CHAPTER 3

Financing Systemically Important Financial Institutions in Bankruptcy

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Introduction

When railroads failed in the second half of the nineteenth century, as many did in the rush to link America's markets to its frontiers, their creditors and the Wall Street professionals who represented them faced a vexing problem. Although the creditors held mortgages on railroad assets and thus were nominally secured, a mortgage on a stretch of railroad track was worth very little unless the railroad continued to operate. Many railroads had been cobbled together through mergers, so the creditors often had mortgages on parts of the business rather than the business as a whole. As a result, the railroads' secured creditors were as anxious to see the railroads restructured as were the shareholders, suppliers and—because of the national interest in improved transportation—the general public. It was against this backdrop that the Wall Street banks and lawyers who represented the secured creditors devised America's first reorganization framework for large-scale corporations—the equity or railroad receivership.[1]

Among the many problems that the architects of the equity receiverships encountered was the question of how to finance the receivership process. The equity receiverships were crafted from foreclosure law,

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1. For a much more complete history of the emergence of railroad receiverships in the United States, see David A. Skeel Jr., *Debt's Dominion: A History of Bankruptcy Law in America* (Princeton, NJ: Princeton University Press, 2001), 52–69.

which provided for the foreclosure and sale of collateral after a default; and from receivership law, which authorized a court to vest authority over a debtor's assets in a receiver. Because equity receiverships were much more complex and often took significantly longer than a traditional foreclosure or receivership, and because railroads were usually starved for cash when the receivership began, they often needed to borrow money to finance the receivership process. But few lenders were anxious to lend money to an insolvent railroad that already had multiple layers of secured debt unless they could be assured priority over the existing debt. Here, too, the architects of the early receiverships devised an ingenious solution: the receiver's certificate. If the railroad needed financing during the receivership process, the receiver would ask the court to authorize a receiver's certificate in the amount of the desired financing. The holder of a receiver's certificate would be promised a first priority charge against the railroad's current income; only the net income, after the debtor's obligations under the receiver's certificates were paid, would be made available to the debtor's other creditors. Receiver's certificates are the direct ancestors of the debtor-in-possession financing provision in current Chapter 11.[2]

A year or so after the enactment of the Dodd-Frank Act in 2010, the Federal Deposit Insurance Corporation devised a mechanism for restructuring troubled, systemically important financial institutions—"single-point-of-entry" resolution—that bears an unmistakable resemblance to the nineteenth-century receiverships.[3] In a

2. See David A. Skeel Jr., "The Past, Present and Future of Debtor-in-Possession Financing," *Cardozo Law Review* 25 (2004): 1905, 1908–13.

3. For early descriptions of this strategy, before it was dubbed single-point-of-entry, see Randall D. Guynn, "Are Bailouts Inevitable?" *Yale Journal on Regulation* 29, no. 121 (2012): 147–50; and comment letter from the Securities Industry and Financial Markets Association and The Clearing House Association to FDIC on its second notice of proposed rulemaking under Title II of the Dodd-Frank Act, May 23, 2011, http://www.fdic.gov/regulatios/laws/federal/2011/11c16Ad73.PDF. Douglas Baird and Ed Morrison also pointed out early on that Title II could be used to recapitalize a systemically important financial institution. See Douglas G. Baird & Edward R. Morrison, "Dodd-Frank for Bankruptcy Lawyers," *American Bankruptcy Institute Law Review* 19 (2011). The FDIC formally endorsed and

single-point-of-entry resolution, regulators would put the holding company of a SIFI into Title II resolution, then transfer the holding company's assets, secured debt, and short-term debt, if any,[4] to a newly created bridge institution, leaving the holding company's long-term debt and stock behind.[5] As with the equity receivership, the FDIC's single-point-of-entry strategy is in form a sale of the debtor's assets but in reality a recapitalization. And both required a creative reinterpretation of laws that were intended for liquidation rather than recapitalization—foreclosure law in the nineteenth century in the first case and the "thou shalt liquidate" commandment in Title II of the Dodd-Frank Act in the second.[6]

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outlined single-point-of-entry in Federal Deposit Insurance Corporation, "The Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy," 78 Fed. Reg. 76614 (Dec. 18, 2013).

4. US bank holding companies generally have very little secured debt or short-term unsecured debt, virtually all of which is issued at the operating subsidiary level. In addition, the Financial Stability Board (FSB) has issued a proposal for imposing new total loss-absorbing capacity (TLAC) on global systemically important banking groups (G-SIBs) that would supplement Basel III regulatory capital requirements. Financial Stability Board, "Consultative Document: Adequacy of Loss-Absorbing Capacity of Global Systemically Important Banks in Resolution" (Nov. 10, 2014). TLAC-eligible instruments would include common equity, other regulatory capital instruments and long-term unsecured debt with a remaining maturity of one year or more. They would exclude short-term unsecured debt. The FSB's proposal would also require TLAC-eligible instruments to be contractually, legally, or structurally subordinate to short term unsecured debt. This would effectively require the bank holding company parents of US G-SIBs either to push any short-term unsecured debt from the parent to the operating subsidiary level or to make such short-term debt contractually senior to the parent's TLAC-eligible instruments. The Federal Reserve has indicated that it intends to issue a regulation imposing TLAC requirements on US G-SIBs similar to the FSB proposal.

5. For additional details, see FDIC, "Resolution of Systemically Important Financial Institutions," note 4.

6. See Dodd-Frank Act section 214 (liquidation requirement). For a skeptical assessment of the single-point-of-entry strategy, see Paul H. Kupiec and Peter J. Wallison, "Can the 'Single Point of Entry' Strategy be Used to Recapitalize a Failing Bank?" AEI Economic Working Paper 2014-08 (December 3, 2014).

The same lawyers who persuaded the FDIC to pursue the single-point-of-entry strategy subsequently realized that a very similar approach might work in Chapter 11 if lawmakers made a handful of amendments to current bankruptcy law. If a SIFI's holding company filed for Chapter 11, it could transfer its assets, secured debt, and any short-term liabilities to a newly created corporation, leaving its stock and long-term debt behind.[7] The bankruptcy alternative to the single-point-of-entry approach does not yet have a generally agreed-upon moniker. As this volume reflects, the Hoover working group on financial institution insolvency incorporated a version of the bankruptcy alternative into a proposal for a new Chapter 14. Those of us in the group generally refer to our proposal as a "quick sale" or "quick section 363 sale," and the proposed statutory framework for implementing it as Chapter 14 2.0. As this book goes to press, lawmakers have included the central features of Chapter 14 2.0 in two bills, one introduced in the Senate and the other both introduced in and passed by the House.[8]

My objective in this chapter is to explore the options for financing SIFIs in bankruptcy, especially in connection with the quick sale process.[9] Financing is the issue on which the proposal to effect a quick sale in Chapter 11 differs most starkly with the single-point-of-entry

7. See Randall D. Guynn, "Framing the TBTF Problem: The Path to a Solution," in *Across the Great Divide: New Perspectives on the Financial Crisis,* ed. John B. Taylor and Martin Neal Baily (Stanford, CA: Hoover Institution Press, 2014); John Bovenzi, Randall Guynn, and Thomas Jackson, "Too Big to Fail: The Path to a Solution," panel discussion for Bipartisan Policy Center, May 14, 2013; and Donald S. Bernstein, Testimony on "The Financial Institution Bankruptcy Act of 2014" Before the Subcommittee on Regulatory Reform, Commercial and Antitrust Law, US House of Representatives (July 15, 2014).

