

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 380

Notice of Interim Final Rule Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Agency: Federal Deposit Insurance Corporation (FDIC).

Action: Interim Final Rule.

SUMMARY: The FDIC is issuing an interim final rule (“Rule ”), with request for comments, which implements certain provisions of its authority to resolve covered financial companies under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), Pub. L. 111-203, 12 U.S.C. 5301 et seq. (July 21, 2010). The FDIC’s purpose in issuing this Rule is to provide greater clarity and certainty about how key components of this authority will be implemented and to ensure that the liquidation process under Title II reflects the Dodd-Frank Act’s mandate of transparency in the liquidation of failing systemic financial companies.

DATES: Written comments on the Rule must be received by the FDIC not later than

[Insert date 60 days after publication in the Federal Register].

ADDRESSES: You may submit comments by any of the following methods:

- *Agency Web Site:* <http://www.fdic.gov/regulations/laws/federal>. Follow instructions for submitting comments on the Agency Web Site.
- *E-mail:* Comments@FDIC.gov. Include “Orderly Liquidation” in the subject line of the message.
- *Mail:* Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, D.C. 20429.

- *Hand Delivery/Courier:* Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m. (EDT).
- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.
- *Public Inspection:* All comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal> including any personal information provided. Paper copies of public comments may be ordered from the Public Information Center by telephone at (877) 275-3342 or (703) 562-2200.

FOR FURTHER INFORMATION CONTACT:

Marc Steckel, Division of Insurance and Research, 202-898-3618; R. Penfield Starke, Legal Division, 703-562-2422; Federal Deposit Insurance Corporation, 550 17th Street N.W., Washington, DC 20429.

SUPPLEMENTARY INFORMATION:

I. Background

Prior to the enactment of the Dodd-Frank Act on July 21, 2010, there was no common or adequate statutory scheme for the orderly liquidation of a financial company whose failure could adversely affect the financial stability of the United States. Instead, insured depository institutions were subject to an FDIC-administered receivership under applicable provisions of the Federal Deposit Insurance Act (“FDI Act”), insurance companies were subject to insolvency proceedings under individual State’s laws, registered brokers and dealers were subject to the U.S. Bankruptcy Code and proceedings under the Securities Investor Protection Act, and other companies (including the parent

holding company of one or more insured depository institutions or other financial companies) were eligible to be a debtor under the U.S. Bankruptcy Code. These disparate insolvency regimes were found to be inadequate to effectively address the actual or potential failure of a financial company that could adversely affect economic conditions or financial stability in the United States. In such a case, financial support for the company sometimes was the only viable option available for the Federal government to avoid or mitigate serious adverse effects on economic conditions and financial stability that could result from the company's failure.

With the enactment of the Dodd-Frank Act, Federal regulators have the tools to resolve a failing financial company that poses a significant risk to the financial stability of the United States. The receivership process established under Title II of the Dodd-Frank Act provides for an orderly liquidation of such a "covered financial company" in a way that addresses the concerns and interests of legitimate creditors while also protecting broader economic and taxpayer interests.

Appointment of Receiver

Title II of the Dodd-Frank Act provides a process for the appointment of the FDIC as receiver of a failing financial company that poses significant risk to the financial stability of the United States (a "covered financial company"). Under this process, certain designated Federal regulatory authorities must recommend to the Secretary of the Treasury (the "Secretary") that the Secretary, after consultation with the President, make a determination that grounds exist to appoint the FDIC as receiver of the company. The Federal Reserve Board and the Securities and Exchange Commission will make the recommendation if the company or its largest subsidiary is a broker or a dealer; the

Federal Reserve Board and the Director of the Federal Insurance Office will make the recommendation if the company is an insurance company; and the Federal Reserve Board and the FDIC will make the recommendation in all other cases. This procedure is similar to that which is applied to systemic risk determinations under section 13 of the FDI Act (12 U.S.C. 1813(c)(4)).

