BETTER MARKETS

Ending Too-Big-to-Fail by Breathing Life into "Living Wills"

By Dennis Kelleher and Frank Medina

Policy Brief | January 2016

JP Morgan Chase CEO Jamie Dimon was right when he testified before Congress about the need to ensure that there are no dangerous too-big-to-fail megabanks on Wall Street by making them all resolvable in bankruptcy like every other company in the United States:

> We have to get rid of anything that looks like too-big-to-fail. We have to allow our big institutions to fail. It is part of the health of the system, and we should not prop them up. We have to allow them to fail. And I would go one step further. You want to be sure that they can fail and not damage the American economy and the American public.
>
> So a big bank, you want to be in a position where a big bank can be allowed to fail. I would not call it "resolution." I think that is the wrong name. I think we should call it "bankruptcy." Personally, I call it "bankruptcy for big dumb banks."
>
> I think that when you have bankruptcy, I would have clawbacks. I would fire the management. I would fire the board. I would wipe out the equity and the unsecured [creditors] should only recover whatever they recover like in a normal bankruptcy. . . .
>
> We are also in favor of one other thing, by the way, which is if the FDIC ever puts money into this bank—but I think the bank should be dismantled after that and the name should be buried in disgrace. So there's a little Old Testament justice here.[1]

We agree with Mr. Dimon: Capitalism and free markets are grounded on the bedrock principal that when a private company fails, it goes into bankruptcy. In bankruptcy, the shareholder and

---

[1] Testimony of Jamie Dimon, Chairman and CEO of JPMorgan Chase & Co. before United States Senate Committee on Banking, Housing, and Urban Affairs, Hearing on "A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?" June 13, 2012, *available at* https://www.gpo.gov/fdsys/pkg/CHRG-112shrg78850/pdf/CHRG-112shrg78850.pdf.

creditors of the failed company bear the losses, and the executives that drove the firm into bankruptcy are often (but not always) replaced. That is true for all companies in America, except for one group: the dangerously too big, leveraged, complex and interconnected banks and non-bank financial companies that pose a threat to the financial system and the economy of the United States ("too-big-to-fail" for shorthand).

Unfortunately, too-big-to-fail banks and non-bank financial firms proliferated in the financial industry before the crash of 2008. As a result, when the financial crisis hit, the government had to use trillions of dollars to bail out those too-big-to-fail banks and firms to prevent their bankruptcy from precipitating a second Great Depression.[2]

Fortunately, the financial reform law passed in 2010 (entitled the "Dodd-Frank Act") was largely directed at making sure that the government would never have to bail out these kinds of banks and firms again by ending too-big-to-fail. Remarkably, the Dodd-Frank Act included most of Mr. Dimon's thinking on too-big-to-fail and bankruptcy. For example, credible resolution plans for bankruptcy—so-called "living wills"—are an essential part of the Dodd-Frank Act and a crucial part of ending too-big-to-fail.

The law requires too-big-to-fail banks to have "living wills": detailed roadmaps that allow them to be resolved in a traditional bankruptcy proceeding, without using taxpayer funds to bail them or their creditors out, and without imperiling the financial system. If the "living wills" submitted by the banks aren't credible, the regulators can force these institutions to reorganize themselves. If these institutions still can't show that they can be resolved in bankruptcy without bailouts, then the regulators have the authority to break these institutions up.

In summary, the law requires too-big-to-fail banks to plan for their own corporate demise in a way that will eliminate or minimize the collateral consequences to the financial system and the country. And, importantly, if they do not provide a credible plan to do so, then regulators have the substantial authority to require the too-big-to-fail bank to downsize, making it resolvable in bankruptcy like every other corporation in America.

For these reasons, experts, regulators, and financial market participants believe that "living wills" represent a substantial step toward ending too-big-to-fail. These expectations were bolstered in the summer of 2014, when the regulators rejected all eleven of the "living wills" that the eleven biggest too-big-to-fail banks submitted. Rejecting all the submissions indicated that regulators took their "living wills" mandate seriously, and that large financial institutions would in fact be required to demonstrate that they could be resolved in bankruptcy.[3]

---

[2] Although a second Great Depression was avoided, the costs of the crash and the economic crisis it caused will be more than $20 trillion, as detailed in Better Markets *The Cost of the Crisis* (July 2015), *available at* https://www.bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis.pdf.