8. The Senate Bill is the Taxpayer Protection and Responsible Resolution Act, S. 1861, 113th Cong. (2013); the House Bill is the Financial Institution Bankruptcy Act of 2014, H.R. 5421, 113th Cong. (2014).

9. Throughout this chapter, I use the term SIFI broadly, to refer to bank holding companies that meet the $50 billion threshold for inclusion in Title I of the Dodd-Frank Act, as well as systemically important nonbank financial institutions. Most or all of the bank holding companies with less than $250 billion in assets actually are not systemically important. Where the distinction between institutions that

approach to Title II of the Dodd-Frank Act. Although the financing arrangements in Title II are controversial, there is little doubt that the receiver of a troubled SIFI would have access to sufficient financing to meet even the most pressing liquidity needs. Title II authorizes the receiver to borrow up to 10 percent of a SIFI's pre-resolution value or 90 percent of its post-resolution value from the United States Treasury.[10] Chapter 11, by contrast, does not currently provide any special financial arrangements for SIFIs, and neither of the pending bills would introduce additional funding for a SIFI bankruptcy. (Indeed, the Senate bill prohibits the government from providing funding in connection with a quick sale.) Advocates of Title II often single out the absence of SIFI-specific financing as an insuperable obstacle to successful resolution of a SIFI in Chapter 11.[11]

I argue in this chapter that the widespread pessimism about a SIFI's ability to borrow sufficient funds—sufficiently quickly—to finance resolution in Chapter 11 is substantially overstated. The criticism appears to be based on the assumption that the largest banks have essentially the same structure as they had prior to the 2008 panic, thus ignoring the effects of the regulatory changes that have taken place as a result of the Dodd-Frank Act. Critics also do not seem to have fully considered the likelihood that the quick sale resolution of a SIFI—like

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are and are not systemically important is significant, I will signal which institutions I have in mind in the text.

10. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 210(n)(2010).

11. Stephen Lubben is among those who have voiced this concern. Stephen J. Lubben, "Resolution, Orderly and Otherwise: B of A in OLA," *University of Cincinnati Law Review* 81 (2012): 485, 517 (arguing that the "key difficulty" with Chapter 14 "rests on funding," and concluding that "something like" the Title II funding mechanism "is a prerequisite to a viable resolution authority"). Also see Stephen J. Lubben, "What's Wrong with the Chapter 14 Proposal," *New York Times,* April 10, 2013 (questioning "the dubious assumption in Chapter 14 that private debtor-in-possession financing will be available in times of financial distress, especially in the size a large financial institution would need"), http://dealbook.nytimes.com/2013/04/10/whats-wrong-with-the-chapter-14-proposal/?_r=0. See also Guynn, "Are Bailouts Inevitable?" (identifying funding limitations as a shortcoming of bankruptcy).

prepackaged bankruptcies of other firms—should require less new liquidity than the traditional bankruptcy process.

Although bankruptcy is better able to handle the financing needs of a troubled SIFI than is generally acknowledged, the doubts of Chapter 14 2.0's critics are not altogether unfounded. The old debtor and new corporation would need to put any financing in place very quickly, which might cause potential lenders to balk, especially if a SIFI fell into financial distress during a period of market-wide instability. I therefore consider two other potential sources of funding: prearranged private funding and governmental funding.

I begin, in the first section, by exploring the financing options that would be available to a SIFI that filed for bankruptcy today, as well as several factors that would determine the extent of the SIFI's financing needs. I conclude both that bankruptcy provides greater access to liquidity than is often appreciated—through its debtor-in-possession financing provision and through several other key rules—and that post-2008 regulation and the quick sale strategy have reduced the amount of liquidity that a SIFI debtor would need at the outset of its restructuring. Although critics may be right about the need for additional liquidity, the limitations of existing bankruptcy law seem much less severe than the conventional wisdom suggests.

In the second section, I explore the possibility that a SIFI could boost its access to liquidity by putting private financing in place prior to a bankruptcy filing—a strategy I refer to as prearranged financing. Prearranged financing could remove much of the uncertainty over a troubled SIFI's ability to obtain enough liquidity for an effective bankruptcy resolution. But the strategy would also face a series of significant obstacles. The most important obstacles are (1) a bankruptcy rule that automatically terminates any pre-bankruptcy loan commitment made to the debtor itself[12] and (2) the likely cost of arranging financing for a hypothetical crisis that may not occur in the foreseeable future. I consider a variety of responses to these obstacles, and also point out that SIFIs are not likely to implement a prearranged financing strategy voluntarily. The Federal Reserve could counteract SIFIs' reluctance

12. 11 USC § 365(c)(2).

to incur the costs of prearranged financing by incorporating prearranged financing into the living-will process. Given the obstacles and the likely availability of funding at the time a SIFI falls into financial distress, I question whether a prearranged funding requirement would make sense.

In the final section, I consider whether an additional source of governmental financing may be necessary. In my view, lawmakers could plausibly conclude that they do not need to authorize either of the most likely sources of government funding: a designated fund analogous to Title II's orderly liquidation fund (OLF) or access to Federal Reserve funding. Given the residuum of uncertainty about a SIFI's ability to obtain adequate liquidity, I conclude that lawmakers should give SIFIs limited, explicit access to Fed funding, preferably by expanding the Fed's emergency lending authority under section 13(3) of the Federal Reserve Act.

Funding Options in Current Chapter 11

In their assessment of a SIFI's funding capacity in a Chapter 11 reorganization, skeptics of the existing bankruptcy rules have emphasized the magnitude and immediacy of a SIFI's likely financing needs.[13] Skeptics question whether a SIFI could arrange adequate financing from private sources quickly enough to fund an effective Chapter 11 sale and resolution. To assess this objection, I begin by describing bankruptcy's debtor-in-possession (DIP) financing provision, which critics fear is too slow and limited in scope to meet a SIFI's immediate financing needs. Although critics are right to worry about the adequacy of traditional DIP financing, a more complete analysis of the liquidity available after the bankruptcy filing and the likely scope of a SIFI's liquidity needs will invite a somewhat more optimistic conclusion.

