Can Regulators End Too Big to Fail?

A Discussion of Dodd-Frank Resolution Planning

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Overview

- Title I vs Title II of Dodd-Frank
- Two Key Questions About Orderly Resolution
- Single Point of Entry vs Multiple Point of Entry Resolution

Dodd-Frank Title I

- Banks must demonstrate through resolution plans that they can achieve an orderly resolution through conventional bankruptcy.

- Regulators must either certify that banks have laid out a credible path to such resolution, or take steps to downsize and/or reorganize them so they can.

Dodd-Frank Title II

- Gives the FDIC receivership powers to achieve an orderly resolution
- Supported by a Treasury (public) liquidity financing mechanism.
- FDIC rulemakings vs bank plans
- Section 214 requires liquidation of bank.

Key Question #1:
Is Orderly Resolution Even Possible?

- What makes resolution 'orderly'?
- Limit economic disruption to third parties.
  - Fear of disruption > ad hoc taxpayer bailout.
- No taxpayer costs.
- Liquidate or restructure failing banks
  - 'zombie banks' create significant economic harm
  - Disorderly liquidation can also destroy economic value

Barriers to Orderly Resolution

- Size
- Complexity
  - International operations
  - Range of business lines and subsidiaries
  - Internal organization
- Need for financing sources scaled to bank size

Key Question #2: Is Resolution A 'Disguised Bailout'?

- What if our orderly resolution mechanism involves substantial public support?
- What if our orderly resolution mechanism does not truly restructure the bank?
- What if the costs of orderly resolution fall on 'innocent' parties?
  - Retail depositors, middle class pensioners.
- Will our orderly resolution mechanism hold responsible parties accountable?

Single Point of Entry (SPOE)

- Resolution powers are applied directly only to the top-level holding company.
- Subsidiaries below the holding company are recapitalized using long-term debt held by the holding company.
- Recapitalized subsidiaries continue to operate, transferred to new entity.
- Advantages and Disadvantages
  - Feasibility? (Key Question #1)
  - Chance of 'disguised bailout'? (Key Question #2)

Multiple Points of Entry (MPOE)

- Application of resolution powers directly to single or multiple subsidiaries.

- Individual subsidiaries may cease to operate, be broken off, or sold.

- Advantages and disadvantages.