Title I: ENDING "TOO BIG TO FAIL" AND BANK BAILOUTS

Repeal of Orderly Liquidation Authority and Creation of Subchapter V

Title II of the Dodd-Frank Act created the orderly liquidation authority ("OLA"), which enables federal regulatory authorities to place a large financial company into a receivership if its failure under ordinary insolvency law would have a serious adverse impact on U.S. financial stability. In the years following the enactment of the Dodd-Frank Act, a 'single point of entry' approach was developed which became the preferred strategy of operationalizing OLA. The approach aims to take advantage of the fact that U.S. financial conglomerates are largely organized under a holding company structure with a top-tier parent holding company and multiple operating subsidiaries. Under this approach, upon failure of a large financial institution, the parent holding company would be put into an FDIC receivership with the institution's bank, broker dealer and other operating subsidiaries remaining open for business.

Title II also created the orderly liquidation fund ("OLF") which can be utilized during an OLA proceeding to make loans to the institution being resolved or its covered subsidiaries, acquire debt, purchase assets or guarantee them against loss, assume or guarantee obligations, and make payments.

Title I of CHOICE Act 2.0 would repeal OLA and replace it with a new subchapter under the Bankruptcy Code, to be located in Subchapter V of Chapter 11 of the Bankruptcy Code. Subchapter V, the details of which are outlined below, would be generally similar to OLA in that it is intended to facilitate the SPOE strategy that most globally systemically important banks have adopted in their resolution plans. There would be no equivalent to the OLF in the new Subchapter V.

Key provisions of Subchapter V are as follows:

- *Covered institutions*. Subchapter V applies only to "covered financial corporations," essentially defined as BHCs, as well as holding companies with total consolidated assets of $50 billion or more and with 85% of the most recent fiscal year consolidated annual gross revenues or consolidated assets derived from or related to financial activities/ownership of insured depositary institution(s).
- *Commencement*. A Subchapter V case may be commenced by the debtor (the financial institution) under penalty of perjury that it is a "covered financial corporation." The members of the Board of Directors of a covered financial institution would not be liable to shareholders, creditors, or other parties in interest for a good faith filing of a petition to commence a case, or for any reasonable action taken in good faith in connection with the filing, whether prior to or after commencement of the case. Subchapter V does not provide for an involuntary bankruptcy proceeding.
- *Regulator Involvement*. The Federal Reserve, SEC, OCC, CFTC and the FDIC may raise and may appear and be heard on any issue in any case or proceeding under Subchapter V.

- *Special transfer of property of the estate*. Subchapter V contemplates that, at the request of the trustee, and after a hearing to occur not less than 24 hours after the order for relief, the court may order a transfer of property of the estate, the assignment of executory contracts, unexpired leases, and qualified financial contracts ("QFCs") of the debtor, to a bridge company. In making the decision, the court must consider, among other things, whether: (i) the transfer is necessary to prevent serious adverse effects on financial stability in the United States, and (ii) the transfer does not provide for the assumption of any capital structure debt (i.e., unsecured debt of the debtor, excluding claims under QFCs) or equity of the debtor.
- *Special trustee*. An order approving the transfer to the bridge institution requires the trustee to transfer all of the equity securities in the bridge company to a qualified and independent special trustee to hold in trust for the sole benefit of the estate. The special trustee would be appointed by the Bankruptcy Court and the Federal Reserve must be consulted regarding the identity of the special trustee. The special trustee would be required to file notice with the court of, among other things, material corporate actions of the bridge company (e.g., recapitalizations, material borrowings, asset sales, and issuances or sales of bridge company securities). The special trustee would be also permitted to dispose of the equity securities of the bridge company in accordance with the trust agreement. However, before any sale, the special trustee must consult with the FDIC and the Federal Reserve and disclose the results of such consultation with the court. Proceeds of the sale must be held in trust for the benefit of the estate, and ultimately, be distributed pursuant to a Chapter 11 plan, or as ordered by the court if there is a Chapter 7 conversion.
- *Temporary and supplementary automatic stay*. A bankruptcy petition under Subchapter V would operate as a temporary and supplementary stay, applicable to all entities, of the termination, acceleration, or modification of any debt, contract, lease or agreement of any kind.
- *Treatment of qualified financial contracts and affiliate contracts*. The filing of the petition would also operate as a stay on the cross-default and termination provisions of QFCs and other executor contracts and debts, and those of affiliates. Additionally, the bridge company would be required to assume all QFCs and related claims and affiliate contracts with a particular counterparty or assume none (i.e., no cherry-picking of contracts).
- *Licenses, permits and registrations*. If a request for the special transfer of property of the estate is made, any federal, state or local license, permit or registration that the debtor or an affiliate held immediately prior to the commencement of the case would not be permitted to be accelerated, terminated or modified solely on account of the insolvency of the debtor, the commencement of the case, the appointment of a trustee or a special transfer.
- *Exemption from securities laws*. A security of the bridge company would be deemed to be a security of the debtor's successor if the court approves the disclosure statement for the plan as providing adequate information.