Bankruptcy's Debtor-in-Possession Financing Provision

Bankruptcy's debtor-in-possession financing provision, which is set forth in section 364 of the Bankruptcy Code, provides a variety of financing options. Section 364 first authorizes a debtor to borrow on

13. See, e.g., Lubben, "What's Wrong with the Chapter 14 Proposal."

an unsecured basis, with the promise of administrative expense treatment for the lender, without first seeking court approval.[14] If unsecured financing is unlikely to be available, the court can give the DIP financer priority over all other administrative expenses or authorize a lien on either unencumbered or already encumbered property.[15] The court's most dramatic power is the right to authorize a new "priming" lien that has priority over an existing lien on the same property.[16] The broad borrowing powers afforded by the financing provision are one of the most striking features of Chapter 11.

In the general run of cases, Chapter 11's DIP financing provision provides extensive access to funding for the bankruptcy process; indeed, it is one of Chapter 11's most noteworthy features. Although DIP financing requires court approval, a debtor often can put the financing in place quite quickly. Bankruptcy courts regularly grant interim approval for proposed financing at the outset of the case. When Eastman Kodak filed for bankruptcy, for instance, it put nearly $1 billion of funding in place within twenty-four hours of its bankruptcy filing.[17]

Whether this would be sufficient for the liquidity needs of a bank holding company or other SIFI is less clear, however. Bankruptcy skeptics argue a SIFI could not borrow nearly enough under a standard DIP financing facility to assure creditors and other market actors that the SIFI is stable and capable of meeting its obligations. On this view, the Chapter 11 quick sale strategy cannot work effectively unless lawmakers provide an additional source of lender-of-last-resort funding.

In our original Chapter 14 proposal—now known as Chapter 14 1.0—we proposed an amendment to bankruptcy's DIP financing provision that would authorize the debtor to make immediate partial payments of its obligations to derivatives counterparties and other creditors that might be destabilized by the debtor's default on

14. 11 USC § 364(a).

15. 11 USC § 364(b) and (c).

16. 11 USC § 364(d).

17. See, e.g., Joseph Checkler, "Judge Says Kodak Can Tap $950M Bankruptcy Loan from Citi," *Daily Bankruptcy Review,* January 20, 2012.

its obligations. "There may be situations," our principal drafter wrote, "where liquidity or other systematic concerns suggest that the appropriate action—without involving a government bailout of any sort—would be for certain liquidity-sensitive creditors to be 'advanced' a portion of their likely bankruptcy distribution."[18] Because existing bankruptcy law does not seem to contemplate partial payments, Chapter 14 1.0 proposed amending section 364 to "permit partial or complete payments to some or all creditors where liquidity of those creditors is a concern."[19] Although our proposal would alleviate the liquidity problems of a SIFI debtor's counterparties, it would not alter the current process for obtaining DIP financing, and it would not address the debtor's own liquidity needs. Indeed, by directing funds to the debtor's counterparties, it actually could reduce the *debtor's* liquidity.

In my view, the question whether bankruptcy would provide sufficient liquidity, sufficiently quickly, is a weighty one. Indeed, I have raised it in my own work,[20] and I will argue below that limited Federal Reserve financing should be extended to the new holding company created by a quick sale in bankruptcy. Yet the concerns seem much less serious in the context of a quick sale of a SIFI than for the ordinary bankruptcy process. In my view, the standard critiques underappreciate the liquidity that would be available to a SIFI in connection with a quick sale, and overestimate the amount of liquidity that would be necessary.

Additional Sources of Liquidity under Current Bankruptcy Law

To appreciate the full extent of the liquidity available in bankruptcy, we need to look beyond the DIP financing provision alone. In addition to the expansive DIP financing rules, bankruptcy provides several

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18. Thomas H. Jackson, "Bankruptcy Code Chapter 14: A Proposal," in *Bankruptcy Not Bailout: A Special Chapter 14*, ed. Kenneth E. Scott and John B. Taylor (Stanford, CA: Hoover Institution Press, 2012), 25, 41.

19. Ibid., 43.

20. See, e.g., Thomas H. Jackson and David A. Skeel Jr., "Dynamic Resolution of Large Financial Institutions," *Harvard Business Law Review* 2 (2012): 435, 449–50.

other liquidity-generating mechanisms that would expand the liquidity available to a SIFI that filed for bankruptcy.[21] First, bankruptcy imposes an automatic stay on creditor collection activities as of the moment a debtor files for bankruptcy.[22] A bank holding company or other SIFI could therefore halt payments on its bond debt and other obligations, freeing up those funds for its bankruptcy financing needs. The benefit of suspending current payments to long-term creditors could prove significant, given that systemically important financial institutions will be required to continue to hold a large swath of bond debt.[23]

The second source of liquidity is more subtle and far more important. The bankruptcy provision that permits a debtor to sell most or all of its assets can enhance a debtor's financing capacity, because the sale is free and clear of debt obligations that might otherwise interfere with a debtor's capacity to borrow money.[24] Once they are sold, the assets can be used as collateral for new loans, shorn of the debt overhang that might otherwise prevent the debtor from borrowing.

A version of this financing technique has already been used in Chapter 11 cases involving smaller financial institutions. When AmericanWest Bancorporation, the holding company of AmericanWest Bank, fell into financial distress in 2011, it could not restructure its debt outside of bankruptcy because it had issued a substantial amount of trust-preferred securities that precluded alteration unless

21. In addition to the two rules discussed in the text that follows, bankruptcy provides a variety of other liquidity-generating mechanisms. If any of the debtor's creditors are secured, for instance, the secured creditor's lien extends only to its current collateral and any proceeds of the collateral. See 11 USC § 552(a). For a more complete analysis, see Kenneth Ayotte & David A. Skeel Jr., "Bankruptcy Law as a Liquidity Provider," *University of Chicago Law Review* 80 (2013): 1557.

22. 11 USC § 362(a).

23. The Financial Stability Board has outlined its expectations for what has become known as the total loss-absorbing capacity, or TLAC. See Financial Stability Board, "Adequacy of loss-absorbing capacity of global systemically important banks in resolution," press release, November 10, 2014. The Federal Reserve has not yet released its TLAC rules for American SIFIs, but is expected to do so in early 2015.

