

# The Limits of Bankruptcy

## The Problem of Large Complex Multinational Financial Institutions

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## **Bankruptcy is**

“A coordinated solution to a collective action problem.”

## **Time for orderly resolution**

To collect claims/assets, reach and execute decisions

Stay of creditor claims/actions

## **Single locus of decision making**

Multiple coordinators: conflicts of interest

Ring fencing and unitary approaches

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## **Timeliness**

Early initiation to preserve assets and going concern value

## **One insolvency, one company**

Little recognition of related, but not subordinate, proceedings

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## **LCMFIs are**

Large collection of legally distinct companies operating under a holding company across multiple legal jurisdictions

Not single unified company

## **LCMFIs usually involve**

Significant derivatives positions which are exempt from stays

Wholesale funding which can “run”

**These realities complicate resolution**

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## **LCMFI resolution will involve multiple proceedings**

Rules governing cooperation and ancillary proceedings may not help much

Subsidiaries are likely to be separately resolved

Tendency to preserve assets for domestic creditors

Multiple proceeding easily leads to conflict and litigation among jurisdictions

E.g., Bank of New England proceedings

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## **Close-out and wholesale funding runs**

Happen very quickly

Little warning (viewed ex ante)

Forces regulators to act hastily

## **Inability to stay close-out/stop runs**

Destroys “going concern”

Guarantees may become inevitable

Haircuts not easily imposed

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## Cannot easily change realities

Break up LCMFIs (trust busting)?

Probably impractical and ill advised

Prevent close-out netting of derivatives?

Enormous adverse consequences to markets

Reduce reliance on wholesale funding?

Worth considering

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## **Inevitable protection of derivatives**

Ensure robust collateralization of positions to reduce costs of taking over derivatives book

Current collateral practices exacerbate crisis

## **Legal fragmentation**

Plan for failure: Where are the assets?

Adapt thinking: It isn't a single company!

Opportunity: Save the systemic parts

## **Requires rethinking and legislation**

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