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Symposium Introduction: Treatment of Financial Contracts in Bankruptcy and Bank Resolution

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~SYMPOSIUM INTRODUCTION~

TREATMENT OF FINANCIAL CONTRACTS IN BANKRUPTCY AND BANK RESOLUTION

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The legal architecture for addressing the failure of a financial firm straddles the law of bank resolution and enterprise bankruptcy. As a result, different entities in the same corporate group may find themselves governed by different bodies of law, or even uncertain which one applies. Where financial contracts are involved, the two regimes follow radically different approaches. This symposium explores how the asymmetry created by the so-called bankruptcy "safe harbors" complicates the straddle, makes it difficult, if not impossible, to restructure a financial firm in bankruptcy court or elsewhere, and may also undercut the ability of a bankruptcy court to restructure a non-financial firm.

This introduction briefly provides an overview of the two conflicting treatments of financial contracts in bankruptcy and bank resolution, the relevant legal instruments, and the legal developments since 2008. The Articles in this symposium each explore aspects of this problem and suggest reforms.

I. BACKGROUND EXAMPLE: SAFE HARBORS AND SIFIS UNDER U.S. LAW

The safety and soundness of the financial system and the content of bankruptcy law are closely intertwined. In the United States, concern about contagion and bank runs, often associated with economic downturns, dates back to the Great Depression and before. Events with significance for the financial system can originate either in the financial sector (Wall Street), or in the regular economy (Main Street). The dividing line between the financial system and the ordinary economy is not clear. In the United States, however, these overlapping systems are handled by two distinct legal architectures—one for banks and one for ordinary businesses.

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Concerns about bank failure and bank runs are handled by the Federal Deposit Insurance Corporation (FDIC) and other bank regulators, while failure or reorganization of "ordinary firms" is handled through bankruptcy under Title 11 of the U.S. Code (Bankruptcy Code).[1] While the recent enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)[2] shifts the dividing line by treating systemically important financial institutions (SIFIs) more like banks, this Main Street/Wall Street division remains legally intact. Indeed, it may even have been reinforced by Dodd-Frank. Large investment banks were always on the "Wall Street" side of the equation.[3] However, it never occurred to anybody that they might fail, so they were left out of the FDIC's bank resolution jurisdiction. The financial crisis and Dodd-Frank Act changed all that, but concerns remain. Many large financial firms are not banks or SIFIs (e.g., a large hedge fund), and the failure of non-financial firms (e.g., Chrysler or GM) can have systemic effects.

The key difference between the two regimes emerged after the enactment of the Bankruptcy Code in 1978, when a number of adjustments were made to the ordinary bankruptcy regime to accommodate the perceived needs of financial markets. The first generation of accommodations was embodied in a series of provisions exempting certain types of financial contracts from the automatic stay and avoidance.[4] These so-called "safe harbors" or "immunities" were incorporated into the Bankruptcy Code, first in the 1980s, and then expanded significantly in 2005. Until recently, they were viewed as "best practices," reflected in the IMF/World Bank Insolvency and Creditors' Rights Regimes ROSC Assessment Methodology (ROSC Methodology) discussed below,[5] and, as noted in Professor Mokal's contribution to this symposium, they remain a feature in UNCITRAL's Legislative Guide for Insolvency (Legislative

1. *Compare* Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (codified as amended in scattered sections of 12 U.S.C.) (providing resolution procedures for FDIC insured banks), *and* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, §§ 201–214, 124 Stat. 1376, 1442–1518 (2010) (codified at 12 U.S.C. §§ 5381–5394 (2012)) (providing resolution procedures for systemically significant financial institutions), *with* the Bankruptcy Code, 11 U.S.C. § 109 (2012) (permitting bankruptcy relief for individual and enterprise debtors).

2. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111–203, 124 Stat. 1376 (2010).

3. Even after Dodd-Frank, discussed *infra*, financial firms are expected to use bankruptcy unless to do so would have systemic consequences. *See* 12 U.S.C. § 5383(b)(2) (2012).

4. Stockbroker-Commodity Broker Amendments to the Bankruptcy Code, Pub. L. No. 97-222, 96 Stat. 235 (1982) (amending 11 U.S.C. § 362(b)(6) and adding §§ 555, 556 (2012)). *See also In re* Grafton Partners, 321 B.R. 527, 532–33 (B.A.P. 9th Cir. 2005) (Klein, J.) ("Public Law 97-222 was a package of amendments designed to protect the carefully-regulated mechanisms for clearing trades in securities and commodities in the public markets from [the] dysfunction that could result from the automatic stay and from certain trustee avoiding powers.").