24. 11 USC § 363.

two-thirds of the generally passive investors agreed.[25] The holding company raised $200 million in new funding from a private equity group by arranging to file for bankruptcy and then sell the stock of AmericanWest Bank to the private equity group pursuant to a section 363 sale.[26] The bankruptcy was completed in forty-two days, and achieved a recapitalization similar to the recapitalization envisioned by the Chapter 11 quick sale strategy.

Chapter 14 2.0 contemplates that the holding company SIFI would transfer any secured and short-term debt to the newly formed corporate buyer, while leaving its long-term debt and stock behind. The reduction in overall debt could facilitate borrowing by the new corporation, much as the section 363 sale of AmericanWest Bank's stock did for its holding company. Because the new corporation formed to acquire the SIFI holding company's assets and some of its debt would not be in bankruptcy itself, it would not need court approval for any new loan it obtained.[27] The buyer could arrange financing before proposing a sale transaction, and have it in place the moment the transaction was approved (and possibly even before).

The recapitalized SIFI's borrowing options may not be quite as simple as I have suggested thus far. The holding company's principal asset is likely to be the stock of its subsidiaries. Although lenders

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25. For a description of the AmericanWest Bankcorporation bankruptcy, see Henry M. Fields, Kenneth E. Kohler, Barbara R. Mendelson, and Alexandra Steinberg Barrage, "AmericanWest Bancorporation: How a Section 363 Sale in Bankruptcy Provides a Viable Recapitalization Option for Troubled Banks," Morrison and Foerster, February 2011.

26. Ibid., 4. The private equity group, whose investors reportedly included Goldman Sachs and Oaktree Management, bid $6.5 million for the stock and agreed to lend up to $200 million. A total of $185 million was ultimately committed. See *In re re American Bancorporation*, 2010 WL 6415766, (Bankr. E.D. Wash), cited in Lev Breydo, "Banking on Bankruptcy: Bank Recapitalization through Chapter 11" (unpublished manuscript, December 2014).

27. Chapter 14 2.0 currently proposes to extend the judge's power to authorize financing to the newly created corporation. See, e.g., Thomas E. Jackson, chapter 2 in this volume. But the new corporation would not be required to ask for court involvement. Judicial involvement would only be necessary if the new corporation wished to take advantage of the additional powers provided by 11 USC § 364.

might be willing to take the stock as collateral, this would leave them structurally subordinated to subsidiary creditors with respect to the subsidiaries' assets. Lenders may therefore require that their loans be secured by one or more subsidiaries' assets. In theory, a creditor of the subsidiary that pledged its assets could challenge the security interest as a fraudulent conveyance, arguing that the subsidiary did not receive reasonably equivalent value for the security interest, since the proceeds of the loan went to the holding company. But a subsequent fraudulent conveyance challenge is only a danger if the subsidiary is insolvent or nearly insolvent at the time of the loan.[28] Moreover, even if the insolvency requirement were met, courts have generally rejected fraudulent conveyance challenges if the subsidiary receives at least an indirect benefit from a loan or other arrangement.[29] A loan that would facilitate the recapitalization of a troubled SIFI, and which is intended to help restore the holding company's stability, would provide obvious benefits for the subsidiaries that pledged their assets to support the loan, even if the funds did not go directly to the subsidiaries.

In practice, a significant portion of the funds almost certainly would in fact go to the subsidiaries, since the liquidity strain is likely to be most pressing at the subsidiary level. The subsidiaries are the locus of most operations, and the holding company itself would have little debt after the quick sale. This suggests that the loans could be made directly to the subsidiaries, with a guarantee by the new holding company.

There are downsides to being outside of the bankruptcy process, such as the absence of court authority to approve extraordinary loan

28. Under Uniform Fraudulent Transfer Act § 4(a)(2), for instance, a creditor would need to demonstrate both that the subsidiary did not receive "reasonably equivalent value" and that it either had "unreasonably small" assets or intended to incur debts beyond the subsidiary's ability to pay.

29. See, e.g., Mellon Bank v. Metro Communications Inc., 945 F.2d 635 (3d Cir. 1991) (indirect benefit sufficient to justify guaranty by subsidiary); and *In re Fairchild Aircraft Corp.*, 6 F.3d 1119 (5th Cir. 1993) (indirect benefit justifies subsidiary agreement to make payments).

provisions. (As noted earlier, Chapter 14 2.0 would address this concern by temporarily extending the bankruptcy court's DIP lending authority to the new corporation if the debtor seeks authorization for a loan.[30]) These complications do not seem likely to prevent a SIFI debtor from arranging for liquidity, however, and by forgoing bankruptcy court authorization a debtor could put financing in place almost immediately.

Liquidity Needs in the New Regulatory Environment

Although the Dodd-Frank Act avoided making any adjustments to current bankruptcy law, it and subsequent regulatory reforms may have altered the liquidity needs of a bank holding company that files for bankruptcy. The most obvious change is a significant increase in the capital requirements for systemically important financial institutions. Under the Basel III standard, which the Federal Reserve has begun to implement, SIFIs will now be required to maintain as much as 10.5 percent capital, due to a 1 percent to 2.5 percent capital surcharge that is being added in the wake of the 2008 crisis. SIFIs also must maintain substantially higher leverage ratios—which are calculated without risk-weighting the SIFI's assets.

At least as important are new liquidity requirements the Federal Reserve now imposes on the largest financial institutions. In keeping with Basel III, the Fed rolled out a new liquidity rule in September 2014. As described in the Fed's press release, the liquidity coverage ratio, which applies to institutions with $250 billion in total assets or $10 billion in foreign exposure,

> will for the first time create a standardized minimum liquidity requirement for large and internationally active banking organizations. Each institution will be required to hold high quality, liquid assets (HQLA) such as central bank reserves and government and corporate debt that can be converted easily and quickly into cash in an amount equal to or greater than its projected cash outflows minus its projected cash inflows

30. See Jackson, chapter 2 in this volume, Appendix section 2(6)(describing § 1413).

> during a 30-day stress period. The ratio of the firm's liquid assets to its projected net cash outflow is its "liquidity coverage ratio," or LCR.[31]

Both liquidity and capital also figure in a series of stress tests the Federal Reserve applies to large bank holding companies. Best known is the Comprehensive Capital Analysis and Review (CCAR) stress test that the Fed administers to the thirty-one bank holding companies that have $50 billion or more in assets.[32] The aim of the stress tests, which were first introduced in 2009, is "to ensure that large financial institutions have robust, forward-looking capital planning processes that account for their unique risks, and to help ensure that they have sufficient capital to continue operations throughout times of economic and financial stress."[33] The Fed tests the banks' ability to withstand adverse economic conditions, modeled in terms of twenty-eight variables ranging from increased unemployment to changes in interest or exchange rates. Bank holding companies that fail the stress test are not permitted to make dividends or other distributions to their shareholders.

