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Mid-Atlantic Bankruptcy Workshop

Working Lunch: Banking Crisis

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Banking Crisis: Panel Participants



Agenda:

- I. Factors Leading up to Banking Crisis
- II. Bank Operations During Crisis
- III. Current Market Dynamics
- IV. Regulatory Update
- V. Questions



I. Factors Leading up to Banking Crisis



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Recent Banking Failures

Year	# of Banks	Total Assets	Median Assets
2001-07	25	\$8,874 M	\$37 M
2008	25	\$373,588 M	\$561 M
2009	139	\$170,615 M	\$279 M
2010	158	\$96,808 M	\$258 M
2011	92	\$36,012 M	\$199 M
2012	51	\$12,055 M	\$164 M
2013-22	71	\$23,299 M	\$86 M
2023 YTD	3	\$548,500 M	\$209,000 M

Source: FDIC

- 2023 Banking Crisis represents an unprecedented period of (short-term(?)) banking uncertainty
- The scale of failed banks, in terms of total assets and assets per failed bank, greatly surpasses Global Financial Crisis
- Only 1 other bank in U.S. history with assets >\$100 BN has failed
 - WAMU – 2008, \$307 BN



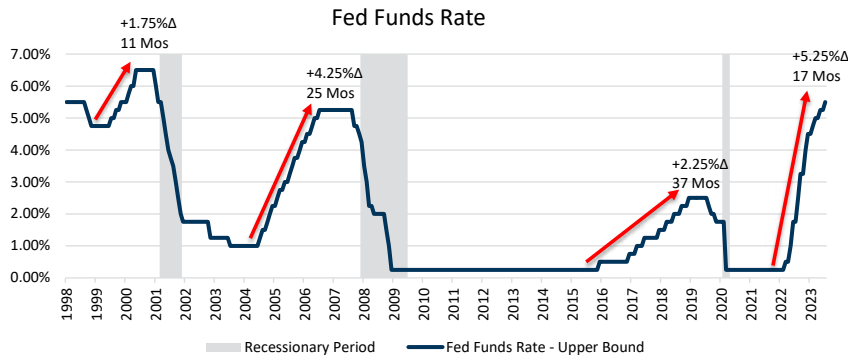
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Key Factors Leading to 2023 Bank Failures

- Rising interest rates
- Unrealized capital losses
- Accounting standards
- Social media / online banking



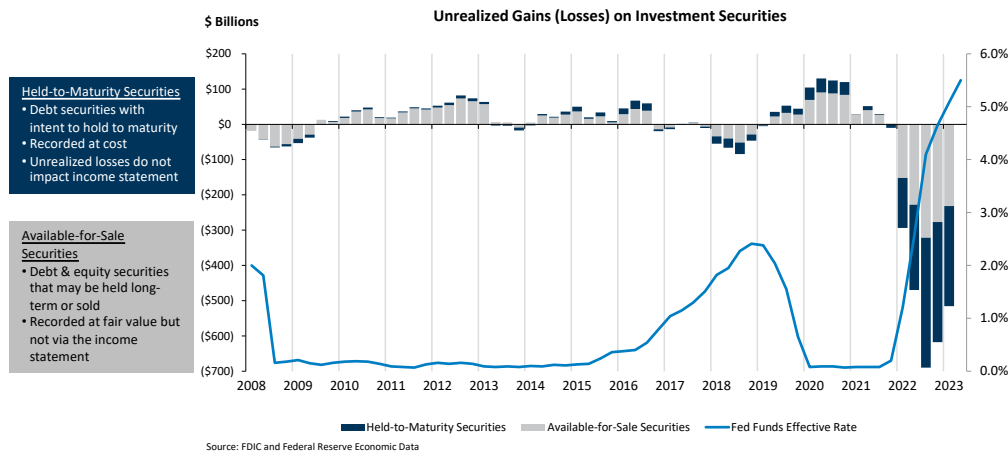
Impact of Rising Rates



- Beginning early 2022 Fed began aggressive monetary policy shift to control soaring inflation
- Fed Funds Effective Rates increased 5.25% over course of 17 months (Mar '22 – July '23)
 - Fastest rate increases by Fed in recent monetary policy history
- Most Fed rate increase campaigns have been followed by recessionary periods dating back to 1950s