5. *See infra* Part II.E.

Guide).[6] The articulated concern that motivated the safe harbors was clearance—or intermediary—risk; a broker-dealer or other financial firm might fail, and the automatic stay and the prospect of avoidance might disrupt the clearance of transactions and undermine confidence in securities markets. When the safe harbors were first added to the Bankruptcy Code in 1982, the House Report stated:

> The commodities and securities markets operate through a complex system of accounts and guarantees. *Because of the structure of the clearing systems in these industries and the sometimes volatile nature [of] the markets*, certain protections are necessary to prevent the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market.[7]

This quotation does not reflect a concern with so-called "Too Big To Fail" or "systemically important" financial institutions. Quite the contrary, the paradigmatic institution was assumed to be a financial intermediary that was *not* too big to fail. The failure of the intermediary itself was not expected to have systemic effects. Instead, the concern was with the effect of certain bankruptcy rules on trading and clearance within certain financial product markets if a small financial firm failed. The concern was about Wall Street, but not about the safety and soundness of the banking system generally.[8] The resulting adjustments to the Bankruptcy Code reflected a desire to preserve the liquidity of securities markets, even at the expense of the insolvent financial firm itself—which would likely be liquidated under the Securities Investor Protection Act (SIPA)[9]—and the firm's non-financial creditors.

These adjustments took two forms. First, certain transactions were exempted from the automatic stay, so: (1) "ipso facto" or "termination" clauses could be enforced upon bankruptcy; (2) obligations arising out of transactions between counterparties could be set off on an aggregate basis (netted); and (3) any collateral securing the contract or contracts could be

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6. U.N. COMM'N ON INT'L TRADE L., UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW, recs. 101–07, U.N. Sales No. E.05.V.10 (2005) [hereinafter LEGISLATIVE GUIDE].

7. H. REP. NO. 97-420, at 1–2 (1982), reprinted in 1982 U.S.C.C.A.N. 583, 583 (emphasis added).

8. While it is not the focus of this symposium, it is important to note that this quote does not reflect a concern about transactions that do not involve a securities intermediary, and may cast in doubt the Second Circuit's recent interpretation of these sections. *See In re* Bernard L. Madoff Inv. Sec. LLC, 773 F.3d 411 (2d Cir. 2014); *In re* Enron Creditors Recovery Corp., 651 F.3d 329 (2d Cir. 2011); *but see In re* MacMenamin's Grill, Ltd., 450 B.R. 414, 425 (Bankr. S.D.N.Y. 2011) (excluding payments from safe harbored treatment by noting that they were not "financial markets" transactions with systemic risk implications, but probably overruled *sub silentio* by the *Madoff* case).

9. Securities Investor Protection Act of 1970, Pub. L. No. 91-598, 84 Stat. 1636 (codified as amended at 15 U.S.C. §§ 78aaa–78lll (2012)).

sold.[10] Collectively, these features are often referred to as "closeout netting," but really there are three steps: termination, setoff, and sale of collateral. Second, these same transactions were treated as final and exempt from preference or other later avoidance for any reason other than intentional (or actual) fraud.[11]

The cumulative effect of these provisions is to allow certain creditors to make themselves whole notwithstanding bankruptcy, while reducing the distribution to other claimants. More importantly, the financial contracts subject to netting are not available for use by the debtor as cash collateral.[12] Hence, the safe harbors have two second-order consequences. They prefer one set of creditors to others, and they reduce the debtor's available cash, thereby limiting or eliminating the possibility for successful reorganization or going concern sale.

The FDIC and U.S. bank regulators follow a different approach to bank insolvency than the Bankruptcy Code. Banks largely hold financial assets, rather than hard assets. Because these assets are liquid and the value is not directly linked to the bank's business operations, the usual practice is to quickly divide the failed bank into two pieces: a good bank—containing performing assets and assets with readily ascertainable value; and a bad bank—containing non-performing or illiquid assets. The performing assets are then sold to another financial institution, while the non-performing assets are transferred to the government. Key differences between bankruptcy and bank resolution are: (1) unlike bankruptcy, which may take an extended period of time, these "bridge bank" transactions are generally accomplished over a weekend, and completed before the end of the business day on Monday; and (2) there is no exemption or "safe harbor" for financial contracts. Indeed, as discussed below, the termination of financial contract is subject to a short stay. The transfer of the financial contract to another financial institution is then deemed to cure any default. In short, netting is stayed briefly, and then resumes in the ordinary course once the financial contract is transferred, but no "termination" or "closeout" occurs.

