold off so that governments will not be given only a Hobson's

*The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

¹Never mind that the assistance was not wanted or needed by some of the institutions or that all of the large banks repaid the assistance quickly and at a profit to the government. Non-banks took longer to repay.

choice in future crises. They argue that without those draconian and dangerous solutions, the government will provide assistance to those banks when faced with a situation in the future comparable to that found in the 00s.

Chairman Gruenberg discussed the work that has been done by the U.S. regulators on living wills and on orderly resolution authority as well as the continuing good cooperation among the regulators of the first world countries, since those are key ingredients in the congressional effort to avoid “bailing out” the big banks in the future.

With respect to living wills, he pointed out that in the most recent submissions by big banks memorializing the way big banks could be resolved without bail outs and without systemic effects, many of the largest banks failed to prepare sufficient “living wills,” that is, sufficiently detailed and well-crafted pathways to resolving their situations in bankruptcy if they were to be faced with an extremely severe economic situation. Those that failed were given a few months to remediate the deficiencies in their documents.²

He mentioned that failure of the firms to correct their deficiencies could result in them being forced to operate under more stringent prudential requirements than even the severe requirements under which they now operate. His comments were measured, however; he did not express major concern.

With respect to Orderly Liquidation Authority, an alternative public receivership provided under Title II of DFA to that of bankruptcy should certain large firms be in severe stress,³ Chairman Gruenberg said that the FDIC has made significant progress in developing the operational capabilities demanded by that procedure to carry out a resolution if necessary.⁴ The FDIC, of course, would have major responsibility for implementing Title II, and its ability to manage the tools provided in the Dodd-Frank Title II toolkit is essential to an orderly resolution. Chairman Gruenberg expressed confidence in the ability of the Corporation to do its assigned job.

He then stated that the government was in a good position to resolve the failures of any of the large institutions:

In my view, we are at a point today that if a systemically important financial institution in the United States were to experience severe distress, it would be resolved in an orderly way under either bankruptcy or the public Orderly Liquidation Authority.

Chairman Gruenberg recognized that global understandings on resolution were also important. The Herstatt bank failure in Germany and the Franklin National Bank failure in the U.S. made it painfully clear to U.S. and U.K. regulators that greater cooperation between regulators in those two countries (and other developed countries) was necessary. Absent that, chaos would follow from the

²On the other hand, and not stressed as much in the media, other large institutions they reviewed did satisfactorily create such a pathway, albeit they were left with some technical problems to resolve.

³Theoretically, any firm that successfully passes its living wills test could be resolved in bankruptcy proceedings since that is the basis for the review. Those that could not would have to be resolved through a federal receivership under Title II. The government is not limited in using that process only for those that failed their living wills reviews, however.

⁴Comparable conclusions have been reached about the performance of the big banks. *Banks and Regulators Converging on Living Wills.*

failure of other banks with portfolios similar to those two banks. Efforts toward such cooperation began immediately, and now global cooperation and agreements on regulation and supervision are the norm.⁵

While Chairman Gruenberg did not signal that all work that needs to be done has been done, he did say that progress internationally has been good:

I believe that these examples [multi-national and bilateral discussions of cross-border resolutions, TLAC agreements, ISDA protocol for stays on derivative contracts] demonstrate a transformed environment for cross-border cooperation on systemic resolution from that which existed before the financial crisis.

It seems clear that Chairman Gruenberg does not believe that the international nature of failing large banks will prevent their orderly windup either through bankruptcy or Orderly Resolution Authority.

The statement that big banks not only can, but would now be resolved without causing the rest of the system to collapse is a benchmark conclusion by a U.S. regulator. That is the nub of the statement from Chairman Gruenberg that resolution would be effected through bankruptcy or Orderly Liquidation Authority. Adding to the significance of this statement is the realization that this regulator has never been seen to be a spokesperson for the big banks, and therefore his conclusions can be given added weight.

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⁵ I attended the small meeting with Peter Cooke at the FDIC on his initial trip to the U.S. to discuss with U.S. regulators his idea of closer regulatory cooperation that ultimately led to the formation of the Basel Committee. While the world has changed since then, his vision of closer international regulatory cooperation bore fruit quickly and since then profusely.