Rising Rates and Declining Value



- Bank investment portfolios, specifically longer-maturity bonds, lost significant value as interest rates rose
 - Banks, such as SVB, had large bond portfolios and were forced to sell at a loss, creating liquidity concerns, resulting in a "run on the bank"



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Current Accounting Standards

- Current accounting standards use the 'Mixed-Measurement Model' (MMM) where certain securities have a direct, or no impact at all, on banks' financial statements
 - Trading Securities (debt & equity) – recorded at fair value, gains/losses recognized on income statement
 - Available-for-Sale Securities (debt & equity) – recorded at fair value, gains/losses recognized via equity on balance sheet
 - Held-to-Maturity Securities (debt only) – recorded at cost, gains/losses not realized until sale or maturity
- MMM scrutinized after 2008 financial crisis, but ultimately retained as accounting standard by FASB

Arguments For MMM

- Management Intent is Relevant
 - If security purchased for yield & maturity value, why subject reporting to market fluctuation
- Fair Value Introduces Volatility
 - Potential to unnecessarily impact financial reporting and metrics

Arguments Against MMM

- Transactions Occur at Fair Value
 - Fair value reflects current conditions and would be basis for sale or collateral based decisions on asset value
- Historical Cost not Relevant
 - Historical basis no longer relevant when market conditions rapidly change
- Investors Adjust Book Value
 - If investors base decisions on fair value, statements should reflect fair value



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Social Media and its Impact on the Banking Crisis

Recent bank failures occurred at a record pace, did social media contagion play a role?

"This was a hysteria-induced bank run caused by VCs"

- Ryan Falvey, Restive Ventures, via The Guardian

"...a bank sprint, not a bank run, and social media played a central role in that."

- Michael Imerman, Professor, UC Irvine, via CNBC

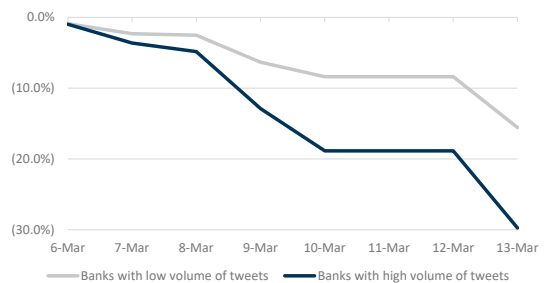
"If you are not advising your companies to get the cash out, then you are not doing your job as a board member or as a shareholder."

- Tweet, Mark Tluszc, CEO of Mangrove Capital

"No matter how strong capital and liquidity supervision are, if a bank has an overwhelming run that's spurred by social media, or whatever, so that it's seeing deposits flee at that pace, the bank can be put in danger of failing..."

- Treasury Secretary Yellen

More Tweets, Bigger Stock Declines



Source: theconversation.com and 'Social Media as a Bank Run Catalyst' ([Link](#))



II. Bank Operations During Crisis



Safety Nets' Role in Crisis

Several well-known and lesser-known 'safety net' institutions played a significant role in recent banking crisis

Federal Deposit Insurance Corporation (FDIC)

- Independent U.S. agency created to maintain stability and public confidence in the nation's financial system
 - Insures deposits
 - Examines and supervises financial institutions for safety, soundness, and consumer protection
 - Makes large and complex financial institutions resolvable; and manages receiverships
- On March 13th, as receiver, FDIC transferred substantially all deposits and assets of SVB into new 'bridge bank' entity
- All such deposits, both insured and uninsured, were protected to the extent provided under Title 12 of the U.S. Code

Fed Discount Window

- Helps depository institutions manage their liquidity risks efficiently and avoid actions that have negative consequences for their customers
- Significant borrowings during 2008 Global Financial Crisis, with limited borrowing since
- Borrowing increased significantly during banking crisis, with banks accessing almost \$1 trillion from January – May 2023
 - Discount window borrowing often signals signs of distress, although borrowings are not made public for 2-years after