Significantly, the focus of the bank resolution regime is not contagion as a result of lost liquidity due to clearance delay (i.e., "intermediary" or

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10. Many derivative counterparties who engage in repeated or multiple transactions conduct their affairs pursuant to a master netting agreement that provides for contract based netting rights. This is one way in which closeout netting, in this context, has a more extensive ambit than standard setoff rights arising by operation of law in many legal systems. *See* INT'L INST. FOR THE UNIFICATION OF PRIVATE LAW [UNIDROIT], PRINCIPLES ON THE OPERATION OF CLOSE-OUT NETTING PROVISIONS 1–2 (2013) [hereinafter UNIDROIT NETTING PRINCIPLES], http://www.unidroit.org/english/principles/netting/netting-principles2013-e.pdf. The current safe harbors can be found at 11 U.S.C. §§ 362(b)(6), (7), (17), (27), 546(e)–(g), 555–556, 559–561 (2012).

11. *See* 11 U.S.C. § 546(e), (g).

12. *See id.* § 363(c).

"clearance" risk). The contagion concern is more immediate; the failure of one institution may have an effect on its counterparties directly. This is sometimes referred to as "counterparty risk" or "Too Big To Fail" risk.

Lehman Brothers demonstrated the mismatch between these distinct approaches to systemic risk.[13] Lehman, like other investment banks, did not take customer deposits, so they were not under the jurisdiction of the FDIC. As an investment bank, however, many of Lehman's assets and liabilities fell into the "safe harbored" category. With no bankruptcy stay or short stay, the early termination of financial contracts proved a serious problem in maximizing the value of Lehman's assets.[14] More specifically, even though a sale to Barclay's was in the works, the absence of a bankruptcy stay meant that a regulatory delay in the United Kingdom made it impossible to complete a going concern sale. The consequences of Lehman's disorderly failure are still being felt today.

The legislative response to Lehman's failure took the form of Title II of the Dodd-Frank Act.[15] The Dodd-Frank Act expanded the FDIC's jurisdiction to include SIFIs.[16] In other words, large nonbank financial institutions were given access to the bank resolution regime in cases where resolution in bankruptcy would create systemic risk.

Even after the Dodd-Frank Act, the regimes for treatment of financial contracts remain divided between the bank resolution regime—focused on limiting contagion caused by the failure of a systemically significant counterparty, and the ordinary bankruptcy regime—focused on isolating clearance or intermediary risk caused by the failure of a systemically insignificant intermediary. The risks are not identical, and the approaches followed in the two systems sometimes work at cross-purposes. As Lehman illustrated, because of its size, the possibility of Lehman defaulting on its own contracts had systemic risk implications. It appears that protecting the early termination and netting rights of Lehman counterparties may have actually accelerated the contagion. The ensuing panic nearly "broke the buck," endangering the securities in money market mutual funds that were axiomatically supposed to trade at par.[17] Where the counterparty is systemically significant, the perceived imperatives of the two systems must be balanced against each other and perhaps reexamined to more effectively address future systemic crises.

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13. *See* Kenneth Ayotte & David A. Skeel, Jr., *Bankruptcy or Bailouts?*, 35 J. CORP. L. 469 (2010).

14. *See* Mark J. Roe & Stephen D. Adams, *Restructuring Financial Firms in Bankruptcy: Lessons from Lehman* (Harvard Law School, Discussion Paper No. 796, 2014).

15. Dodd-Frank Act, Pub. L. No. 111–203, tit. II, 124 Stat. 1376, 1442 (2010).

16. *Id.* §§ 161, 165, 203, 124 Stat. 1376, 1420–1421, 1423–1432, 1450–1454.

17. Philip Swagel, *Why Lehman Wasn't Rescued*, N.Y. TIMES (Sept. 13, 2013, 1:18 PM), http://economix.blogs.nytimes.com/2013/09/13/why-lehman-wasnt-rescued/?_php=true&_type=blogs&_r=0.