Recent history warns us not to put too much confidence even in significantly stiffened capital and liquidity requirements.[34] And a SIFI that winds up in bankruptcy will inevitably have run short on capital, liquidity, or both. But the stringent new rules should reduce the magnitude of a SIFI's liquidity needs at the time of a potential bankruptcy as compared to the rules in place before the recent crisis.

If the SIFI seeks to resolve its financial distress through a quick sale, rather than a traditional bankruptcy process, its liquidity needs should be further reduced. The quick sale is somewhat analogous to

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31. Federal Reserve System and FDIC, "Federal Banking Regulators Finalize Liquidity Coverage Ratio," press release, September 3, 2014, http://www.federalreserve.gov/newsevents/press/bcreg/20140903a.htm.

32. The Dodd-Frank Act calls for additional stress tests.

33. Federal Reserve System, press release, October 23, 2014, http://www.federalreserve.gov/newsevents/press/bcreg/20141023a.htm.

34. Bear Stearns had considerable liquidity only a week before its collapse. And Citigroup appeared to be adequately capitalized in early 2008, yet it was almost certainly insolvent a month or two later.

the prepackaged bankruptcy of a traditional corporation, in which a corporation that wishes to restructure some of its unsecured debt (usually bonds) files its Chapter 11 petition and its proposed reorganization plan at the same time. Because prepackaged bankruptcies quickly recapitalize the troubled company, they require much less DIP financing than other Chapter 11 cases: debtors often do not seek any DIP financing for their prepackaged bankruptcy case. SIFIs are quite different from the companies that generally file prepackaged bankruptcy cases, of course; their liquidity can disappear much more quickly, and liquidity is central to their business model.[35] But the general pattern should hold true. Just as prepackaged bankruptcies do not require as much liquidity as traditional Chapter 11 cases, the quick sale resolution of a SIFI in Chapter 11 should be less liquidity-intensive than a more traditional SIFI bankruptcy.

Just how much financing would be necessary? It is of course hard to predict in advance, but we can perhaps arrive at a ballpark number by comparison to the rescue financing that was secured during the 2007–2009 recession. When Bear Stearns threatened to default, the Federal Reserve provided $29 billion in loan guarantees to facilitate its sale to J. P. Morgan Chase. The bankruptcy of a large SIFI might require more funding—perhaps $30–50 billion, and possibly more for the very largest—but if resolution is achieved through a quick sale, it is unlikely to require the huge amounts skeptics seem to envision. And smaller SIFIs could probably achieve a quick sale with significantly less financing. Although even $10–20 billion is substantially more than debtors have obtained from private lenders in previous Chapter 11 cases,[36] it seems plausible that a smaller SIFI could obtain private funding of this magnitude for its newly created holding company and its subsidiaries, especially if it planned for its bankruptcy in advance.

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35. Interestingly, banks do sometimes recapitalize through a prepackaged bankruptcy. Anchor Bancorp Wisconsin Inc. recently did precisely this, recapitalizing its secured debt and its TARP obligations through a prepackaged bankruptcy that took only eighteen days. See, e.g., Brian D. Christiansen, Van C. Durrer II, and Sven G. Mickisch, "The Use of Pre-Packs in Bank Restructuring and M&A," *Financier Worldwide,* January 2014.

36. I discuss some of the largest recent DIP facilities in the next subsection.

If I am right about the effect of bankruptcy's liquidity enhancing rules and about the reduced need for funding in the Chapter 14 2.0 context, it seems plausible that a bank would be capable of raising adequate funding for its bankruptcy case from private lenders, or at the least much more plausible than before the Dodd-Frank reforms.

Do Private Markets Work in a Crisis?

It is of course possible that private lending would dry up altogether in a crisis as widespread as the 2008 crisis. Auto czar Steven Rattner and other commentators have argued that the government needed to bail out General Motors and Chrysler because the DIP financing market had completely collapsed in 2008 and 2009. This logic suggests that financing might not be available when it is most needed, even if it would be available under ordinary circumstances.

Although the DIP financing market clearly was stressed in 2008 and 2009, the rumors of its demise have been significantly exaggerated. In 2009, for instance, during the crisis, the CIT Group obtained $5.5 billion in funding for its reorganization. Also in 2009, Lyondell Chemical Co. obtained $8 billion in DIP financing. A significant portion of the Lyondell loan was "rolled up" pre-petition debt, but roughly $3 billion was new financing. Prior to Lehman Brothers' bankruptcy filing in September 2008, a group of lenders had tentatively agreed to a multibillion-dollar loan package to facilitate the sale of Lehman's brokerage operations to Barclays. (The arrangement faltered when UK regulators declined to waive the regulatory requirements that impeded an immediate sale.) A large troubled SIFI would need to secure considerably more funding, but the private lending market did not shut down altogether, even during the crisis. This suggests that private financing may be available in all but the most severe, market-wide crises.

Could the Government Serve as Financer?

If private financing really did dry up due to a market-wide crisis, the Federal Reserve could fill in the gap.[37] The Dodd-Frank Act restricted

37. At least, this is the case under existing law or under the subchapter V proposal that was recently approved by the House. The Toomey-Cornyn legislation

the Fed's authority to provide extraordinary financing like its rescue loans to Bear Stearns, Lehman, and AIG in 2008. Dodd-Frank amended the Fed's so-called 13(3) powers—its emergency lending authority under section 13(3) of the Federal Reserve Act—to prohibit the Fed from making emergency loans to individual institutions.[38] But the Dodd-Frank Act does authorize the Fed to provide industry-wide lending programs. In the event of a market-wide crisis, the Fed could presumably set up an industry-wide mechanism for borrowing that would be available to the new holding company created for the purposes of a SIFI restructuring or to the SIFI's subsidiaries. I will consider below the question of whether lawmakers should provide explicit authorization for Fed funding in a financial institution bankruptcy. Even without additional authorization, however, the Fed could step in under an industry-wide program.

I do not mean to suggest that concerns about the adequacy of bankruptcy funding are unfounded. But once we consider the full range of bankruptcy's liquidity-enhancing mechanisms, together with the likelihood that the new capital and liquidity rules have reduced the magnitude of the loan that would be necessary, it seems plausible that private funding sources would suffice for the purposes of a quick sale in bankruptcy.

Prearranged Bankruptcy Funding Alternatives

The funding strategies I have considered thus far would not require any advance coordination or legislative change. A second strategy would be to establish a prearranged private funding mechanism that could be quickly deployed if a SIFI fell into financial distress. The chief benefit of prearranged funding is that it would significantly reduce concerns about a troubled SIFI's ability to put together a big enough financing package at the outset of its bankruptcy case. The chief limitations are a legal impediment under current bankruptcy

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introduced in the Senate in late 2013 would preclude the federal government from providing financing in connection with a SIFI restructuring.