Other Sources of Liquidity

- Bank Term Funding Program – source of liquidity created by Fed in response to recent banking crisis
- Federal Home Loan Banks – long-standing lender to financial institutions, playing increasing role in bank liquidity during times of crisis

Source: FDIC, Federal Reserve



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Banking Lifeline – Bank Term Funding Program

- The Bank Term Funding Program (BTFP) was created by the Federal Reserve Board on March 12, 2023 in response to SVB and Signature Bank failures
 - BTFP offers loans of up to one year in length to banks, savings associations, credit unions, and other eligible depository institutions pledging qualifying assets as collateral
 - Qualifying assets/collateral include any security eligible for purchase by the Federal Reserve Banks in the open market, provided collateral was owned by borrower
- BTFP allowed banks to access capital equal to par value of pledged securities in order to meet customer withdrawal demands, without having to sell government issued bonds at a loss
- Department of the Treasury, using the Exchange Stabilization Fund, provided \$25 billion as credit protection to the Federal Reserve Banks in connection with the BTFP
- At the end of March, banks borrowed over \$64 billion from the BTFP and in excess of \$100 billion as of July 13th

Source: Federal Reserve



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Banking Lifeline – Federal Home Loan Banks

- Established during the Great Depression to promote mortgage lending, and regulated by the Federal Housing Finance Agency, the Federal Home Loan Bank System (FHLB) is comprised of 11 regional banks
 - Intended to provide liquidity for mortgage and community investment lending, the FHLB became a critical source of liquidity in late 2022 and during the recent banking crisis
- FHLB supports member financial institutions by issuing debt into global markets and subsequently making advances/loans, as needed, to members
 - Borrowing members must have sufficient collateral to post in order to receive advances from FHLB
- FHLBs take super-priority liens on pledged collateral, even ahead of FDIC if member institution fails and is placed into receivership
- During March 2023, FHLB advances rose to a record \$1 trillion as banks sought liquidity outside of Fed Discount Window
 - SVB, Signature Bank and Silvergate Bank had over \$30 billion in advances with FHLB as of December 31, 2022
- While critical to recent support of banking system, critics argue providing liquidity to banks is counter to FHLBs stated mission

Source: fhfbanks.com, Bloomberg



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DIP and Trustee Banking

- Debtors-in-possession (DIPs) and trustees must account for the safety of deposits or other investments of estate funds
- For any deposit accounts above the FDIC insurance limits, section 345 provides that DIPs and trustees must require from a bank or other depository where estate moneys are held (i) a **BOND** complying with section 345(b) or, alternatively, (ii) the deposit of **SECURITIES** at the Federal Reserve consistent with 31 U.S.C. § 9303, unless the court orders otherwise
- The USTP requires that funds be held in accounts at depositories that have entered into a Uniform Depository Agreement (**UDA**) with the UST in the District where the bankruptcy case is filed
- The UDA requires the depository to **MAINTAIN COLLATERAL** (i.e., a **BOND** or deposit of **SECURITIES**), in an amount of no less than 115% of the aggregate bankruptcy funds on deposit in each bankruptcy estate that exceeds the FDIC insurance limit. The UDA also requires periodic **REPORTING** by the depository



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Chapter 11 Banking

- For DIPs, this process is **NOT AUTOMATIC** even when the DIP's prepetition bank is an authorized depository
- If the DIP does not ensure all of its accounts are properly designated as DIP accounts once the bankruptcy is filed, then the authorized depository may not treat those accounts as DIP accounts and may not maintain the required collateralization
- Recent bank failures of authorized depositories highlight the importance of swift DIP compliance with section 345
- United States Trustees routinely object—and will continue to do so when DIPs seek broad waivers of section 345 (special circumstances may justify narrowly targeted relief)
- Before the federal backstop was issued over the weekend in March 2023, several DIPs that had not acted with alacrity to comply with section 345 faced the prospect of significant losses of estate funds