[3] These grossly deficient submissions and the regulators' rejection of them highlight an enormous tension in the "living wills" process: while the "living wills" process is essential in ending too-big-to-fail, the process largely relies on the too-big-to-fail banks who are powerfully and irresistibly incentivized to make sure too-big-to-fail is never ended

This was a good and essential start, but there's still much more to do before too-big-too-fail firms are fully and properly subject to the discipline of the free market and capitalism. Regulators must improve the "living wills" process in several ways, including the following:

- The regulators have provided far too little information about the purposes, methods, and criteria that underlie the "living wills" process. They must provide substantially more information to the public about this entire process. We suggest that the Federal Reserve, at least initially, use its CCAR stress-testing program as a model for how and how much to disclose in the "living wills" process.

- The publicly available summaries of the "living wills" contain very little information, which makes it impossible for an institution's creditors, shareholders or its counterparties (*i.e.*, the market) to accurately price for risk, which defeats any meaningful market discipline, and thereby undermines the credibility of the "living wills" process. The regulators should require much greater public disclosure about the information contained of the "living wills," if not public disclosure of the "living wills" themselves." Greater public disclosure would not only strengthen market discipline but also improve the credibility of the "living wills" process.

- Resolution under the bankruptcy code is a multiparty process that requires negotiation and coordination among an institution's management, creditors, counterparties, and sources of debtor-in-possession financing. Yet under the current "living wills" process, the only participants in the process are the institution that submits the "living will" and the regulators who review it. The regulators should seek the input of an institution's major creditors, potential sources of financing, and potential purchasers of assets in the "living wills" process.

- Although the Dodd-Frank Act requires that "living wills" facilitate an orderly resolution under the Bankruptcy Code, the publicly available portions indicate that the measures being contemplated by the institutions and the regulators are inconsistent with the requirements of bankruptcy law. The regulators should establish advisory committees consisting of independent bankruptcy scholars, lawyers, and judges to provide technical expertise about resolution of too-big-to-fail firms under the bankruptcy code. (For this to be credible, all committee members must be in fact independent and have no direct or indirect conflicts of interest.)

(at least for them). Put differently, if too-big-to-fail means getting taxpayer bailouts and avoiding bankruptcy and all the bad things that come from that (*i.e.*, management losing jobs, shareholders wiped out, creditors losing money, etc.), then why would any too-big-to-fail firm want to become <u>not</u> too-big-to-fail? While the too-big-to-fail firms and their allies all say they are for ending too-big-to-fail (and, indeed, many are claiming that it is already ended), the reality is that they are going to have to be forced to become <u>not</u> too-big-to-fail. *See* "Wall Street's Too-Big-To-Fail Banks Still Trying to Get Taxpayer Bailouts" (Aug. 6, 2014), *available at* https://www.bettermarkets.com/blog/wall-streets-too-big-fail-banks-still-trying-get-taxpayer-bailouts.

- One of the biggest impediments to a credible resolution under the Bankruptcy Code is the billions of dollars of funding required to carry out a reorganization in bankruptcy. The regulators should require financial institutions that submit "living wills" to disclose publicly the amount of financing necessary to effectuate a reorganization under the Bankruptcy Code and the source of that funding under various scenarios.

Background: The State of Play of "Living Wills"

Section 165 of the Dodd-Frank Act requires large bank holding companies to submit "resolution plans"—popularly known as "living wills"— that show how these firms can be resolved if they fail in a bankruptcy court like every other business in America. The Dodd-Frank Act requires that these resolution plans must be "credible" and "facilitate an orderly resolution" of the company under the U.S. bankruptcy code.

If the Fed and the FDIC find that the plan is not credible or would not facilitate an orderly resolution under the bankruptcy code, the Fed and the FDIC notify the company of the deficiencies in the plan. The company must then resubmit the plan with revisions that show that the plan is credible and would result in an orderly resolution under the bankruptcy code.

In 2013, 11 of the largest banks submitted their "living wills" to the regulators. The Fed and the FDIC rejected all 11 plans on the grounds that they were based on "unrealistic or inadequately supported" assumptions—for example, the organizations had assumed that the government would provide funding to facilitate a bankruptcy. The Fed and the FDIC also found that current structures of these organizations were so complex that resolving them in a bankruptcy proceeding would be difficult or impossible.