38. Dodd-Frank Act § 1101(a) (extraordinary loans must be part of a "program or facility with broad-based eligibility").

law and the costs of putting in place a funding package that may never be used.

Prearranged funding would formalize an approach that was used in more ad hoc (and ex post) fashion to handle several major financial collapses in the late 1990s. When South Korea threatened to default on its sovereign debt in 1997, the International Monetary Fund put together a substantial rescue package—totaling $55 billion—but the financing failed to reassure the markets.[39] As lenders exited Korean debt, the US Treasury and Fed convened a meeting of major lenders at the New York Fed on December 22, 1997, and pressured the bank lenders to roll over their loans.[40] In effect, the roll-over amounted to a new $22 billion loan package provided by a group of the world's largest banks.

When the high-profile hedge fund Long-Term Capital Management faced collapse in 1998 due to the Russian crisis, regulators responded in similar fashion. Convened in New York by the New York Fed, sixteen major banks agreed to provide $3.625 billion to LTCM.[41] The rescue financing was used to close out LTCM's positions and unwind its portfolio. Similarly, as noted earlier, shortly before Lehman Brothers filed for bankruptcy, a group of banks had tentatively agreed to provide a multibillion-dollar loan to Lehman to facilitate its sale to Barclays.

In theory, regulators and leading banks could use the same ad hoc strategy in connection with the quick sale of a troubled SIFI in bankruptcy. The Fed could convene a group of the largest banks and prod them to provide funding to their troubled peer. But the ad hoc approach has several important limitations. First, if the funding is not prearranged, there may be considerable uncertainty as to whether the SIFI would successfully obtain the funding. This uncertainty would make it more difficult to assure markets that the troubled SIFI is stable.

39. See Paul Blustein, *The Chastening: Inside the Crisis That Rocked the Global Financial System and Humbled the IMF* (New York: Public Affairs, 2001), 148.

40. Ibid., 177–205.

41. Goldman Sachs, AIG, and Berkshire Hathaway had previously offered LTCM's partners $250 million for their partnership interests and $3.75 billion in funding, but the one-hour deadline for the offer elapsed before a deal was reached. See Roger Lowenstein, *When Genius Failed: The Rise and Fall of Long-Term Capital Management* (New York: Random House, 2000), 203–4.

Second, the ad hoc approach depends heavily on moral suasion; lenders are not under any obligation to contribute. Particularly in a period of industry-wide stress, lenders might decline to participate. (Ironically, the one major Wall Street bank that resisted the moral suasion, and declined to contribute to the LTCM bailout, was Bear Stearns.) Finally, the ad hoc approach significantly constrains the range of potential lenders. If regulators need to quickly convene a group of potential lenders, they inevitably will limit their gaze to a small group of the largest financial institutions.

A more coordinated approach theoretically could address these shortcomings (although at a stiff cost, as we shall see). If the financing were already in place and the markets were informed of its general scope, the threat of destabilizing uncertainty would be substantially reduced. Prearranged funding also would greatly reduce the risk that lenders would decline to provide funding. And the funding would not necessarily need to come entirely from a small group of the largest banks if a SIFI arranged for financing in advance, before the urgency of an actual crisis. If SIFIs were required to have prearranged funding in place, additional lenders such as smaller banks, hedge funds, or savvy investors like Warren Buffett might commit to provide some of the funding. Some or all of these other lenders might be less likely than other SIFIs to have fallen into financial distress themselves at the same time as the troubled SIFI.

Although prearranged financing has considerable attractions, it also would face several important obstacles. The first is a surprising and somewhat dubious bankruptcy provision. Under current law, any pre-bankruptcy loan commitment made by a lender to the debtor itself is terminated the moment the debtor files for bankruptcy.[42] Congress would do well to remove this automatic termination provision, which lacks any compelling policy basis, and to give debtors the same right to enforce loan commitments that they have with other contracts.[43] Fortunately, so long as the old SIFI holding company would not need new

42. 11 USC § 365(c)(2).

43. For a more detailed argument for amending § 365(c)(2), see Ayotte and Skeel, 1608–9.

funding after filing for bankruptcy, the new holding company or the SIFI's operating subsidiaries could arrange for the loan commitment. So long as none of the borrowers were in bankruptcy themselves, the termination provision would not apply. An alternative strategy would be to create a bail-in fund, either for a single institution or for a group of institutions. If funds were escrowed under such an arrangement, and released if the debtor defaulted, the arrangement could provide bankruptcy liquidity to a debtor as well as the new holding company and the debtor operating subsidiaries without running afoul of the bankruptcy termination provision.[44]

The second, more intractable obstacle is cost. A financial institution would be required to take a capital charge in connection with the loan arrangement. In addition, the prearranged financing could be quite costly, given that it would commit lenders for a potentially lengthy period of time to make loans to another financial institution based on pure speculation about the likely condition of the debtor at the time the loan would be needed and other factors that might affect the terms of the loan or escrow arrangement. As noted earlier, under the quick sale approach, the loan would not need to be as large as commentators often assume. A $20 billion loan commitment would probably be sufficient even for a fairly large financial institution. But given the uncertainties of the funding, the costs of even a manageable ex ante loan commitment could be steep.

A key design question would be whether to set the prearranged funds aside in advance, or whether the lenders should simply commit to provide the funds in the event the financial institution in question filed for bankruptcy. The tradeoffs between the two approaches are well known. Setting aside the funds assures that they will be available if needed, but it also can create moral hazard—the temptation to use the

44. This arrangement echoes the proposal J. P. Morgan has made for resolution of a troubled clearinghouse. See J. P. Morgan Chase & Co., Office of Regulatory Affairs, *What is the Resolution Plan for CCPs?* September 2014, discussed in Darrell Duffie's, "Resolution of Failing Central Counterparties," this volume. The multi-debtor version of this approach is similar in some respects to bank guaranty arrangements used in some states in the nineteenth century.

funds. The funds would be tied up for the duration of the loan commitment, which could interfere with the lenders' own liquidity needs. In my view, the moral hazard of a pre-committed fund is a relatively small concern in this context; it is the rare bank manager who would file for bankruptcy to get her hand in the honeypot. But the need to set the funds aside and manage them for potentially long periods is more problematic. If lenders committed to supply the funds if needed, by contrast, without actually providing the funding up front, the costs of setting the funds aside disappear. But there is a risk that lenders would default on their funding commitment if the debtor does indeed file for bankruptcy—especially if the debtor falls into distress during a period of general crisis.