II. POST-CRISIS DEVELOPMENTS AND SUBSEQUENT INTERNATIONAL INSTRUMENTS

Since the 2008 financial crisis, there have been significant developments in the approach to systemic risk in the financial system. In the United States, this was manifested through the enactment of Titles I and II to the Dodd-Frank Act discussed above. At the international level, the Financial Stability Board (FSB) and UNIDROIT have reevaluated the appropriate framework from a post-crisis perspective.

Under these newer standards, preservation of liquidity remains important, but the scope of the recommended safe harbors has been narrowed to focus more tightly on intermediary risk, reaching only transactions where a financial institution is actually involved. With regard to counterparty risk, by contrast, the focus has been expanded beyond resolution of banks to include non-bank SIFIs.

A. FSB KEY ATTRIBUTES

The FSB has published a list of "Key Attributes" for resolution of financial institutions.[18] Their approach to netting follows the FDIC bank

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18. FIN. STABILITY BD., KEY ATTRIBUTES OF EFFECTIVE RESOLUTION REGIMES FOR FINANCIAL INSTITUTIONS (2014) [hereinafter FIN. STABILITY BD., KEY ATTRIBUTES], http://www.financialstabilityboard.org/wp-content/uploads/r_141015.pdf. The Key Attributes provides in pertinent part:

> 4. Set-off, netting, collateralisation, segregation of client assets
>
> 4.1 The legal framework governing set-off rights, contractual netting and collateralisation agreements and the segregation of client assets should be clear, transparent and enforceable during a crisis or resolution of firms, and should not hamper the effective implementation of resolution measures.
>
> 4.2 Subject to adequate safeguards, entry into resolution and the exercise of any resolution powers should not trigger statutory or contractual set-off rights, or constitute an event that entitles any counterparty of the firm in resolution to exercise contractual acceleration or early termination rights provided the substantive obligations under the contract continue to be performed.
>
> 4.3 Should contractual acceleration or early termination rights nevertheless be exercisable, the resolution authority should have the power to stay temporarily such rights where they arise by reason only of entry into resolution or in connection with the exercise of any resolution powers. The stay should:
>
>> (i) be strictly limited in time (for example, for a period not exceeding 2 business days);
>>
>> (ii) be subject to adequate safeguards that protect the integrity of financial contracts and provide certainty to counterparties (see Annex IV on Conditions for a temporary stay); and
>>
>> (iii) not affect the exercise of early termination rights of a counterparty against the firm being resolved in the case of any event of default not related to entry into resolution or the exercise of the relevant resolution power occurring before, during

regime described above, not the bankruptcy regime. Section 4 of the Key Attributes recommends either limiting early termination rights to exclude entry of the firm into resolution, or imposing a short stay.[19] Unlike the "safe harbor" approach used in bankruptcy (i.e., general enterprise insolvency), commencement of the resolution of a financial institution is not a basis for early termination of financial contracts. Even if termination is provided for by contract, such termination is stayed for a short period. The purpose of the stay is to permit the resolution authority to arrange for a transfer of assets to another solvent financial institution.

Such a transfer would accomplish nothing if upon transfer of the assets the contracts were still subject to early termination, so upon transfer, the termination of financial contracts is further stayed—or more accurately deemed not a default.[20] In short, unlike the bankruptcy safe harbor regime that contemplates immediate termination, netting, and protection of finality notwithstanding insolvency, the regime proposed by the FSB Key Attributes contemplates preservation of netting rights. However, if all works as planned, premature termination and close-out netting will not occur, but neither will any market disruption, beyond the short stay.

> > or after the period of the stay (for example, failure to make a payment, deliver or return collateral on a due date).
>
> The stay may be discretionary (imposed by the resolution authority) or automatic in its operation. In either case, jurisdictions should ensure that there is clarity as to the beginning and the end of the stay.
>
> 4.4 Resolution authorities should apply the temporary stay on early termination rights in accordance with the guidance set out in Annex IV to ensure that it does not compromise the safe and orderly operations of regulated exchanges and FMIs.

Id. at 10–11 (Key Attribute 4).