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Bankruptcy Fallout

- Since March, the USTP remained in contact with trustees and other stakeholders. This included updates to the trustees that addressed the continued effectiveness of uniform depository agreements by the successors to Silicon Valley Bank and Signature Bank, as well as reports of authorized depositories receiving notices of cancellations or non-renewal of surety bonds
- Updates reminded trustees that while the authorized depository institutions they select to hold estate funds are responsible for complying with the terms of the UDAs, it is ultimately the trustee's responsibility to ensure that the funds on deposit in their estate accounts comply with section 345 and the requirements in the trustee handbooks
- Depositories faced with surety bond cancellations have either secured replacements or now pledge collateral with the Federal Reserve. 90-day cancellation notice term in the bonds facilitated a smooth transition that avoided compliance disruptions



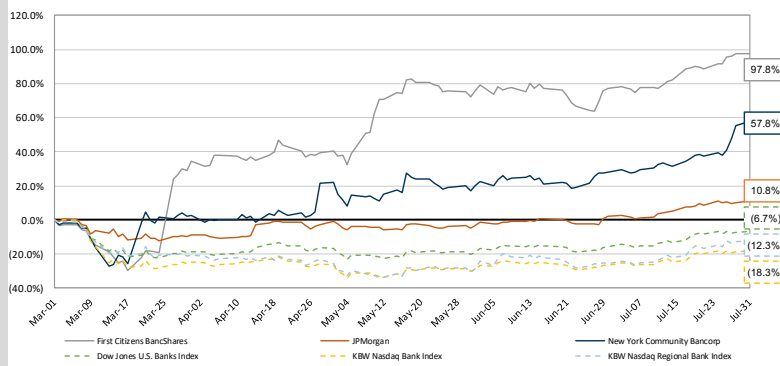
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III. Current Market Dynamics



Banking Sector Performance

- The broader U.S. public bank stock segment has been under pressure since early March
- The acquirers of First Republic, SVB and Signature Bank assets have performed better
 - First Citizens Banc acquired SVB assets and is up almost 100% since March 1



Source: S&P Capital IQ, Barrons

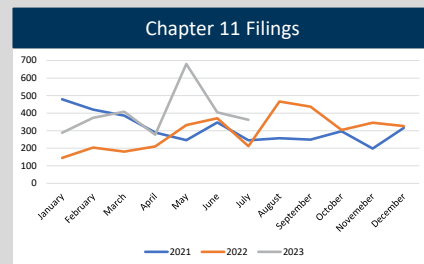


Impacts to Restructuring and M&A



- Commercial bank mergers slowed considerably since pre-pandemic period and as interest rates have increased
 - Data does not include 'assisted' mergers, which include failing banks
- Unrealized bank losses reduce bank values and potential buyers may have to bear risk associated with unrealized losses in future
- Proposed regulatory changes seen as potential catalyst for up-tick in regional bank mergers

Source: Federal Reserve, Epiq Bankruptcy, Bloomberg



- Commercial Chapter 11 filings have continued to increase YoY since pandemic
- Macroeconomic headwinds, including rising interest rates are cited as leading factors for increase in filings
- Lenders also becoming less willing to restructure outside of bankruptcy



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What Else Could go Wrong

Commercial Real Estate

- Total CRE market estimated at ~\$10 trillion, with offices as the largest segment at ~24%
- As of December 31, 2022, institutional CRE debt is ~\$4.5 trillion
 - Banking sector holds ~\$1.7 trillion, or 38%
- Office vacancy rates in metro cities continues to rise, hitting 18.7% at end of 2022
- Estimates peg losses in mid-to-high single digits
 - Losses could have been worse – improved underwriting (LTV, DSCR) since GFC expected to mitigate worst case scenarios

Additional Interest Rate Increases and Recession

- Fed raised upper bound of Fed Funds Rate to 5.5%, the highest level in 22 years
 - Potential for additional rate increases in 2023, based on economic data
- Concerns for recession easing, with economists expecting ‘soft landing’ as result of continued strong, but softening market conditions