One way to balance these effects would be to set a portion of the funds aside, rather than the full amount of a SIFI's potential liquidity needs, and to rely on lenders' lending commitments for the remainder. This approach is somewhat analogous to the obligations imposed on members of a clearinghouse, who make initial contributions to capital and also are liable for additional contributions if necessary in the event the clearinghouse defaults.[45]

From a SIFI's perspective, any of the prearranged funding mechanisms I have described imposes serious costs. In theory, the cost could be offset by the benefits to creditors of preserving the SIFI's value in the event of a subsequent bankruptcy. But there are good reasons to suspect that the benefits would not be fully priced. The risk of failure is quite small, for instance, which could dampen the price effects. Perhaps more importantly, if the most plausible alternative to an orderly bankruptcy is a governmental bailout, even an effective liquidity mechanism could diminish the value of the SIFI's debt by reducing the bailout subsidy traditionally enjoyed by creditors—especially bondholders—of systemically important financial institutions.

If prearranged funding were in fact desirable, industry coordination would be one way to overcome the disincentive each individual SIFI has to put such a liquidity mechanism in place. Since the number

45. Darrell Duffie analyzes these clearinghouse arrangements in detail in his chapter for this volume.

of financial institutions in question is small, industry coordination is a plausible response; the banking industry has used precisely this approach to address key resolution issues. The most important recent illustration is the adoption of a new industry protocol imposing a contractual stay on cross-default provisions.[46] But governmental pressure appears to have played a central role in the banks' newfound willingness to coordinate on a limited stay. The initiative seems to have originated with the head of the Bank of England, and it does not seem coincidental that it quickly gathered steam after the FDIC rejected as "not credible" the 2012 living wills prepared by eleven of the largest bank holding companies and the Fed indicated that they all contained various shortcomings that needed to be addressed.[47]

The Fed could, if it wished, use the living will process to insist that each of the largest bank holding companies put a liquidity mechanism in place. Under Title I of the Dodd-Frank Act, systemically important financial institutions must submit "rapid resolution plans," or living wills, explaining how the SIFI would restructure or liquidate in bankruptcy in an orderly fashion, without causing systemic harm.[48] As just noted, the Fed has already used its living will authority as a stick, requiring eleven banks to address various shortcomings identified in their 2012 living wills; it could require, as a condition for approval, that banks show that they have arranged for funding in the event they fall into financial distress. By refusing to approve a living will that does not include provision for liquidity in the event of a bankruptcy, the Fed could ensure that SIFIs provide adequately for the possibility of failure.[49] The liquidity mechanism would need to include a commit-

46. The new protocol, which has been endorsed by eighteen of the leading global banks, can be found at http://www2.isda.org/functional-areas/protocol-management/protocol/20.

47. Bill Kroener discusses the FDIC's rejection of the eleven SIFIs' 2012 living wills as "not credible" and the Fed's conclusion that those living wills had various shortcomings in his chapter for this volume, "Revised Chapter 14 2.0 and Living Will Requirements Under the Dodd-Frank Act."

48. The living will requirement comes from Dodd-Frank Act § 165(d).

49. For an analogous argument that the International Monetary Fund could play a credentialing role in connection with private lenders' rescue funding

ment to provide financing not just to the SIFI itself, but also to any new corporation created for the purposes of a quick sale, so that liquidity will be available for whatever bankruptcy option the SIFI chooses.

The principal question is whether the game would be worth the candle. Given the likely costs of prearranged funding and the need to sidestep bankruptcy's automatic termination of pre-bankruptcy loan commitments, prearranged funding would be expensive and potentially complex. It also is not clear it is necessary, given the liquidity options that are available at the time a financial institution files for bankruptcy. Perhaps the best argument for incorporating at least a limited expectation of prearranged funding into the living-will process is that it would encourage financial institutions to look to a broader range of potential lenders than they would if they were arranging funding after having fallen into financial distress. But the cost of even a limited facility would be steep.

My conclusion thus far is a cautiously optimistic one: the absence of massive, orderly liquidation fund-style funding in bankruptcy may not be as crippling a limitation as the conventional wisdom suggests. Bankruptcy has more tools for generating liquidity than is often recognized; a SIFI could put a financing package in place as soon as a quick sale was completed, since the newly created corporation would not be in bankruptcy itself. To further reduce the likelihood of liquidity shortfalls, the Fed could require that the largest SIFIs arrange for funding in advance as part of the living will process, although this seems ill-advised on balance given the likely costs.

Should Congress Provide Designated Governmental Funding?

One final question remains: what about government funding? Do the sources of liquidity that I have described make governmental funding unnecessary, or is governmental funding essential? And if governmental funding is needed, what form should it take?

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arrangements with sovereign debtors, see Patrick Bolton and David A. Skeel Jr., "Redesigning the International Lender of Last Resort," *Chicago Journal of International Law* 6 (2005): 177, 196–201.

In my view, additional governmental funding is not absolutely essential for the bankruptcy process, given the potential availability of private funding and the last-resort backstop of a Federal Reserve lending program. The case for adding a more explicit governmental funding option is nevertheless strong. The first reason that governmental funding is desirable is the behavior of bank regulators themselves. Particularly if a SIFI falls into financial distress during a period of general market turmoil, as in 2008, bank regulators may be reluctant to leave a SIFI's fate to the bankruptcy process, no matter how promising the bankruptcy resolution strategy appears to be. Providing an explicit source of government funding might diminish the temptation for regulators to bail out the SIFI (as part of an "industry-wide" program, of course) rather than permit it to file for bankruptcy.[50] Second, if the SIFI did not have prearranged funding in place, there would likely be a short gap between the time the SIFI filed for bankruptcy and the moment when financing was fully available, since a lender might condition its financing on bankruptcy approval of the quick sale. By putting prearranged funding in place, the SIFI could eliminate even this small gap, but a residuum of market uncertainty might nevertheless remain until it was clear that the funding would indeed be made available. The presence of a governmental backstop would further reduce the uncertainty, and would strengthen the credibility of the bankruptcy option.

Although some form of governmental funding still seems desirable, the presence of substantial non-governmental liquidity options has significant implications for the issue of what form the governmental funding should take. The two principal options on offer are guaranteed funding comparable to the orderly liquidation fund and Federal Reserve funding under its discount window or emergency lending powers.

50. As noted earlier, the Fed theoretically could permit a SIFI to file for bankruptcy, while also providing DIP financing under an industry-wide funding arrangement. But the Fed might well conclude that it would rather provide the funding outside of bankruptcy, where the Fed has more control.