19. *Id.*

20. *Id.* Key Attribute 3.3 provides in pertinent part:

> Transfer of assets and liabilities
>
> 3.3 Resolution authorities should have the power to transfer selected assets and liabilities of the failed firm to a third party institution or to a newly established bridge institution. Any transfer of assets or liabilities should not:
>
> > (i) require the consent of any interested party or creditor to be valid; and
> >
> > (ii) constitute a default or termination event in relation to any obligation relating to such assets or liabilities or under any contract to which the failed firm is a party (see Key Attribute 4.2).

B. UNIDROIT PRINCIPLES ON THE OPERATION OF CLOSE-OUT NETTING PROVISIONS

UNIDROIT has similarly developed a set of principles on close-out netting for financial contracts (UNIDROIT Principles).[21] While the FSB Key Attributes apply only to close-out netting in the context of financial institution resolution, the UNIDROIT Principles provide guidance on the operation of close-out netting generally, including their operation in insolvency. In this respect, they are designed also to apply to the insolvencies of entities that are not financial institutions. While the two sets of principles can be reconciled, there are some important differences in approach.

The UNIDROIT Principles advocate respect of close-out netting provisions in financial contracts. They are narrower than the U.S. safe harbors, described above, and the approach advocated by such pre-crisis instruments as the UNCITRAL Legislative Guide.[22] The specific differences are:

- As a suggested minimum standard, the definition of financial contract is limited to those contracts where one of the parties is a financial institution or public authority.
- They take account of the possibility that the domestic law will impose a stay on termination of financial contracts in the context of its bank resolution regime.
- Neither the Key Attributes nor the UNIDROIT Principles address issues relating to sale of collateral or insulation from later avoidance as a preference or constructive fraudulent conveyance.[23]

Principle 1 defines the scope of the UNIDROIT Principles as limited to transactions where at least one party is a financial institution or central bank.[24] It states that the UNIDROIT Principles, "deal with the operation of close-out netting provisions that are entered into by eligible parties in respect of eligible obligations."[25] "Eligible parties," include any person who is not an individual engaged in a consumer transaction.[26] "Eligible obligations," are defined in Principle 4 as any of a wide variety of financial contracts where at least one party is a "qualifying financial market participant" or "public authority."[27] For transactions covered by the

21. UNIDROIT NETTING PRINCIPLES, *supra* note 10.
22. LEGISLATIVE GUIDE, *supra* note 6, recs. 101–07.
23. Though, under UNIDROIT Principle 7.1(c), the act of netting post-petition, pursuant to the safe harbor would not, in and of itself, be a basis for avoidance. UNIDROIT NETTING PRINCIPLES, *supra* note 10, princ. 7.1(c).
24. *Id.* princ. 1.
25. *Id.*
26. *Id*. princ. 3.
27. *Id.* princ. 4. Those terms are defined in Principle 3 as follows:

UNIDROIT Principles, Principle 7 states that early termination and closeout of the transaction would not be stayed.[28] However, under Principle 8, if there *is* a stay under the nation's bank resolution regime, that stay would still apply with regard to the insolvency of the financial institution.[29]

Thus, if the debtor is a financial institution, a short stay will likely apply to its financial contracts when it is resolved, but if the debtor is a non-financial institution that has entered into a financial contract with a financial institution, the netting of the transaction will not be stayed. The UNIDROIT Principles, thus, provide safe harbors for derivatives when they are an asset held by a financial institution and the debtor is not subject to the bank resolution regime. By contrast, a short stay is likely to apply and termination is likely to be foreclosed when it is the bank itself that fails and owes obligations under the financial contract.

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(2) 'Qualifying financial market participant' means any of the following:

(a) a bank, investment firm, professional market maker in financial instruments or other financial institution which (in each case) is subject to regulation or prudential supervision;

(b) an insurance or reinsurance company;

(c) an undertaking for collective investment or an investment fund;

(d) a central counterparty or a payment, clearing or settlement system, or the operator of such a system which (in each case) is subject to regulation, oversight or prudential supervision;

(e) a corporation or other entity that, according to criteria determined by the implementing State, is authorised or supervised as an important participant in the implementing State's markets in contracts giving rise to eligible obligations.

(3) 'Public authority' means any of the following:

(a) a governmental or other public entity;

(b) a central bank;

(c) the Bank for International Settlements, a multilateral development bank, the International Monetary Fund or any similar entity.