The Dodd-Frank Act requires that recommendations to the Secretary include an evaluation of whether the covered financial company is in default or in danger of default, a description of the effect that the company's default would have on the financial stability of the United States, and an evaluation of why a case under the Bankruptcy Code would not be appropriate. If the Secretary determines that the FDIC should be appointed as receiver, the Secretary must make specific findings in support, including: that the company is in default or in danger of default; that the failure of the company and its resolution under otherwise applicable Federal or State law would have serious adverse consequences on financial stability in the United States; no viable private sector alternative is available; any effect on the claims or interests of creditors, counterparties, and shareholders is appropriate; any action under the liquidation authority will avoid or mitigate such adverse effects taking into consideration the effectiveness of the action in mitigating the potential adverse effects on the financial system, cost to the general fund of the Treasury, and the potential to increase excessive risk taking; a Federal regulatory agency has ordered the company to convert all of its convertible debt instruments that are subject to regulatory order; and the company satisfies the definition of a financial company under the law.

If the Secretary makes the recommended determination and the board of directors (or similar governing body) of the company consents to the appointment, then the FDIC's appointment as receiver is effective immediately. If the company's governing body does not consent, the Dodd-Frank Act provides for immediate judicial review by the United States District Court for the District of Columbia of whether the Secretary's determinations that the covered financial company is in default or danger of default and that it meets the definition of financial company under Title II are arbitrary and capricious.¹ If the court upholds the Secretary's determination, it will issue an order authorizing the Secretary to appoint the FDIC as receiver.² If the court fails to act within twenty-four hours of receiving the petition, then the appointment of the receiver takes effect by operation of law.

Orderly Liquidation

Title II of the Dodd-Frank Act (entitled "Orderly Liquidation Authority") also defines the policy goals of the liquidation proceedings and provides the powers and duties of the FDIC as receiver for a covered financial company. Section 204(a)³ succinctly summarizes those policy goals as the liquidation of "failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard." The statute goes on to say that "creditors and shareholders will bear the losses of the financial company" and the FDIC is instructed to liquidate the covered financial company in a manner that

¹ The immediate judicial review required by the Dodd-Frank Act contrasts with the analogous provisions in the National Bank Act (12 U.S.C. 191(b)), the Home Owner's Loan Act (12 U.S.C. 1464(c)(2)(B)), and the Federal Deposit Insurance Act (12 U.S.C. 1821(c)(7)). Each of these statutes permits judicial review of the appointment of the receiver, but only after the appointment has taken effect.

² If the court overrules the Secretary's determination, the Secretary is provided the opportunity to amend and refile the petition immediately. The Dodd-Frank Act includes appeal provisions, but does not provide for a stay of the actions taken by the receiver after its appointment.

³ Unless the context requires otherwise, all section references are to the Dodd-Frank Act.

maximizes the value of the company's assets, minimizes losses, mitigates risk, and minimizes moral hazard. See sections 204(a) and 210(a)(9)(E). Fundamentally, a liquidation under the Dodd-Frank Act is a liquidation of the company that imposes the losses on its creditors and shareholders. Not only is the FDIC prohibited from taking an equity interest in or becoming a shareholder of a covered financial company or any covered subsidiary, but other provisions of the Dodd-Frank Act bar any Federal government bail-out of a covered financial company. See sections 210(h)(3)(B) and 716. In this way, the statute will prevent any future taxpayer bailout by providing a liquidation process that will prevent a disorderly collapse, while ensuring that taxpayers bear none of the costs.

Similarly, management, directors, and third parties who are responsible for the company's failing financial condition will be held accountable. The FDIC must remove any management and members of the board of directors of the company who are responsible for the failing condition of the company. See section 206.

While ensuring that creditors bear the losses of the company's failure under a specific claims priority, Title II incorporates procedural and other protections for creditors to ensure that they are treated fairly. For example, creditors can file a claim with the receiver and, if dissatisfied with the decision, may file a case in U.S. district court in which no deference is given to the receiver's decision. See section 210(a)(2)-(4). Once claims are proven, the FDIC has the authority to make interim payments to the creditors, consistent with the priority for payment of their allowed claims, as it does in resolutions of insured depository institutions. This accelerated or advance dividend authority, provided in section 210(a)(7), is a valuable tool to provide payments to

creditors and lessen the economic and financial impact of the closing. In addition, creditors also are guaranteed that they will receive no less than they would have received if the covered financial company had been liquidated under Chapter 7 of the Bankruptcy Code. See section 210(d)(2)(B). Shareholders of a covered financial company will not receive payment until after all other claims are fully paid. See section 210(b)(1). This helps ensure that the priority of payments will be enforced.