Guaranteed Funding (the OLF Approach)

The OLF's guaranteed funding approach has the great virtue of removing any serious doubts about the adequacy of the funding available to a troubled SIFI. In this sense, the use of the OLF in a SPOE recapitalization honors the memory of Walter Bagehot, whose classic lender-of-last-resort strategy called for unlimited funding to solvent institutions secured by good collateral in response to a liquidity crisis.[51] Although OLF funding is not unlimited, it is nearly so. And it would be available under all circumstances, even if the SIFI were not recapitalized, did not have sufficient unencumbered assets to support a secured loan, or could not demonstrate that it was solvent. The OLF approach removes any serious concerns about the availability of funding.

Yet the availability of very good alternative sources of funding suggests that it should not be necessary to put massive amounts of government funding in place. The conclusion is reinforced by the obvious downsides of the guaranteed funding approach. Because it does not distinguish between SIFIs that are insolvent and those that are simply illiquid, OLF-style funding could function very much like a bailout. The FDIC could flood funding into an insolvent SIFI and effectively bail out many of its creditors.[52] In Title II itself, neither the SIFI nor the bridge institution formed for the purposes of a single-point-of-entry resolution would be subject to taxes during the resolution, which adds to the bailout-like features of the process.[53]

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51. Although he advocated unlimited rescue funding to solvent institutions secured by good collateral, Bagehot proposed that it come with a penalty rate of interest, to discourage reliance on the funding after the liquidity crisis had passed. Title II does not follow Bagehot quite so closely in this regard. It calls for an interest rate based on a basket of corporate bonds.

52. Given the potential abuses of OLF funding, I strongly endorse Randy Guynn's argument that the FDIC should commit to using the funds only on a fully secured basis.

53. Dodd-Frank Act § 210(h)(10) states that: "Notwithstanding any other provision of Federal or State law, a bridge financial company, its franchise, property, and income shall be exempt from all taxation now or hereafter imposed by the

In theory, at least, American taxpayers would not bear the costs of OLF funding that functioned like a bailout. If the SIFI is unable to repay its loans from the OLF fund, Title II provides for an assessment on other SIFIs.[54] The banking industry, rather than taxpayers, would make up the shortfall. In reality, however, taxpayers would at least indirectly bear the costs, since the other SIFIs would probably pass the costs onto their customers.[55] More importantly, if a SIFI failed during a period of market-wide crisis, the prospect of assessments could exacerbate the strain on the banking industry.

Extending the Fed's Emergency Liquidity Powers to a SIFI in Bankruptcy

The other principal option is Federal Reserve lending, either through the Fed's discount window, which enables banks to borrow money on a secured basis from the Federal Reserve,[56] or through its emergency lending powers under section 13(3) of the Federal Reserve Act. As compared to OLF-style liquidity, either of these options would be considerably more targeted and less likely to invite open-ended borrowing. Fed lending is limited to financial institutions that are solvent and are capable of providing adequate collateral. The new financial institution that acquired a troubled SIFI's assets should be able to meet both requirements, but a troubled financial institution that used the ordinary bankruptcy process could not, since it would almost certainly be insolvent. As a result, access to the funds would be tightly constrained. The risk of a disguised bailout would be significantly lower than with

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United States, by any territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority."

54. Dodd-Frank Act § 210(o).

55. See, e.g., John Taylor, "Who is Too Big to Fail: Does Title II of the Dodd-Frank Act Enshrine Taxpayer-Funded Bailouts?" Testimony before the Subcommittee on Oversight and Investigations, Committee on Financial Services, US House of Representatives, May 15, 2013.

56. The Fed's discount window authority comes from section 10B of the Federal Reserve Act. For an overview of discount window operations, see Board of Governors of the Federal Reserve System, "Discount Window Lending," http://www.federalreserve.gov/newsevents/reform_discount_window.htm.

OLF-style liquidity, and there would be no need either to set aside the funds in advance or to impose a tax on other SIFIs after the fact. Given that the new capital and liquidity standards should reduce the need for liquidity, as well as the other private sources of liquidity that are available, Federal Reserve lending is a more attractive source of government funding than an OLF-style approach.

Of the two options, the Federal Reserve's emergency lending powers are somewhat more restricted, and seem especially attractive for this reason. Not only is the Fed constrained under section 13(3) by the requirement that it lend on a fully secured basis; but the Fed must also determine that the loan is needed to prevent systemic or other harm. With the discount window, by contrast, the Fed provides access even in the absence of a crisis or risk of market-wide harm.

The systemic harm prerequisite to funding under section 13(3) would effectively limit governmental funding to bankruptcy recapitalizations of the largest SIFIs, but this is appropriate. The ordinary liquidity options should be adequate for effective resolution of financial institutions that are not systemically important.

The Federal Reserve backstop isn't foolproof. The presence or absence of adequate security is to some extent in the eye of the beholder, especially with a complicated financial institution whose assets are not easily valued. The Fed could manipulate access, much as it is thought by many to have manipulated its emergency lending powers in 2008. But it is subject to significantly more constraints than OLF-style funding.

Conclusion

The most surprising finding in this analysis of liquidity in a SIFI bankruptcy is the amount of liquidity that should be available even in the absence of additional government-supplied liquidity. A SIFI's ability to suspend payments on its long-term debt will free up a small amount of liquidity, and the borrowing capacity of the newly formed quick sale corporation should generate much more liquidity. Moreover, the liquidity needs of a troubled SIFI in 2015 or 2020 should be significantly less than they were in 2008, due to the much more stringent capital and liquidity requirements imposed in the wake of the crisis.

One interesting implication is that subchapter V of the Financial Institution Bankruptcy Act of 2014, the quick sale reforms approved by the House on December 1, 2014, may not be as incomplete as is sometimes supposed. Primarily due to concerns that adding a provision for governmental liquidity would provoke political opposition, subchapter V omits any reference to liquidity. My analysis of existing liquidity options suggests that additional liquidity may not be as necessary as I and others previously imagined.

In my view, Congress would do well to extend the Fed's emergency lending powers to the SIFI quick sale context even in the absence of an industry-wide program. The requirements that any loan be fully collateralized and be available only under emergency conditions would limit the risk of bailouts and provide a backstop for extraordinary cases. Explicitly authorizing the Fed to step in under these conditions also might reduce the Fed's temptation to manipulate the existing rules—by establishing an "industry-wide" program, for instance, that clearly is designed for a single financial institution.

Whether or not lawmakers extend the Fed's lending authority to SIFI bankruptcies, a SIFI's liquidity needs for a quick sale in bankruptcy appear to be manageable. This is further evidence, it seems to me, that the quick sale contemplated by Chapter 14 2.0 could work.