Source: Franklin Templeton, Bloomberg



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Opportunity in the Crisis

Who are some of the ‘Winners and Losers’ of the recent banking crisis

Winners

- Large money center banks – record profits, outsized influence and rising deposits
- Shadow banks – PE / direct credit funds / alternative money managers
 - Some argue shadow banks / non-bank lenders should be subject to additional oversight/regulation
 - As of 2021, non-bank financial institutions held 49% of global assets (\$239 trillion)
- Crypto currencies
 - After poor performance from peak in late 2021, Bitcoin is up 76% YTD and 45% since SVB collapse

Losers

- Borrowers – increased cost to borrow
 - Most U.S. banks tightening lending standards after banking crisis, significantly impacting sub-prime borrowers/households
- Regional banks and banks with <\$250bn in deposits
 - Some analysts predict a renewed wave of banking mergers, as banks now facing added requirements look to gain scale
- Existing shareholders as some banks will be forced to raise additional capital

Source: Financial Stability Board, CoinDesk



IV. Regulatory Update



Regulatory Update – Changes are Coming

Regulatory revisions to banking sector already in Fed crosshairs prior to 2023 banking crisis

- Michael Barr, Vice Chair of Supervision, joined the U.S. Federal Reserve in July 2022
- First speech in September 2022 highlighted the need for stricter regulations after easing of capital requirements under prior administration
- Recognized regulation needs to keep pace with changing finance landscape, particularly with prominent role of crypto currencies
- Specific focus on regional lenders, which have experienced considerable growth
- 2023 banking crisis reinforced need for holistic review of regulations, according to Barr, focused on “an approach that makes banks resilient to familiar and unanticipated risks”



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Proposed Regulatory Revisions

- An interagency proposal was released on July 27th and is supported by the Fed, FDIC and Office of the Comptroller of the Currency
 - The proposal implements final components of Basel III agreement and includes responses to recent banking crisis
- The proposal's goal is to modify large bank capital requirements to:
 - Better reflect underlying risks, and
 - Increase the transparency and consistency of the regulatory capital framework
- Regional/smaller banks (>\$100 billion assets) will face stricter oversight, along with banks having significant trading activity
 - Current threshold for stress testing is >\$250 billion of assets
- Four identified areas of focus include:
 - Credit risk – arising when an obligor fails to perform on an obligation
 - Market risk – resulting from changes in the value of trading securities
 - Operations risk – resulting from inadequate or failed internal processes, people, and systems, or from external events
 - Credit valuation adjustment risk – resulting from the risk of losses on certain derivative contracts

Source: Federal Reserve, FDIC



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Proposed Regulatory Revisions *cont'd*

- Specific responses to 2023 banking crisis include:
 - Inclusion of unrealized gains and losses from certain securities in capital ratios
 - Compliance with supplementary leverage ratio (Basel III Tier 1 capital ratio)
 - Compliance with countercyclical capital buffer (CCyB), if activated
 - o CCyB raises bank capital requirements during economic expansions, to protect against growing loan volumes, and releases capital during downturns
- Revisions expected to result in up to additional 19% of capital reserves/common equity tier 1 capital
 - Increase will principally affect largest and most complex banks; smaller banks likely to experience increases of 5% - 10%
 - Most banks are claimed to already have enough capital to meet requirements
- Proposal is subject to public/industry comment through November 30, 2023
- 3-year transitional period beginning July 1, 2025
- Fed, FDIC and Office of Comptroller of the Currency required to sign off on revisions, with affirmative vote by Boards of the Fed and FDIC

Source: Federal Reserve, FDIC



Bank/Market Reaction to Regulatory Change

- Overall reaction mixed amongst regulatory bodies, banking industry and Congress
- Banking industry argues revisions will hinder economic activity, curb lending and impair lines of business
 - Industry believes capital increases not justified, claiming lack evidence for stricter regulation
- Proposed revisions likely to become partisan debate across congressional and regulatory bodies