These 11 organizations have resubmitted their "living wills," and the Fed and the FDIC are now reviewing these resubmitted plans to determine if they are credible. If the regulators find them to be inadequate, they can take actions that would make the company less likely to fail and pose a systemic risk to the financial system. For example, the Fed can require these firms to meet higher capital, leverage, and liquidity requirements. The Fed can also restrict the growth, activities, and operations of the company. Finally, if after all that, the Fed and FDIC determine that the plans are still not credible, then the regulators can order the institution to divest assets and become smaller.

Recommendations

Even though the "living wills" process is off to a promising start, the process can be and must be improved in a number of key ways if they are to fulfill their intended purpose.

1. ***The regulators should provide greater information and clarity about the purposes, methods, and criteria that underlie the "living wills" process.***

Despite the importance of the "living wills" process to ending the problem of too-big-to-fail, the Fed and the FDIC have provided surprisingly little information about the purpose, methods and criteria behind the "living wills" process. The Fed's relatively greater transparency in explaining its stress-test program shows how the regulators can provide more insight into the purposes and methods that underlie the "living wills" process.

In comparison to the "living wills" process, the Federal Reserve has been significantly more transparent about its stress- testing program. The Fed's website contains several speeches from Fed governors—and one from Chairman Bernanke himself—devoted entirely to explaining the Fed's stress-testing program.[4] Fed economists and staff have written multiple reports about the methodology, criteria, and aims behind the stress tests.[5] And each year, the Fed issues an annual report on its stress-testing program, complete with appendices showing how individual banks fared on the stress tests.[6]

In stark contrast, there is very little that the Fed has put out to explain the "living wills" process. At best, the "living wills" process receives cursory mentions in speeches.[7] And after reviewing thousands of pages of confidential documents that were off limits to market participants and the public, the regulators put out only two pages explaining why they rejected the "living wills" of 11 of the largest financial institutions in the world.[8]

The regulators should provide greater clarity about the underlying purpose for which they are using the "living wills." Doing so would help explain to the public, market participants, and

---

[4] *See, e.g.,* Chairman Ben S. Bernanke, "Stress Testing Banks: What Have We Learned?" (April 8, 2013), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20130408a.htm; Vice Chairman Stanley Fischer, "Supervisory Stress Testing of Large Systemic Financial Institutions," (June 24, 2015), *available at* http://www.federalreserve.gov/newsevents/speech/fischer20150624a.htm; Governor Daniel K. Tarullo, "Stress Testing After Five Years," (June 25, 2014), *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20140625a.htm.

[5] *See, e.g.,* Beverly Hirtle and Andreas Lehnert, "Supervisory Stress Tests," Staff Report No. 696 (Nov. 2014), *available at* https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr696.pdf; James McAndrews, "Economic Research and Stress Testing" (June 24, 2015), *available at* https://www.newyorkfed.org/newsevents/speeches/2015/mca150624; Beverly Hirtle et al., "Assessing Financial Stability: The Capital and Loss Assessment under Stress Scenarios (CLASS) Model," Staff Report No. 663 (revised July 2015), *available at* https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr663.pdf.

[6] *See, e.g.,* Board of Governors of the Federal Reserve System, "Comprehensive Capital Analysis and Review 2015: Assessment Framework and Results" (March 2015), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20150311a1.pdf.

[7] *See, e.g.,* Governor Daniel K. Tarullo, "Toward an Effective Resolution Regime for Large Financial Institutions," (March 18, 2010), *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20100318a.htm and Chair Janet L. Yellen, "Finance and Society," (May6, 2015), *available at* http://www.federalreserve.gov/newsevents/speech/yellen20150506a.htm.

[8] Federal Reserve Board and FDIC, "Agencies Provide Feedback on Second Round Resolution Plans of 'First-Wave' Filers," (Aug. 5, 2014), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20140805a.htm.

financial institutions the rationale behind the "living wills" process and how "living wills" will help end the problem of too-big-to-fail. The regulators should also provide greater clarity about the methods and criteria they are using to evaluate these "living wills," which would give the "living wills" process greater credibility.

For example, regulators should make clear that "living wills" provide them with an additional tool in bank-holding-company supervision. By means of the "living wills" process, the regulators can encourage banks to examine themselves and their corporate structures to rationalize their operations and expose potentially nasty surprises lurking in the background.