Parties who are familiar with the liquidation of insured depository institutions under the FDI Act or the liquidation of companies under the Bankruptcy Code will recognize many parallel provisions in Title II. Some provisions are drawn from analogous provisions of the Bankruptcy Code in order to clarify and supplement the authority that the FDIC normally exercises in a bank receivership. The provisions of Title II governing the claims process (including the availability of judicial review of claims disallowed by the receiver), the termination or repudiation of contracts, and the treatment of qualified financial contracts are modeled after the FDI Act, while provisions that empower the FDIC to avoid and recover fraudulent transfers, preferential transfers, and unauthorized transfers of property by the covered financial company are drawn from Bankruptcy Code provisions. The rules of Title II governing the setoff of mutual debt provide equivalent protections to those under the Bankruptcy Code.

The liquidation rules of Title II are designed to create parity in the treatment of creditors with the Bankruptcy Code and other normally applicable insolvency laws. This is reflected in the direct mandate in section 209 of the Dodd-Frank Act to “to seek to harmonize applicable rules and regulations promulgated under this section with the insolvency laws that would otherwise apply to a covered financial company.” One of the

goals of the Rule is to begin the implementation of this mandate in certain key areas. Of particular significance is § 380.2 of the Rule, which clarifies that the authority to make additional payments to certain creditors will never be used to provide additional payments, beyond those appropriate under the defined priority of payments, to shareholders, subordinated debt holders, and bondholders. The FDIC, in this Rule, is making clear that these creditors of the covered financial company will never meet the statutory criteria for receiving such additional payments.

Fundamental to an orderly liquidation of a covered financial company is the ability to continue key operations, services, and transactions that will maximize the value of the firm's assets and avoid a disorderly collapse in the market place. Under the Dodd-Frank Act, this is accomplished, in part, through authority for the FDIC to charter a bridge financial company. The bridge financial company is a completely new entity that will not be saddled with the shareholders, debt, senior executives or bad assets and operations that led to the failure of the covered financial company. Shareholders, debt holders, and creditors will receive "haircuts" based on a clear priority of payment set out in section 210(b). As in prior bridge banks used in the resolution of large insured depository institutions, however, the bridge financial company authority will allow the FDIC to stabilize the key operations of the covered financial company by continuing valuable, systemically important operations.

Assets and operations that are necessary to maximize the value in the liquidation or prevent a disorderly collapse can be continued seamlessly through the bridge financial company. This is supported by the clear statutory provisions that contracts transferred to the bridge financial company cannot be terminated simply because they are assumed by

the bridge financial company. See section 210(c)(10). As in the FDI Act, derivatives contracts that are needed to continue operations can be transferred to the bridge and cannot be terminated and netted by counterparties. This is an important tool to avoid market destabilization because, unlike the Bankruptcy Code, it can prevent the immediate and disorderly liquidation of collateral during a period of market distress. The absence of funding for continuing valuable contracts and the rights of counterparties under the Bankruptcy Code to immediately terminate those contracts resulted in a loss of billions of dollars in market value to the bankruptcy estate in the Lehman insolvency.⁴

The bridge financial company arrangement will provide a timely, efficient, and effective means for preserving value in an orderly liquidation and avoiding a destabilizing and disorderly collapse. While the covered financial company's board of directors and the most senior management responsible for its failure will be replaced, as required by section 204(a)(2), operations would be continued by the covered financial company's employees under the strategic direction of the FDIC and contractors employed by the FDIC to help oversee those operations. Section 380.3 of the Rule addresses the treatment of these employees.