28. *Id.* princ. 7. Principle 7 provides:

Operation of close-out netting provisions in insolvency and resolution

(1) Subject to Principle 8 and in addition to Principle 6, the law of the implementing State should ensure that upon the commencement of an insolvency proceeding or in the context of a resolution regime in relation to a party to a close-out netting provision:

(a) the operation of the close-out netting provision is not stayed; . . .

(c) the mere entering into and operation of the close-out netting provision as such should not constitute grounds for the avoidance of the close-out netting provision on the basis that it is deemed inconsistent with the principle of equal treatment of creditors;

29. *Id.* princ. 8.

C. ISDA RESOLUTION STAY PROTOCOL

The asymmetry between bankruptcy and bank insolvency caused another problem that has required post-crisis adjustment. While the FDIC has the power to impose the short stay in bank resolution, and many other jurisdictions do the same, there is no guaranty that the short stay approach will be recognized across international boundaries. A similar problem arises under Dodd-Frank, which assumes that the usual approach to restructuring SIFIs will be in bankruptcy, unless the use of bankruptcy, rather than receivership, would have systemic effects.[30] In order to ensure international recognition of the short stay and to facilitate SIFI restructuring in bankruptcy, regulators and the International Swaps and Derivatives Association (ISDA) entered into a series of discussions about how one might impose a short stay by contract. The result of these discussions was the ISDA 2014 Resolution Stay Protocol (2014 Protocol). The approach was to amend the master netting agreements handling derivative contracts between and among signatory institutions to implement short stay treatment. While the 2014 Protocol applied only to swaps, it has now been superseded and expanded by the ISDA 2015 Universal Resolution Stay Protocol (ISDA Protocol) which covers a broader range of derivatives.[31]

D. SINGLE POINT OF ENTRY – BAIL-IN

The ISDA Protocol is an integral part of a larger strategy advocated by the FDIC to implement a so-called "single point of entry" approach to resolution of large financial firms. The approach envisions a holding company structure in which the parent company would be structured to serve as a source of capital and liquidity should a financial shock strike one or a number of its subsidiaries. In the event of a financial shock to one of its subsidiaries, the parent would transfer assets to the subsidiary. The holding company would then, if necessary, file for bankruptcy, or enter receivership, while the recapitalized subsidiaries would continue to operate.[32] It is assumed that this resolution process would be accomplished

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30. 12 U.S.C. § 5383(a)(2), (b)(2) (2012).

31. *See* 2014 ISDA RESOLUTION STAY PROTOCOL (INT'L SWAPS & DERIVATIVES ASS'N 2014), https://www2.isda.org/functional-areas/protocol-management/protocol/20 (the protocol, "enables parties to amend the terms of their Protocol Covered Agreement to contractually recognize the cross-border application of special resolution regimes applicable to certain financial companies and support the resolution of certain financial companies under the United States Bankruptcy Code."). *See also ISDA 2015 Universal Resolution Stay Protocol*, INT'L SWAPS & DERIVATIVES ASS'N, http://www2.isda.org/functional-areas/protocol-management/protocol/22 (last visited Mar. 6, 2016) ("The operative provisions of the ISDA 2015 Universal Protocol are nearly identical to the ISDA 2014 Protocol [except for the addition of an annex] . . . . that expands the ISDA 2015 Universal Protocol to cover certain securities finance master agreements.").

32. *See* Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18 2013).

in forty-eight hours, consistent with the short stay. Needless to say, the strategy has not yet been tested.

To the extent that the parties to financial contracts are signatories to the ISDA Protocol, early termination will not be a problem. However, this may not always be the case. In order to facilitate reorganization in bankruptcy, legislation has been proposed in Congress. There are currently Bills pending in the Senate, and House of Representatives.[33] The Senate Bill contemplates the creation of a Chapter 14 of the Bankruptcy Code to address the insolvency of financial firms. The House Bill would add a number of provisions to Chapter 11 of the Bankruptcy Code that would apply to financial firms. All versions contemplate a short stay to facilitate the transfer of the firm's assets to a bridge bank, and then transfer to a solvent counterparty. For eligible firms, the bankruptcy safe harbors would be overridden during the pendency of the short stay.