The regulators should also make clear that "living wills" are a means for financial institutions to collect—and for regulators to have available—the information necessary to avoid the panics created by bankruptcy filings when there is little or no information available about a large financial institution, its assets and liabilities, its business relationships, or its far-flung business operations. Ideally, if the "living wills" process works, there will be no more "Lehman bankruptcies," in which large financial institutions file for bankruptcy as armies of lawyers and regulators scurry to learn everything they need to know to effectuate such a bankruptcy in 48 hours.

2. *The regulators should require greater public disclosure of the information contained in the "living wills."*

The regulators should require bank holding companies to publicly disclose more information about their "living wills." Right now, the confidential portion of the "living wills"—the portions that the regulators review to determine whether these "living wills" are credible and to which only they have access—run to tens of thousands of pages. By way of contrast, the public summaries the banks themselves disclose are a tiny fraction of the confidential submission. In many cases, the public summaries provide even less information than the annual 10-K report that the institution files with the Securities and Exchange Commission.

The financial journalist Matt Levine pithily assessed the public summaries of the initial round of submissions this way—"Banks Prove That They Are Not Too Big To Fail By Saying 'We Can Fail' on a Piece of Paper":

> One way you could spend this slow week is reading the "living wills" submitted by a bunch of banks telling regulators how to wind them up if they go under. Don't, though: they're about the most boring and least informative things imaginable and I am angry that I read them.[9]

Although the most recent round of public summaries are an improvement over the public summaries that were provided during the first round of the "living wills" process, these

[9] Matt Levine, "Banks Prove That They Are Not Too Big to Fail by Saying We Can Fail on a Piece of Paper," *Dealbreaker* (July 5, 2012), *available at* http://dealbreaker.com/2012/07/banks-prove-that-they-are-not-too-big-to-fail-by-saying-we-can-fail-on-a-piece-of-paper-moving-on/.

summaries still provide little information that would help the public independently assess the credibility of the confidential submission or the regulators' assessment of these plans.

As a result, the public summaries fail in three ways. First, they provide too little information to market participants, including a firm's creditors and counterparties about how their claims would be treated in bankruptcy. This lack of information prevents these parties from appropriately pricing the credit they are extending to these institutions and undermines market discipline. As economists at the Federal Reserve Bank of New York have pointed out,

> By collecting and publicly revealing elements of these ["living wills"], regulators are likely to have a marked effect on information production and security prices. Market participants will have an increased ability to understand the losses they potentially face if their borrowers and counterparties fail—and thus will have an increased incentive to push for changes that make the firm less likely to fail in the first place.[10]

The information contained in these "living wills" thus has the potential to significantly improve market discipline, thereby helping to end the too-big-to-fail problem.

But "living wills" have not been able to live up to this potential. They can't, because the public summaries contain far too little information to be useful to market participants, creditors, or counterparties in pricing risk. As FDIC Vice Chairman Tom Hoenig explains, although the submission and review of these "living wills" is

> a critical supervisory process with major implications for the stability of the industry . . . . Too little of these plans is publicly available, and it would serve investors and the public well to understand better what they might imply for financial stability.[11]

For that reason, Vice Chairman Hoenig has suggested that the "living wills" submitted to the regulators be made public.[12]

Second, the public summaries fail to provide enough information that would allow the public and market participants to independently assess the regulators' determination of the credibility of these "living wills." Instead of being able to determine for themselves whether these "living wills" are credible, the public and market participants have no choice but to take the regulators' word that their determinations are fair and accurate. Providing more information about the contents of these "living wills"—as well as more detailed information about the process and

---

[10] Hamid Mehran and Lindsay Mollineaux, "Corporate Governance of Financial Institutions," Federal Reserve Bank of New York Staff Report no. 539 (Jan. 2012), *available at* http://www.newyorkfed.org/research/staff_reports/sr539.pdf .

[11] "FDIC's Hoenig Urges More Big Bank 'Living Will' Disclosure," First Word (March 2, 2015), *available at* http://www.thedeal.com/first_word/2015/03/fdics_hoenig_urges_more_big_bank_living_will_disclosure.html.

[12] Mayra Rodriguez Valladares, "Living Wills Still Alive for Regulators," NY Times Dealbook (Nov. 6, 2014), *available at* http://dealbook.nytimes.com/2014/11/06/living-wills-still-alive-for-regulators/ .

criteria that are being used to evaluate these "living wills"—would also help protect the credibility and integrity of the regulators that are making judgments about the credibility of these "living wills."

