

# Factbox: How Dodd-Frank's orderly liquidation regime works

By Reuters

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(Reuters) - Aiming to prevent more U.S. taxpayer bailouts, the Dodd-Frank Wall Street reforms of 2010 set up an "orderly liquidation process" for dealing with distressed financial firms. Here is how that process works:

- \* If a large, non-bank financial firm is in default or headed that way, regulators can move to put it into "orderly liquidation" if they think its collapse would threaten financial stability. It is an alternative to bankruptcy.
- \* Under the "three keys" process, orderly liquidation can be triggered only with the agreement of the Treasury secretary and the Federal Reserve, with the concurrence of Federal Deposit Insurance Corp, the Securities and Exchange Commission or the new Federal Insurance Office, depending on the type of firm. The president has to be consulted too.
- \* An orderly liquidation order can be challenged and blocked, if found improper, in court. The court must act within 24 hours. If it does not, the order goes ahead.
- \* Once orderly liquidation begins, the firm is placed in receivership. That means the FDIC takes over. It develops a plan for dealing with the firm's problems, and it provides funds to keep the firm from collapsing. FDIC receivership can last up to five years.
- \* For broker-dealers, the Securities Investor Protection Corp acts as trustee to handle the liquidation. For insurers, state regulators are supposed to step in since the insurance industry has no federal regulator. If a state agency does not act within 60 days, the FDIC handles it.
- \* The FDIC must coordinate its work with foreign authorities if the firm has assets or operations abroad.
- \* The FDIC must dismiss the officers and directors responsible for the firm's problems.
- \* Shareholders of the firm get no money until all other claims against the firm are paid.
- \* The FDIC itself may not invest in the firm.
- \* Creditors owed money by the firm can file a claim to get it back. The FDIC can disallow claims in part or entirely, and must draw up a priority list of who gets what.
- \* To settle the firm's debts, the FDIC can sell the firm's assets, sell the firm itself, or merge it with another firm. The FDIC can transfer assets into a bridge company, created by the agency, that can be active for up to five years. The bridge company can be sold or merged by the FDIC, as well.
- \* The FDIC can borrow money from the Treasury Department to cover liquidation costs. The amount it can borrow is limited, based on the value of the firm involved.
- \* The FDIC and the Treasury have to agree, with congressional consultation, on a plan to repay the debt, plus interest, out of income derived from liquidating the firm's assets, as well as assessments charged by the FDIC against claimants that got more money back from the FDIC than they would have in a bankruptcy. If these sources of funds are not enough, the FDIC can charge fees against other firms, including bank holding companies with more than \$50 billion in assets and non-bank financial firms regulated by the Fed.
- \* The FDIC can enforce or break legal contracts made by the firm before it was seized. This is an important area for large financial firms involved in qualified financial contracts (QFCs), such as repurchase agreements, swaps, options, futures, forwards and other types of derivatives. Some counter-parties to QFCs may close out their contracts with the firm in receivership. But the FDIC can impose a temporary stay of counter-parties' termination rights that restricts them from closing out QFC positions for one business day after the FDIC takes over. The FDIC can block walkaway clauses in QFCs, preventing counter-parties from abandoning their obligations. The agency can invalidate "ipso facto" clauses that allow one party to cancel a contract if the other party becomes insolvent or bankrupt. It can transfer QFCs, as well, to a bridge company and bar counter-parties from closing out due solely to the transfer.
- \* The FDIC can pursue former officers and directors of the firm for negligence. It can move to ban culpable managers from the financial services industry for two years or more.
- \* Any financial company put into orderly liquidation must be liquidated and no taxpayer funds may be used to prevent that from happening. All funds used to cover liquidation costs must be recovered by the FDIC from the sale of assets or assessments on the industry, not from taxpayers.
- \* Studies of orderly liquidation and bankruptcy must be done by the courts and the Government Accountability Office. Each must report to Congress on July 2011, 2012 and 2013. A GAO study on international coordination is due in July 2011.

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