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F.D.I.C. Outlines Path to Financial Repair

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WASHINGTON — Federal bank regulators took a first step on Tuesday to spell out how they would use a new law to seize and dismantle large, failing financial institutions so that taxpayers are not on the hook, as they were in the 2008 financial crisis.

The Dodd-Frank overhaul of Wall Street regulations that President Obama signed in July allows for the Federal Deposit Insurance Corporation to be appointed as a receiver to bring about the “orderly liquidation” of huge financial companies as an alternative to bankruptcy court.

The new power, known as resolution authority, is intended to avoid a recurrence of an event like the September 2008 bankruptcy of Lehman Brothers, which plunged financial markets around the world into turmoil and quickly led to several government-financed bailouts.

Created in 1933, the F.D.I.C. has long had the power to take over failed banks. Now it must prepare to perform a similar role for giant, global financial institutions that are not traditional commercial banks.

Considerable doubt remains among legal specialists about whether the new mechanism is feasible, particularly because international regulators have yet to agree on “cross-border resolution” of failing institutions that have global reach.

Even so, the F.D.I.C. said Tuesday that its board had agreed to propose a rule spelling out how it will handle the claims of creditors under the new authority.

“Shareholders and unsecured creditors should understand that they, not taxpayers, are at risk,” Sheila C. Bair, the F.D.I.C. chairwoman. said.

The proposal would require the creditors of a large financial firm to suffer losses if the firm fell apart. It would “absolutely bar” additional payments to shareholders and holders of long-term senior debt and subordinated debt, who would not be treated better than other creditors. “All creditors must expect to absorb losses in any liquidation,” the notice of the proposal said.

But the proposal would give the F.D.I.C. board some flexibility to make payments to certain creditors if the payments were for “essential operations,” or help to maximize what can be later recovered from the company’s assets and minimize losses.

The F.D.I.C. would have to take a recorded vote on such payments, in the name of accountability, and the payments could be recouped if the money recovered from the firm was ultimately insufficient to pay back any temporary government lending to help liquidate the company. After that money was recouped, or “clawed back,” the financial industry would be charged a general assessment to “cover any shortfalls,” the proposal says.

Critics have warned that allowing any discretion to make payments to creditors could be dangerous. They fear it could accelerate the failure of an institution by encouraging creditors to flee or call in loans.

Ms. Bair said the proposed regulation “represents a significant narrowing of the discretion provided under Dodd-Frank for differentiation among creditors, consistent with the law’s overarching public policy objective to maximize market discipline and make clear that all equity and unsecured debt holders are at risk.”

The proposal also specifies that secured creditors would only be protected up to the value of their collateral. It encourages corporate borrowers to put up “highly liquid and easy-to-value collateral, such as U.S. government obligations,” against their short-term debts. The proposal, which will be subject to a period of public comment before it is completed, leaves unanswered several questions, including the logistics of taking apart a failing firm and how to impose a levy on the financial industry if the government has to step in to provide temporary financing. Officials said those issues would be addressed in additional rule making.