Select Commentary

- *"There is no justification for significant increases in capital at the largest U.S. banks and no other jurisdiction is likely to adopt the approach proposed today, which will only increase the significant disparity that already exists between U.S. and foreign bank capital requirements"*
– Kevin Fromer, CEO, Financial Services Forum
- *"The mini-liquidity crisis just poured gasoline on Michael Barr's fire and gave him an enormous amount of political capital"*
– Isaac Boltansky, Director of Policy Research, BTIG
- *"Recent events demonstrated the effects that stress at a few large, regional banking organizations could have on the stability, public confidence, and trust in the banking system"*
– Michael Hsu, Acting Comptroller of the Currency
- *"It's kind of hard for me to sit here and say that we won't be commenting forcefully that we are very well capitalized"*
– James Gorman, CEO, Morgan Stanley
- *"The increased capital requirements could lead to an increase in interest rates for low- and moderate-income and other historically underserved borrowers...making it that much harder for these families to achieve homeownership"*
– FDIC board member Jonathan McKernan (voted against new proposed regulations)

Source: Reuters, WSJ



V. Questions

Faculty

Hon. Lisa G. Beckerman is a U.S. Bankruptcy Judge for the Southern District of New York in New York, sworn in on Feb. 26, 2021. From May 1999 until she was appointed to the bench, she was a partner in the financial restructuring group at Akin Gump Strauss Hauer & Feld LLP. From September 1989 until May 1999, she was an associate and then a partner in the bankruptcy group at Stroock & Stroock & Lavan LLP. Prior to her appointment, Judge Beckerman served as a co-chair of the Executive Committee of UJA-Federation of New York's Bankruptcy and Reorganization Group, as co-chair and as a member of the Advisory Board of ABI's New York City Bankruptcy Conference, and as a member of ABI's Board of Directors of from 2013-19. She is a Fellow and a member of the board of directors of the American College of Bankruptcy and a member of the National Conference of Bankruptcy Judges (NCBJ) and the 2021 NCBJ Education Committee. She also is a member of the Dean's Advisory Board for Boston University School of Law. Judge Beckerman received her A.B. from University of Chicago in 1984, her M.B.A. from the University of Texas in 1986 and her J.D. from Boston University in 1989.

Michael J. Bujold is the associate general counsel for General and Administrative Law in the Executive Office for U.S. Trustees at the U.S. Department of Justice in Washington, D.C. He also currently serves as the acting assistant U.S. Trustee (AUST) for the U.S. Trustee Program's Houston field office. As associate general counsel, Mr. Bujold provides leadership and guidance on complex administrative issues to both EOUST senior leadership and to U.S. Trustee field offices, oversees all aspects of the USTP Ethics Program, assists the Office of the General Counsel (OGC) in its implementation of policy initiatives. He also manages a broad range of administrative and general law matters on the USTP's behalf, such as those related to the Privacy Act, the Freedom of Information Act, the Federal Tort Claims Act, the Administrative Procedures Act, the Equal Access to Justice Act and the Department's Touhy regulations. In addition, he supervises a team of OGC trial attorneys and received an Attorney General's Award for Distinguished Service. As Acting AUST, Mr. Bujold manages the administrative and legal operations of the USTP's Houston field office, including supervision of personnel, the implementation of USTP policies and priorities and enforcement strategies to combat fraud and abuse in the bankruptcy system, and the supervision of private trustees. Prior to becoming associate general counsel, he served as a trial attorney in OGC and focused on chapter 11 proceedings. Before joining OGC in 2014, he served as a trial attorney in the U.S. Trustee's Riverside field office and clerked for the U.S. Bankruptcy Court for the Eastern District of North Carolina. Mr. Bujold has lectured on bankruptcy retention and compensation, chapter 11 creditor committees and USTP case oversight. He is an active ABI member and a published author in the *ABI Journal*. Mr. Bujold received both his B.A. and J.D. from the University of Michigan in Ann Arbor.

