July 2012

BANKRUPTCY

Agencies Continue Rulemakings for Clarifying Specific Provisions of Orderly Liquidation Authority

GAO Accountability * Integrity * Reliability

Highlights

Highlights of GAO-12-735, a report to congressional committees

Why GAO Did This Study

The Dodd-Frank Act created OLA for resolving failed, systemically important financial companies. Since the act was passed in 2010, regulators have been developing regulations to implement this authority and avoid disorderly resolutions that create substantial losses for the financial system. In July 2011, GAO issued the first of its statutorily mandated reports on the effectiveness of the Bankruptcy Code for resolving or liquidating complex, internationally active financial companies. Among the topics examined in this second report, GAO reviewed: (1) federal rules or regulations relating to OLA and the resolution of financial institutions, including living wills; and (2) status of efforts to improve coordination on international resolutions, data collection efforts, and the outcomes of financial institutions that were in the bankruptcy process.

To address these objectives, GAO reviewed agencies' draft and final rules related to OLA and comment letters submitted. GAO continued to monitor developments related to the Lehman Brothers and Washington Mutual bankruptcies, and began monitoring a recent bankruptcy filing by MF Global. GAO also studied available data on the number of financial company bankruptcies and met with relevant agency and court officials.

GAO makes no new recommendations in this report. GAO provided a draft for comment to AOUSC, the Department of the Treasury, and federal financial regulators. None provided written comments and technical comments have been incorporated, as appropriate.

View GAO-12-735. For more information, contact Alicia Puente Cackley at (202) 512-8678 or cackleya@gao.gov.

What GAO Found

The federal financial regulators have issued certain final rules for resolving large, complex financial companies under the Dodd-Frank Wall Street Reform and Consumer Protection Act's (Dodd-Frank Act) established Orderly Liquidation Authority (OLA). Under OLA, the Federal Deposit Insurance Corporation (FDIC) could serve as receiver of a failing financial company instead of the company entering the bankruptcy process. Regulators continue to address a number of issues related to FDIC's new authority, including how creditors will ensure that they receive no less than they would under a Chapter 7 bankruptcy liquidation; how certain assets and liabilities would be treated in a new company created by FDIC under OLA; and what role the Securities Investor Protection Corporation would play in the resolution of a broker-dealer under OLA. Regulatory officials reported that they were continuing to draft rules to clarify how OLA would be used. FDIC and the Board of Governors of the Federal Reserve (Federal Reserve) also have issued final rules requiring certain financial companies to file resolution plans or "living wills" that must detail how companies would resolve their operations through an orderly bankruptcy. Regulators told GAO that the plans also would help FDIC plan for the exercise of its resolution authority, including OLA. The filing dates for these plans are phased in over the next year and a half, with the first group of financial companies filing their first plans on July 1, 2012. However, "nonbank financial companies" that also will need to provide plans have yet to be designated.

International coordination remains a critical component in resolving the failure of a large, complex financial company and regulators have been taking steps to address this and are testing new data collection efforts. Specifically, efforts are under way to develop a universal legal entity identifier that allows companies to identify and manage risks from companies with which they are engaged in financial transactions. This additional information could help regulators in resolving internationally active financial companies. Data to identify financial institutions filing for bankruptcy protection as well as their outcomes are limited. Since neither FDIC nor federal judicial agencies have a database that tracks financial companies in bankruptcy, the Administrative Office of the U.S. Courts (AOUSC) and the Federal Judicial Center have begun a new effort to track financial company bankruptcies, but reported court data are untested for this purpose. Several large financial institution bankruptcies are still in progress. Two of the largest financial company bankruptcies, Lehman Brothers Holdings Inc. (Lehman Brothers) and Washington Mutual, Inc.—both of which filed in September 2008—recently had their reorganization plans confirmed by creditors and approved by the courts. However, these cases are not yet fully resolved. In the Lehman Brothers case, international litigation could take several years to resolve. The October 2011 bankruptcy of MF Global Holdings Ltd., a holding company with a securities and commodities broker, has raised concerns about how commodity customers are treated under a liquidation regime and also involves international litigation over customer property. These financial company bankruptcies highlight the challenges FDIC and other regulators would face in resolving large, complex financial companies under the OLA process.