

Resolution Authority Redux

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The Financial CHOICE Act before Congress would rewrite the Dodd-Frank Act of 2010 and replace its dual approach to the prevention of systemic collapse: Title I—Systemic Risk Regulation and Oversight—and Title II—Orderly Liquidation Authority (OLA) for Systemic Risk Companies.

The CHOICE Act provides a regulatory off-ramp that would relax or remove Dodd-Frank safeguards such as required stress tests and Living Wills. This improvident deregulatory proposal suffers from two main conceptual flaws. First, it ignores the fact that not only regulators, but market actors as well, can be mistaken about financial risks. Second, in its zeal to address moral hazard, the proposal forgets the lessons of the 1930s. It is a dangerous idea that the only option in a systemic crisis is simply to let firms fail, regardless of the consequences.

We endorse the CHOICE Act's proposed replacement of the OLA with a new subchapter of the bankruptcy code and we favor the Act's proposed elimination of an industrywide fund assessment. The new bankruptcy subchapter should, however, allow for DIP financing by the federal government as part of a more general authority to address systemic liquidity concerns.