Third, the lack of information in the public summaries reinforces the belief that the implicit taxpayer backstop for too-big-to-fail institutions is alive and well. By limiting the amount of information available to the public, the regulators have adopted a *de facto* "trust us" policy that will result in market participants and creditors believing that the government will bail out the too-big-to-fail banks, just as it did the 2008 financial crisis. It is not enough for the regulators to deem a "living will" to be credible. The public and the market must also have sufficient information about these "living wills" to determine for themselves that these "living wills" are in fact credible and that the government no longer stands behind these too-big-to-fail banks. Until shareholders and creditors believe that the implicit taxpayer backstop has been eliminated, they will not have the ability or the incentive to properly price the risk of lending to these too-big-to-fail institutions.

Right now, the "living will" process is a black box, to both supporters of the process and its opponents. As former FDIC Chairman Sheila Bair pointed out in 2013, the review and assessment of the "living wills" is "not a public process. . . . So you kind of take it on faith" that the regulators are accurately and fairly assessing the credibility of these "living wills."

This lack of transparency—"taking it on faith," as Sheila Bair put it—undermines the credibility of the process. Because the public summaries contain so little information about the underlying "living wills," the public has no way to independently assess the validity of the review process. Instead, the results are used to justify the validity of the process.

Making the "living wills" public—as Vice Chairman Hoenig has suggested—would help make the "living wills" process credible. It would give market participants the opportunity to assess for themselves whether these plans represent a credible means of resolving these institutions under the bankruptcy code, rather than having to "take it on faith" that the regulators made the right determination. Regulators should also give more detailed explanations for their determinations: rather than providing a page-and-a-half statement for the 11 largest banks, the regulators should provide individualized and detailed results, explaining where each bank's "living will" was deficient.[13]

[13] Of course there may be a need to redact legitimately sensitive business information for a period of time (a year maybe), but such issues have not been significant in the stress test context and shouldn't be in the living will context either. The more difficult issue is the banks' ability to reverse engineer and thereby game the living will process. This requires balancing the imperative for much greater disclosure with the regulators need to ensure the process is robust. However, again, this issue is also present in the stress test context and has been addressed reasonably well, although Better Markets believes that, even in the stress test context, much greater disclosure is necessary and possible.

3. The regulators should seek the input of an institution's major creditors, potential sources of funding, and potential purchasers of assets in the "living wills" process.

Some have argued that the "living wills" are analogous to "prepackaged bankruptcies" or a reorganization plan filed under Chapter 11 of the Bankruptcy Code, albeit much more anticipatory. In a prepackaged bankruptcy, management, owners, and creditors negotiate a bankruptcy plan before bankruptcy is filed. The negotiated plan minimizes the cost and disruption of bankruptcy, and some proponents of the "living wills" process believe that the plans submitted to the regulators could help provide a similar roadmap to resolution. In a Chapter 11 reorganization plan, the firm files for bankruptcy and then the parties negotiate a plan that adjusts the claims of creditors and owners so that the firm can continue to function.

But as Baruch University Law Professor Nizan Geslevich Packin explains, "living wills" are quite different from "pre-packaged" bankruptcies or Chapter 11 reorganization plans under the bankruptcy code:

> [U]nlike traditional plans, "living wills" are not the result of multi-party negotiations and planning that result in a deal. As demonstrated in virtually all of the big corporate enterprise bankruptcy cases, reorganization and liquidation plans concerning funding, capital, liquidity and disposition of assets and properties are never developed in a vacuum. Such plans mandate the input of key creditors, different government agencies, and main stakeholders, based on each case's circumstances. Therefore, it would be extremely difficult to prepare such plans without knowing, at least to some extent, which capital markets can or will provide funding to the planning [institution], if need be, and if so, on what terms they will do so, or which purchasers will be willing and able to consummate a purchase of assets.[14]

Professor Baruch's criticism implies one way to breathe life into the "living wills" process: given the multiple parties affected by the bankruptcy of a large financial institution, in such a bankruptcy many different parties would be involved in negotiating a plan and would have to agree to it before the plan could be considered "credible." Yet under the current "living wills" process, the only participants in the process are the institutions that submit the plan and the regulators who review it. The irony, of course, is that under current bankruptcy law, the regulators would play no role in the bankruptcy proceeding itself, and the interests of the firm's managers and shareholders would be subsumed to that of the firm's creditors. At a minimum, the institution's major creditors, potential sources of funding, and potential purchasers of assets should play some role in assessing the credibility of these "living wills."