- *Inapplicability of certain avoiding powers*. A transfer made prior to or after the commencement of the case would not be avoidable under traditional bankruptcy or non-bankruptcy law.
- *Financial stability concerns*. The Subchapter V plan would only be approved if all payable fees, costs and expenses of the special trustee had been paid or provided for and the plan was found to be unlikely to cause serious adverse effects on the financial stability of the United States. The court would be permitted to consider the effect that *any* decision in connection with Subchapter V may have on financial stability in the United States.
- *Judge for a case under Subchapter V*. The Chief Justice of the United States would be required to designate not fewer than 10 bankruptcy judges to hear a Subchapter V case. The judge would be randomly assigned to hear the case by the Chief Judge of the Court of Appeals for the circuit in which the case is pending.

Repeal of Obligation Guarantee Program

CHOICE Act 2.0 would repeal certain emergency stabilization provisions created by the Dodd-Frank Act, including Sections 1104, 1105 and 1106 of the Dodd-Frank Act. Section 1104 provides that, upon a determination of both the FDIC and the Federal Reserve that a liquidity event exists that warrants use of the guarantee program provided for under Section 1105 of the Dodd-Frank Act, the FDIC would be permitted to create a widely available program to guarantee obligations of solvent insured depository institutions or solvent deposit institution holding companies (and their affiliates). Section 1106 suspends the FDIC's parallel authority under section 13(c)(4)(G) of the Federal Deposit Insurance Act to establish a widely available debt guarantee program.

Repeal of Systemic Risk Determination in Resolutions

CHOICE Act 2.0 would repeal section 13(c)(4)(G) of the Federal Deposit Insurance Act which operates as a "systemic risk" exception to the "least-cost resolution" requirement. The exception allows the FDIC to take necessary actions or provide assistance to an insured depository institution if the Secretary of the Treasury (in consultation with the President) determines that: (i) the institution would have serious adverse effects on economic conditions or financial stability of the United States, and (ii) any action or assistance under that paragraph would avoid or mitigate such adverse effects.

Restrictions on Use of the Exchange Stabilization Fund

CHOICE Act 2.0 would also prevent the use of the ESF, a Department of the Treasury fund designed for foreign exchange intervention and international financial support operations, as a guarantee for nongovernmental entities. This is in response to the ESF being used as a guarantee of the Temporary Liquidity Guarantee Program for certain money market funds in September 2008. Additionally, it would prohibit the use of the ESF to prevent the insolvency of "any entity."

Reforms to FSOC

Title I of the Dodd-Frank Act created the FSOC and tasked it with identifying risks to the financial stability of the United States, promoting market discipline, and responding to emerging threats to the stability of the U.S. financial system. The Dodd-Frank Act also authorizes the FSOC to designate certain nonbank financial companies as nonbank systemically important financial institutions ("SIFIs") if it determines that such institutions could pose a threat to the financial stability of the United States and thus subject it to enhanced supervision and regulation. CHOICE Act 2.0 would repeal FSOC's authority to designate nonbank SIFIs and repeal all designations that have been made, along with the enhanced prudential standards in respect of these designated financial institutions. CHOICE Act 2.0 would also repeal Title VIII of the Dodd-Frank Act, which authorizes the FSOC to designate central counterparty clearinghouses or CCPs and payment systems as systemically important financial market utilities, or SIFMUs. As a result, SIFMUs would no longer have access to the Federal Reserve's discount window.