To achieve these goals, the FDIC is given broad authority under the Dodd-Frank Act to operate or liquidate the business, sell the assets, and resolve the liabilities of a covered financial company immediately after its appointment as receiver or as soon as conditions make this appropriate. This authority will enable the FDIC to act immediately to sell assets of the covered financial company to another entity or, if that is not possible, to an FDIC-created bridge financial company while maintaining critical functions. In receiverships of insured depository institutions, the ability to act quickly and decisively

⁴ Examiner's Report, pg. 725, <http://lehmanreport.jenner.com/VOLUME%202.pdf>.

has been found to reduce losses to the deposit insurance funds while maintaining key banking services for depositors and businesses, and it is expected to be equally crucial in resolving non-bank financial firms under the Dodd-Frank Act.

A vital element in the essential continuity of key operations in the bridge financial company is the availability of funding for those operations. The Dodd-Frank Act provides that the FDIC may borrow funds from the Department of the Treasury to provide liquidity for the operations of the receivership and the bridge financial company. See sections 204(d) and 210(n). The bridge financial company also can access debtor-in-possession financing as needed. Once the new bridge financial company's operations have stabilized as the market recognizes that it has adequate funding and will continue key operations, the FDIC would move as expeditiously as possible to sell operations and assets back into the private sector.

An essential prerequisite for any effective resolution – particularly one designed to avoid a disorderly collapse – is advance planning, a well-developed resolution plan, and access to the supporting information needed to undertake such planning. This has been a critical component of the FDIC's ability to smoothly resolve failing banks. This critical issue is addressed in the Dodd-Frank Act in provisions that grant the FDIC back-up examination authority and require the largest companies to submit so-called "living wills" or resolution plans that will facilitate a rapid and orderly resolution of the company under the Bankruptcy Code. See section 165(d). Such plans are not for the purpose of supervision, which is the responsibility of the primary federal regulator and the Federal Reserve Board as designated, but for evaluation of the company's resolution plans and for the FDIC's resolution planning, readiness, and analysis of how best to be prepared for

any necessary resolution. An essential part of such plans will be to describe how the resolution process can be accomplished without posing systemic risk to the public and the financial system. If the company cannot submit a credible resolution plan, the statute permits increasingly stringent requirements to be imposed that, ultimately, can lead to divestiture of assets or operations identified by the FDIC and the Federal Reserve to facilitate an orderly resolution. The FDIC will jointly adopt a rule with the Federal Reserve to implement the resolution plan requirements of the Dodd-Frank Act. The undertaking to ensure that adequate information is available and that feasible resolution plans are established is all the more critical because the largest covered financial companies operate globally and their liquidation will necessarily involve coordination among regulators around the world.

To strengthen the foundation for effective resolutions, the FDIC also will promulgate other rules and provide additional guidance in consultation with the members of the Financial Stability Oversight Council to ensure a credible liquidation process that realizes the goal of ending “too big to fail” while enhancing market discipline.

II. The Notice of Proposed Rulemaking

Section 209 of the Dodd-Frank Act authorizes the FDIC, in consultation with the Financial Stability Oversight Council, to prescribe such rules and regulations as the FDIC considers necessary or appropriate to implement Title II. Section 209 also provides that, to the extent possible, the FDIC shall seek to harmonize such rules and regulations with the insolvency laws that would otherwise apply to a covered financial company. On October 19, 2009, the FDIC caused to be published in the Federal Register a Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of

the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Proposed Rule”).

The Proposed Rule addressed discrete issues within the following broad areas:

- (1) the priority of payment to creditors (by defining categories of creditors who shall not receive any additional payments under section 210(b)(4) or (d)(4));
- (2) the authority to continue operations by paying for services provided by employees and others (by clarifying the payment for services rendered under personal services contracts);
- (3) the treatment of creditors (by clarifying the measure of damages for contingent claims); and
- (4) the application of proceeds from the liquidation of subsidiaries (by reiterating the current treatment under corporate and insolvency law that remaining shareholder value is paid to the shareholders of any subsidiary).

The NPR solicited public comment on the proposed rule for a period of 30 days. The NPR also contained a general overview of the orderly liquidation process under Title II of the Dodd-Frank Act and solicited for a 90-day period any comments that would be more broadly related to the implementation of Title II. These comments will be considered in connection with additional rulemaking in the future.