[14] Nizan Pakin, "The Case Against the Dodd-Frank Act's Living Wills: Contingency Planning Following the Financial Crisis," *Berkeley Business Law Journal* (2013), *available at* http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1093&context=bblj.

4. ***The regulators should establish advisory committees consisting of bankruptcy scholars, lawyers, and judges to provide them technical expertise about resolution under the bankruptcy code.***

The regulators should make clear that the "living wills" they are reviewing comply with the Bankruptcy Code to the greatest extent possible. Although the Dodd-Frank Act mandates that the "living wills" provide for a credible resolution under the Bankruptcy Code, bankruptcy scholars have pointed out that some of the "living wills" diverge significantly from the bankruptcy code—so much so that they violate fundamental principles of bankruptcy.

For example, several of the "living wills" submitted contemplate that before the bank holding company files for bankruptcy, it will downstream capital or liquidity to a failing subsidiary or forgive the subsidiary's debt to the parent to ensure that the subsidiary continues to operate while the holding company goes into bankruptcy. But bankruptcy experts have pointed out that such a pre-petition transfer of assets or forgiveness of debt could be voided as a fraudulent transfer.

According to the publicly available portion of the "living wills" submitted by JPMorgan Chase and Bank of America, the operating subsidiaries of these institutions would be recapitalized through the forgiveness of intercompany debts. But as law professor Stephen Lubben has noted,

> there is no discussion of whether this would be permissible under the bankruptcy code. Prebankruptcy forgiveness might be attacked as a fraudulent transfer, and post-bankruptcy forgiveness would require court approval in the face of the debtor's fiduciary duty to creditors—the holding company's creditors, that is.[15]

At a minimum, such a divergence from the fundamental principles of "Bankruptcy 101" requires acknowledgment and explanation from the institutions that have submitted those plans and the regulators who are reviewing them. More fundamentally, this divergence raises the question of whether these plans are in fact "credible" under the bankruptcy code.

Although the "living wills" process is supposed to provide for a "credible resolution" under the bankruptcy code, given the opacity of the review process it is not at all clear that the banking regulators—whose area of expertise is bank supervision, not bankruptcy—are reviewing these plans from the perspective of bankruptcy practitioners. For that reason, the Fed and the FDIC should establish advisory committees consisting of bankruptcy scholars, lawyers, and judges to provide technical expertise about resolution under the bankruptcy code.[16]

---

[15] Stephen Lubben, "Banks 'Living Wills' Are Murky Guides," New York Times Deal Book, July 7, 2015, available at http://www.nytimes.com/2015/07/11/business/dealbook/banks-living-wills-are-murky-guides.html.

[16] Given the many conflicts of interest among academics and lawyers, all committee members must be in fact independent and have no direct or indirect conflicts of interest if such a committee is to be itself credible.

5. ***The regulators should require financial institutions that submit "living wills" to disclose publicly the amount of financing necessary to effectuate a reorganization under the Bankruptcy Code and the source of that funding***

As bankruptcy lawyers and scholars are fond of pointing out, a bankruptcy filing does not create its own funding—the debtor has to obtain the funding necessary to accomplish a reorganization under the bankruptcy code. For ordinary companies in bankruptcy, this funding—which is known as debtor-in-possession financing—is typically arranged by a financial institution and funded by a consortium of lenders. Given the daily liquidity needs of large, complex financial institutions that are heavily-leveraged and dependent on short-term funding, it is not clear where such financing would come from.

The largest debtor-in-possession facility established by private lenders was $8 billion.[17] In the midst of the financial crisis, General Motors received a $33 billion debtor-in-possession loan—but given the magnitude of GM's financing needs and the unwillingness or inability of commercial lenders to provide that much lending in a financial crisis, that loan came not from private institutions but from the U.S. Treasury.