E. World Bank Standard

As the discussion above shows, in the wake of the 2008 financial crisis, the short stay approach to financial crisis has expanded beyond bank resolution to include the resolution of large financial firms, even in bankruptcy. This posed a problem to the World Banks' efforts to evaluate the legal systems of countries that receive loans under their ROSC Methodology. Until recently, their best-practice standard for debtor/creditor regimes required treatment that tracked the pre-crisis safe harbor approach. The World Bank convened a Task Force to determine whether the existing standard was consistent with current best practice.[34] In response, the World Bank revised its standard C10.4 to allow for a regime that contemplated a short stay to facilitate orderly transfer of a derivative portfolio.[35]

III. THE VOLUME

The Articles in this symposium volume discuss the issues above in greater detail.

Riz Mokal examines the bankruptcy treatment of financial contracts from an international perspective. He discusses the role of the safe harbors as potential contagion accelerators, as well as the way in which they distort investment incentives. He argues that, instead of increasing the safety of the

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33. S. 1840, 114th Cong. (2015); S. 1841, 114th Cong. (2015); H.R. 2947, 114th Cong. (2015).

34. *See* World Bank, Working Group Meeting Notes, *Insolvency and Creditor/Debtor Regimes Principles: The Treatment of Financial Contracts in Insolvency* (Dec. 17, 2014), http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTLAWJUSTICE/EXTGILD/0,,contentMDK:23659444~menuPK:9771000~pagePK:4789622~piPK:64873779~theSitePK:5807555,00.html (follow "Expert Group Meeting Notes").

35. *See id.*

financial system, bankruptcy "safe harbors" actually increase systemic risk in two key ways. First, they create "froth" by encouraging overinvestment; and, second, they increase the macroeconomic risk faced by the banks that invest in derivatives. In the process, he also reviews the legal evolution described above, and, in particular, the process of amendment to the World Bank's best practice standard.

Anna Gelpern and Erik Gerding develop the concept of "safe assets"—assets that capital markets treat as risk free. They explain how the safety of these assets is constructed through a series of legally bestowed attributes, credit enhancements (guarantees), and labeling. Some of these attributes are created by private ordering, some by special legal treatment, and some through public backstops. On the one hand, preserving the value of these safe assets is an important aspect of the bank resolution regime, and the bankruptcy safe harbors are an attempt to use special legal treatment to enhance the safety of certain instruments. On the other hand, the need to maintain the market perception (perhaps "myth") of safety raises a number of concerns about unanticipated risk in the financial system, and nontransparent political choices. Their Article assesses the bankruptcy safe harbors in this context.

Adam Levitin explores another mechanism for making assets "safe"—clearinghouses. For certain instruments, instead of clearing directly, the instruments clear through clearing intermediaries that have their own loss-bearing capacity and impose margin requirements on participants. To the extent that they are involved, clearinghouses do much of the work in preserving the liquidity of "safe" instruments by insuring against the failure of clearinghouse members. In Levitin's view, clearinghouses may preserve the liquidity of financial instruments without some of the distortive effects of the safe harbors. However, he acknowledges that, by concentrating risk in the clearinghouses, they themselves may become "too big to fail."

Edward Janger and John Pottow directly address the asymmetry between bankruptcy and bank resolution regimes for financial contracts, and suggest changes to the Bankruptcy Code to implement symmetric treatment. Dodd-Frank creates an Orderly Liquidation Authority (OLA) that can be used to resolve SIFIs. However, the OLA is contemplated as a backstop to the Bankruptcy Code, to be used only where necessary for systemic risk reasons. Moreover, there are a significant number of financial firms that may not be classified as SIFI's, and can, therefore, only be restructured in bankruptcy. The safe harbors make such restructuring impossible. Janger and Pottow suggest that a short stay approach might be extended to financial firms that use bankruptcy to restructure, and explore the nuts and bolts changes that would have to be made to the Bankruptcy Code to effectuate an orderly transfer or assumption of a derivatives portfolio.

Finally, Irit Mevorach discusses international recognition of resolution orders. She acknowledges the importance of the ISDA Protocol, but notes that since the Protocol does not cover all parties or all instruments, a legally constructed recognition regime may be necessary as well. For this, she advocates a regime that mirrors the recognition architecture used for ordinary enterprises under the UNCITRAL Model Law for Cross-Border Insolvencies.

Together, these Articles acknowledge the progress that has been made in rationalizing the treatment of financial contracts in bank and bankruptcy resolution, but also describe the steps that must be taken if the next financial crisis is to be addressed in an orderly fashion.