During the 30-day comment period for comments specifically with regard to the Proposed Rule, the FDIC received 27 comment letters and held two meetings with various industry representatives and trade associations. The comments generally expressed support for the FDIC’s efforts to promulgate rules for implementing the orderly liquidation authority of Title II. A majority of comments related to matters beyond the scope of the Proposed Rule, indicating the need for additional rulemaking in

the future. Other comments, however, addressed specific facets of the Proposed Rule. Many commenters requested additional time to comment on various provisions of the Proposed Rule, and recommended that the FDIC delay issuing a final rule in order to permit additional comments and further consideration. The FDIC believes that additional comments would be helpful in refining certain aspects of the regulation and therefore is issuing the Rule at this time as an interim final rule, with request for comments. This action will provide the certainty of a final regulation, while permitting the FDIC to solicit and obtain additional comments that may serve as the basis for further clarification of certain issues and revision of the Rule, if necessary.

Comments on specific aspects of the Proposed Rule are addressed in the following discussion of the Rule.

III. The Rule

Definitions. Section 380.1 of the Rule gives the terms “bridge financial company,” “Corporation,” “covered financial company,” “covered subsidiary,” and “insurance company” the same meanings these terms are given in the Dodd-Frank Act. No comments were received on this section of the Proposed Rule.

Treatment of Similarly Situated Creditors. Sections 210(b)(4), (d)(4), and (h)(5)(E) of the Dodd-Frank Act permits the FDIC to pay certain creditors of a receivership more than similarly situated creditors if it is necessary (1) to “maximize the value of the assets”; (2) to initiate and continue operations “essential to implementation of the receivership and any bridge financial company”; (3) to “maximize the present value return from the sale or other disposition of the assets”; or (4) to “minimize the amount of any loss” on sale or other disposition. In addition, section 210(d)(4) permits

the FDIC to make additional payments to certain creditors if it is determined that such payments are necessary or appropriate to minimize losses from the orderly liquidation of the covered financial company. The appropriate comparison for any additional payments received by some, but not all, creditors similarly situated is the amount that the creditors should have received under the priority of expenses and unsecured claims defined in section 210(b) and other applicable law. In addition, the Dodd-Frank Act requires that all creditors of a class must receive no less than what they would have received in a Chapter 7 proceeding under the Bankruptcy Code.

Fundamental to an orderly liquidation of a covered financial company is the ability to continue key operations, services, and transactions that will maximize the value of the firm's assets and avoid a disorderly collapse in the market place. As is well illustrated by comparisons with some liquidations under the Bankruptcy Code, the inability to continue potentially valuable business operations can seriously impair the recoveries of creditors and increase the costs of the insolvency. In bank resolutions under the "least costly" requirement of the Federal Deposit Insurance Act, many institutions purchasing failed bank operations have paid a premium to acquire all deposits because of the recognized value attributable to acquiring ongoing depositor relationships. In those cases, the sale of all deposits to the acquiring institutions has maximized recoveries and minimized losses consistent with the "least costly" requirement.

The ability to maintain essential operations under the Dodd-Frank Act would be expected to similarly minimize losses and maximize recoveries in any liquidation, while avoiding a disorderly collapse. Examples of operations that may be essential to the implementation of the receivership or a bridge financial company include the payment of

utility and other service contracts and contracts with companies that provide payments processing services. These and other contracts will allow the bridge company to preserve and maximize the value of the bridge financial company's assets and operations to the benefit of creditors, while preventing a disorderly and more costly collapse.

Other creditors who do not receive such "additional payments," but who are within the same statutory priority for payment as creditors receiving "additional payments," will receive payment under section 210(b)(1), or other priorities of payment specified by law. The fact that additional payments to a limited group of creditors are permitted under the strict standards provided by section 210(b)(4), (d)(4), and (h)(5)(E) of the Dodd-Frank Act and the Rule does not entitle other similarly situated creditors to payments in excess of those provided under their statutory priority. At a minimum, such creditors must receive no less than the creditor would have received under Chapter 7 of the Bankruptcy Code or any similar provision of state insolvency law applicable to the covered financial company. Sections 210(b)(7)(B) and (d)(2).