Kurt F. Gwynne is the managing partner of the Delaware office of Reed Smith LLP and a member of the firm's Financial Industry Group, having practiced in the area of Commercial Restructuring & Bankruptcy for more than 25 years. He has served as a court-appointed expert, a court-appointed examiner and a court-appointed trustee in chapter 11 cases. In addition, he has represented indenture trustees, secured creditors, creditors' committees, debtors and other parties in interest in bankruptcy cases throughout the U.S. and its territories. Mr. Gwynne is a Fellow of the American College of Bankruptcy (23rd Class) and is recognized in *Chambers USA: America's Leading Lawyers* as a "Band

l” reorganization/bankruptcy attorney in Delaware. In 2010, he was selected as one of the “10 Most Admired Bankruptcy Attorneys” in the U.S. by *Law360*. He also is recognized in *The Best Lawyers in America* and *Delaware Super Lawyers*. Mr. Gwynne received his B.A. *summa cum laude* in political science, with a minor in business administration, from the University of Central Florida in 1988 and his J.D. in 1992 from the University of Pennsylvania Law School, where he was a senior editor of the *Journal of International Business Law* and a winner of Penn’s Edwin R. Keedy Cup Moot Court Competition. Following law school, he clerked for Hon. Bruce Fox of the U.S. Bankruptcy Court for the Eastern District of Pennsylvania.

Tanya Meerovich, CFA, CFE, CIRA, CTP is a senior managing director with FTI Consulting, Inc. in New York and specializes in providing financial and strategic solutions to companies, their creditors and investors. She has worked with both public and private companies across many sectors. Ms. Meerovich has industry expertise in the financial services, real estate, nonprofit, insurance, health care, education, energy, manufacturing, infrastructure, print, entertainment and retail industries. Her advisory services include assisting senior management teams and various stakeholders in developing and implementing strategic alternatives, revenue enhancement initiatives and cost-reduction initiatives. In addition, she has experience in the review and assessment of business plans and financial models, preparation of financial projections and cash-flow models, financial analysis, cash management, asset management and liquidation, claims analysis, fraud investigations and forensic accounting. Ms. Meerovich’s recent engagements include advising management teams and boards of AG Mortgage Investment Trust Inc, the Government Development Bank of Puerto Rico, Impac Mortgage, MFA Financial, Ocwen Financial, Puerto Rico Highways and Transportation Authority, Residential Capital (ResCap), Three Lions Entertainment, Workflow Management and several mortgage REITs. She also has advised senior secured lenders. Prior to joining FTI Consulting, Ms. Meerovich was in the Financial Services Advisory group of RSM Cayman Islands, where she was involved in a number of high-profile and complex cross-border insolvency engagements in the financial services sector. Prior to that, she worked for a securities broker-dealer in the Chicago area. Ms. Meerovich previously held NASD Series 24, 7 and 63 licenses and served on several boards, including the New York Chapter of the International Women’s Insolvency & Restructuring Confederation and Rock & Rawhide, a nonprofit organization. She is a member of ABI, the Association for Financial Professionals, the Association of Certified Fraud Examiners, the Association of Insolvency & Restructuring Advisors, the Chartered Financial Analyst Institute, the New York Society of Security Analysts and the Turnaround Management Association. Ms. Meerovich received her B.S. in finance and business management from Roosevelt University.

Craig D. Warznak is a senior vice president with SSG Capital Advisors, LLC in West Conshohocken, Pa. He is responsible for leading financial analyses, market research and general oversight of the deal process. Mr. Warznak works closely with SSG’s clients on a wide range of special-situations transactions, including mergers and acquisitions, divestitures, restructurings, recapitalizations and private placements of both senior and subordinated debt and equity. Prior to joining SSG, he served as a vice president for an international investment firm, where he was responsible for sourcing and executing middle-market investments. Prior to that, he held senior-level positions with CDI Corp. and Day & Zimmermann, where he led corporate development and strategic planning. He began his career in investment banking at Lazard. Mr. Warznak received The M&A Advisor’s 11th Annual Emerging Leaders Award in 2020. He is a member of the Turnaround Management Association, ABI

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Justin M. Winerman is a counsel in the Corporate Restructuring department of Skadden, Arps, Slate, Meagher & Flom LLP in Chicago. He represents clients around the world in all aspects of complex corporate restructurings both in and out of court and across a wide range of industries, including health care, financial services, airlines, energy and media. He also advises on various insurance and reinsurance receivership and restructuring transactions. Mr. Winerman counsels creditors, lenders and other parties in interest on business reorganization and insolvency matters. He received his B.S. *magna cum laude* in 2002 from Northwestern University and his J.D. *cum laude* in 2008 from the University of Michigan Law School.