By contrast, the size and business models of the large, complex financial institutions that have submitted "living wills" ensure that their funding needs will dwarf those of GM. For example, JPMorgan Chase has estimated that it would need $200 billion in funding to be resolved under the FDIC's "Orderly Liquidation Authority."[18] Bankruptcy professor Stephen Lubben has estimated that Bank of America's liquidity needs are $400 billion.[19] And former Treasury official Morgan Ricks has written that "Day-one funding needs for a failing SIFI . . . could be in the hundreds of billions of dollars."[20]

The scope of these funding needs raises serious doubt about the credibility of the "living wills" that have been submitted and are being reviewed by the regulators. As bankruptcy professor David Skeel has pointed out, "There are serious questions whether private financing could be raised quickly enough in the midst of a systemically important financial institution's distress to

---

[17] John J. Rapisardi and George A. Davis, "Lyondell: the largest commercial DIP in history," *Butterworths Journal of International Banking and Financial Law* (July/August 2009), *available at* http://www.cadwalader.com/uploads/books/del_unpublished_a0039779953c67a4929b0b2523f99731.pdf.

[18] Tom Braithwaite, "JP Morgan doomsday scenario revealed," *Financial Times* (June 12, 2013), *available at* http://www.ft.com/intl/cms/s/0/720e8746-b4ab-11e1-aa06-00144feabdc0.html. Note that in this scenario, JPMorgan Chase envisaged it would be resolved under Title II of the Dodd-Frank Act, rather than the Bankruptcy Code. Among other things, resolution under Title II means that the Treasury—rather private lenders as provided for in the "living wills" process—would provide the funds necessary to reorganize the firm. For a discussion of the differences between the "living wills" process in Title I and the "Orderly Liquidation Authority" in Title II, *see* Mike Konczal, "Progress, Yet No Progress: The Two Lines of Defense Against Too-Big-To-Fail" (Aug. 7, 2014), *available at* http://rooseveltinstitute.org/progress-yet-no-progress-two-lines-defense-against-too-big-fail/.

[19] Stephen J. Lubben, "Resolution, Orderly and Otherwise: B of A in OLA" (Apr. 10, 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2037915.

[20] Morgan Ricks, *The Money Problem: Rethinking Financial Regulation* (forthcoming 2016, University of Chicago press).

satisfy its liquidity needs [in a bankruptcy filing]. Most commentators who have followed the bank resolution discussions believe that it could not be."[21] The Financial Stability Board has similarly pointed out that a privately-funded debtor-in-possession lending facility "is unlikely, by itself, to provide the amount of funding that would likely be necessary to support the funding needs" of a global systemically important bank in bankruptcy.[22]

At this point, given the liquidity needs that large financial institutions have, the only credible source of that liquidity appears to be the U.S. government. However, the regulators have made clear that bank holding companies should assume that there will be no government support to fund a reorganization.

In light of that constraint, many believe that are the description of the funding needs and the possible sources of that funding in the "living will" submissions might not be believable. As a result, one of the largest impediments to demonstrating that a "living will" is credible might be the requirement that private financing be available to provide the debtor-in-possession financing needed to make a resolution under the bankruptcy code workable. (This is all the more true in light of the serial creditor runs that fueled the most recent financial crisis.)

Therefore, the regulators should require the financial institutions that submit "living wills" to provide a dollar figure on the amount of financing that these institutions estimate would be necessary to effectuate a reorganization under the bankruptcy code. The regulators should also require these institutions to identify the source of that funding. And because the amount of private funding required to facilitate a resolution under the bankruptcy code might be the single greatest impediment to resolving these institutions without government support, the regulators should make public the institutions' estimates of the funding they would need as well as institutions' descriptions of the source of that funding.

Conclusion

Living wills are critical to eliminating or minimizing the threat of too-big-to-fail, but the process to date has been far too opaque for anyone to determine if the "living wills" that have been submitted are credible or will do the job as intended. The Dodd Frank Act provided regulators with substantial authority and powers to ensure that living wills are credible. To breathe life into the "living wills" process, the Fed and the FDIC must take these very important, concrete steps to make the process much more transparent and credible if they to succeed and ending too-big-to-fail.

---

[21] David A. Skeel Jr., "Single Point of Entry and the Bankruptcy Alternative," (Feb. 26, 2014), *available at* http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1949&context=faculty_scholarship.

[22] Financial Stability Board, "Guiding principles on the temporary funding needed to support the orderly resolution of a global systemically important bank ('G-SIB')" (Nov. 3, 2015), *available at* http://www.financialstabilityboard.org/wp-content/uploads/Funding-in-Resolution-Guiding-Principles-Consultative-Document.pdf.