To clarify the application of these provisions and to ensure that certain categories of creditors cannot expect additional payments under them, § 380.2 of the Rule defines certain categories of creditors who never satisfy this requirement. Specifically, this section puts creditors of a potential covered financial company on notice that creditors of a covered financial company who hold certain unsecured senior debt with a term of more than 360 days will not be given additional payments compared to other general creditors such as general trade creditors or any general or senior liability of the covered financial company, nor will exceptions be made for favorable treatment of holders of subordinated debt, shareholders or other equity holders. The Rule focuses on long-term unsecured

senior debt (i.e., debt maturing more than 360 days after issuance) in order to distinguish bondholders from commercial lenders or other providers of financing who have made lines of credit available to the covered financial company that may be essential for its continued operation and orderly liquidation.

The treatment of long-term unsecured senior debt under the Rule is consistent with the existing treatment of such debt in bank receiverships. The FDIC has long had the authority to make additional payments to certain creditors after the closing of an insured bank under the Federal Deposit Insurance Act, 12 U.S.C. 1821(i)(3), where it will maximize recoveries and is consistent with the “least costly” resolution requirement or is necessary to prevent “serious adverse effects on economic conditions or financial stability.” 12 U.S.C. 1821(d) and 1823(c). In applying this authority, the FDIC has not made additional payments to shareholders, subordinated debt, or long-term senior debt holders of banks placed into receivership because such payments would not have helped maximize recoveries or contribute to the orderly liquidation of the failed banks. This experience supports the conclusion that the Rule appropriately clarifies that shareholders, subordinated debt, or long-term senior debt holders of future non-bank financial institutions resolved under the Dodd-Frank Act should never receive additional payments under the authority of sections 210(b)(4), (d)(4), or (h)(5)(E).

While the Rule distinguishes between long-term unsecured senior debt and shorter term unsecured debt, this distinction does not mean that shorter term debt would be provided with additional payments under sections 210(b)(4), (d)(4), or 210(h)(5)(E) of the Dodd-Frank Act. As general creditors, such debt holders normally will receive the amount established and due under section 210(b)(1), or other priorities of payment

specified by law. While holders of shorter term debt may receive additional payments, this will be evaluated on a case-by-case basis and will only occur when such payments meet all of the statutory requirements. Under the Rule, the Board must specifically determine that additional payments or credit amounts to such holders are necessary and meet all of the requirements under sections 210(b)(4), (d)(4), or (h)(5)(E), as applicable. The Board's authority to make this decision cannot be delegated to management or staff of the FDIC. By requiring a vote by the Board, the Rule requires a decision on the record and ensures that the governing body of the FDIC has made a specific determination that such payments are necessary to the essential operations of the receivership or bridge financial company, to maximize the value of the assets or returns from sale, or to minimize losses

Much of the commenters' concern regarding the Proposed Rule's provision not to pay long-term debt holders any more than the amount they would have received if the company were liquidated under chapter 7 of the Bankruptcy Code appears to be based on the misapprehension that this provision makes it more likely that short-term debt holders will receive additional payments. Under the standards of the Dodd-Frank Act, and the Rule, that concern is unwarranted. Short-term debt holders (including, without limitation holders of commercial paper and derivatives counterparties) are highly unlikely to meet the criteria set forth in the statute for permitting payment of additional amounts. In virtually all cases, creditors with shorter-term claims on the covered financial company will receive the same pro rata share of their claim that is being provided to the long-term debt holders. Accordingly, a potential credit provider to a company subject to the Dodd-

Frank resolution process should have no expectation of treatment that differs depending upon whether it lends for a period of over 360 days or for a shorter term.

These provisions illustrate that ‘additional payments’ to any creditor will be very rare. Possible examples of creditors who might receive additional payments, in addition to essential and necessary service providers noted above, could include creditors with contract claims that are tied to performance bonds or other credit support needed for the covered financial company to qualify to continue other valuable contracts. Where continuation of those valuable contracts will meet the standards specified in sections 210(b)(4), (d)(4), or (h)(5)(E), as applicable, additional payments to the other creditors may also meet those standards if essential to maintain the requisite performance bonds or credit support agreements. These examples are not binding on the FDIC as receiver and serve to illustrate the exceeding rarity of any permissible additional payments.