While CHOICE Act 2.0 would not abolish the FSOC, it would make significant reforms to its structure and oversight. For example, CHOICE Act 2.0 would modify the FSOC's membership to include all members of multi-member agencies (i.e., the SEC, Federal Reserve, FDIC, OCC, CFTC and NCUA) with each agency collectively having one vote on the FSOC, I addition to the directors of the Consumer Law Enforcement Agency ("CLEA") and the FHFA. The members of the multi-member agencies would themselves have to vote to determine the agencies' vote at the FSOC meeting. CHOICE Act 2.0 would also create more transparency in respect of the FSOC. For example, members of the authorization and oversight committees of the House Financial Services and Senate Banking Committees would be permitted to attend all public FSOC meetings, and the FSOC would be required to create transcripts for all non-public meetings. The FSOC would be subject to both the "Government in the Sunshine Act" and the Federal Advisory Committee Act.

CHOICE Act 2.0 would also eliminate the Office of Financial Research, an independent office that was created within the U.S. Department of the Treasury by the Dodd-Frank Act. Finally, CHOICE Act 2.0 would authorize $4 million to be appropriated to the FSOC to carry out its duties. Its budget previously came out of the Office of Financial Research's budget.

Resolution Plans

CHOICE Act 2.0 would vest the living will process solely with the Federal Reserve and amend section 165(d) of the Dodd-Frank Act to eliminate the FDIC's role in the process. Among other changes, CHOICE Act 2.0 would:

- reduce the frequency of living will submissions to every 2 years;
- require the Federal Reserve to provide feedback on "living wills" to banking organizations within six months of their submissions of the resolution plans; and

- require the Federal Reserve to publicly disclose its resolution plan assessment framework and subject such framework to notice and comment.

CHOICE Act 2.0 also provides that any other federal banking agency that requires the submission of a resolution plan would adhere to the limitations on the resolution planning process described above which, in effect, would result in the application of these new requirements to insured depository institution resolution plans that are required to be submitted to the FDIC.

Stress Testing

CHOICE Act 2.0 would overhaul the current stress testing regime for banking organizations, including introducing a number of new provisions to reduce the burden of the stress testing exercises.

The key changes in respect of DFAST would include:

- requiring the Federal Reserve to issue regulations, after providing for notice and comment, that provide for at least three different sets of conditions under which the evaluation required by Section 165 of the Dodd-Frank Act would be conducted (baseline, adverse and severely adverse) and disclose the methodologies, including models used to estimate losses, used by the Federal Reserve;
- eliminating DFAST requirements for financial companies other than BHCs;
- removing the semi-annual submission of company run DFAST; and
- requiring the Federal Reserve to publish a summary of all stress test results.

The key changes in respect of CCAR would include:

- applying the requirements detailed above and within CHOICE Act 2.0 in respect of DFAST to the parameters and consequences applicable to CCAR;
- removing the potential for the Federal Reserve to object to a company's capital plan on the basis of qualitative deficiencies in the company's capital planning process;
- enabling a company to amend its capital plan and resubmit a new streamlined plan at any time if a company receives a quantitative objection to its plan; and
- requiring the Federal Reserve to establish and publish procedures for responding to inquiries from companies subject to CCAR, including establishing the timeframe in which such responses would be made, and making such procedures publicly available.

Miscellaneous Provisions

- *Notice and hearing requirements*. Notice and hearing requirements of Section 3(b)(1) of the BHC Act would only be permitted to be waived in the event that a company is becoming a BHC in order to acquire a bank that is critically undercapitalized.

- *Concentration limits*. CHOICE Act 2.0 would amend the BHC Act to remove concentration limits for financial companies but would retain all such limits for banking organizations.
- *Operational risk capital requirements*. CHOICE Act 2.0 would prohibit federal bank regulators from establishing an operational risk capital requirement for banking organizations, unless such requirement, among other things: (i) is based on risks posed by a banking organization's current activities and businesses, (ii) is appropriately sensitive to the risks posed by such current activities and businesses, and (iii) permits adjustments based on qualifying operational risk mitigants.