This provision must also be considered in concert with the express provisions of section 203(c)(3)(A)(vi). This subsection requires a report to Congress not later than 60 days after appointment of the FDIC as receiver for a covered financial company specifying “the identity of any claimant that is treated in a manner different from other similarly situated claimants,” the amount of any payments and the reason for such action. In addition, the FDIC must post this information on a web site maintained by the FDIC. These reports must be updated “on a timely basis” and no less frequently than quarterly. This information will provide other creditors with full information about such payments in a timely fashion that will permit them to file a claim asserting any challenges to the payments.

The Dodd-Frank Act also includes the power to “claw-back” or recoup some or all of any additional payments made to creditors if the proceeds of the sale of the covered financial company’s assets are insufficient to repay any monies drawn by the FDIC from Treasury during the liquidation. See section 210(o)(1)(D). The “claw-back” provision only applies if the liquidation proceeds of the covered financial company are insufficient to fully repay any monies received from Treasury in the liquidation. This requirement is subject to an exception for “payments or amounts necessary to initiate and continue operations essential to implementation of the receivership or any bridge financial company...” It is highly unlikely that payments to short-term lenders would be found to qualify for such an exemption. A possible example of payments not subject to the “claw-back” provisions might be payments to trade creditors, such as a payment necessary to ensure that a vendor is able to continue to provide the failed company with essential software or hardware that could not be replicated, or payments to a utility with a local monopoly.

This provision underscores the importance of a strict application of the authority provided in sections 210(b)(4), (d)(4), and (h)(5)(E) of the Dodd-Frank Act and will help ensure that if there is any shortfall in proceeds of sale of the assets the institution’s creditors will be assessed before the industry as a whole. Most importantly, under no circumstances in a Dodd-Frank liquidation will taxpayers ever be exposed to loss.

The Rule expressly acknowledges the potential importance of ongoing credit relationships with lenders who have provided lines of credit that are necessary for maintaining ongoing operations. Under section 210(c)(13)(D) of the Dodd-Frank Act,

the FDIC can enforce lines of credit to the covered financial company and agree to repay the lender under the credit agreement.

A major driver of the financial crisis and the panic experienced by the market in 2008 was in part due to an overreliance by many market participants on funding through short-term, secured transactions in the repurchase market using volatile, illiquid collateral, such as mortgage-backed securities. In applying its powers under the Dodd-Frank Act, the FDIC must exercise care in valuing such collateral and will review the transaction to ensure it is not under-collateralized. Under applicable law, if the creditor is under-secured due to a decline in the value of such collateral, the unsecured portion of the claim will be paid as a general creditor claim.

Section 380.2 of the Proposed Rule also clarified that any portion of a claim secured by a legally valid and enforceable security interest that exceeds the fair market value of the collateral shall be treated as an unsecured claim and paid in accordance with the order of priority established under section 210(b)(1) of the Dodd-Frank Act. The Proposed Rule noted that collateral consisting of direct or fully guaranteed obligations of the United States or any agency of the United States (“government securities”) would be valued at par. Commenters expressed concern about the process for valuation of collateral for the purpose of determining whether a creditor is wholly or partly secured. Upon consideration of these comments, the FDIC concludes that all collateral, including government securities, should be valued at fair market value. We believe that a fair market value determination will provide crucial certainty in the valuation of this collateral. In the same vein, the FDIC believes that the establishment of a clear date for determining the value of securities or other assets that constitute valid security for a

proven claim will provide potential claimants greater certainty when determining what portion of a claim may be secured, or unsecured if under-collateralized. In some circumstances of great market volatility, it may be appropriate to determine the value of collateral based on fair market values existing on the day prior to the appointment of the FDIC as receiver. The FDIC is soliciting comments on this issue. The Rule establishes that the FDIC will use the fair market value of collateral as of the date that the FDIC was appointed as receiver. The provision in the Proposed Rule that the fair market value of government issued or government guaranteed securities shall be deemed to be par value has been eliminated in the Rule.

Personal Services Agreements. Section 380.3 of the Rule concerns personal services agreements, which may include, without limitation, collective bargaining agreements. Like other contracts with the covered financial company, a personal services agreement is subject to repudiation by the receiver if the agreement is determined to be burdensome and its repudiation would promote the orderly liquidation of the company. Prior to determining whether to repudiate, however, the FDIC as receiver may need to utilize the services of employees who have a personal services agreement with the covered financial company. The Rule provides that if the FDIC accepts services from employees during the receivership or any period where some or all of the operations of the covered financial company are continued by a bridge financial company, absent a contrary agreement or consent by the employee, those employees shall be paid according to the terms and conditions of their personal service agreement and such payments shall be treated as an administrative expense of the receiver. The acceptance of services from the employees by the FDIC as receiver (or by a bridge financial company) does not

impair the receiver's ability subsequently to repudiate a personal services agreement.⁵ The Rule will also not impair the ability of the receiver to reach an agreement with the employee that is more favorable to the FDIC than the original personal services agreement. The Rule also clarifies that a personal service agreement will not continue to apply to employees in connection with a sale or transfer of a subsidiary or the transfer of certain operations or assets of the covered financial company unless the acquiring party expressly agrees to assume the personal service agreement. Likewise, the transfer will not be predicated on such assumption. Paragraph (e) of § 380.3 clarifies that the provision for payment of employees does not apply to senior executives or directors of the covered financial company,⁶ nor does it impair the ability of the receiver to recover compensation previously paid to senior executives or directors under section 210(s) of the Dodd-Frank Act. The definition of "senior executive" in this section substantially follows the definition of "executive officer" in Regulation O of the Board of Governors of the Federal Reserve System (12 C.F.R. 215.2). This definition is commonly understood and accepted.

Contingent Obligations. Section 380.4 of the Rule addresses the treatment of contingent claims in the receivership of a covered financial company. The text of the Proposed Rule was revised in the Rule in response to comments recommending that the rule eliminate any ambiguity regarding the treatment of contingent claims. The revised

⁵ In this regard, the Proposed Rule is consistent with the Federal Deposit Insurance Act regarding the treatment of personal service contracts (see 12 U.S.C. 1821(e)(7)).

⁶ Section 213(d) of the Dodd-Frank Act requires the FDIC and the Board of Governors of the Federal Reserve System, after consultation with the Financial Stability Oversight Council, to prescribe, *inter alia*, "rules, regulations, or guidelines to further define the term "senior executive" for the purposes of that section, relating to the imposition of prohibitions on the participation of certain persons in the conduct of the affairs of a financial company. In the future, the FDIC will conform the definition of "senior executive" in § 380.3 of the Proposed Rule to the definition that is adopted in the regulation that is adopted pursuant to section 213(d).

text strengthens the Rule to make clear that the treatment of contingent claims under Title II parallels their treatment under the Bankruptcy Code. The text of the Proposed Rule also has been slightly modified in the Rule in order to more precisely follow the text of section 210(c)(3)(E) of the Dodd-Frank Act, which it will implement.

Under § 380.4, holders of contingent claims should expect to receive no less than the amount they would have received had the covered financial company had been a debtor in a case under chapter 7 of the U.S. Bankruptcy Code. Like the Bankruptcy Code, the Dodd-Frank Act defines the term “claim” to include a right to payment that is contingent (see 11 U.S.C. 101(5); section 201(a)(4)). Accordingly, paragraph (a) of § 380.4 affirms that that the FDIC as receiver of a covered financial company shall not disallow a claim solely because the claim is based on an obligation that was contingent as of the date of the appointment of the receiver. The Bankruptcy Code requires the estimation of any claim the liquidation of which would unduly delay the administration of the estate, such as a contingent claim (see 11 U.S.C. 502(c)). Similarly, paragraph (a) of § 380.4 provides that to the extent that an obligation is contingent, the receiver shall estimate the value of the claim, as such value is measured based upon the likelihood that the contingent obligation would become fixed and the probable magnitude of the claim. The Bankruptcy Code does not specify when a contingent claim should be estimated, however. The FDIC is soliciting additional comments regarding whether the receiver should designate a specific time during the term of the receivership to estimate contingent claims.

Paragraph (b) of § 380.4 implements section 210(c)(3)(E) of the Dodd-Frank Act, which provides that the FDIC may prescribe by rule or regulation that actual direct

compensatory damages for repudiation of a contingent guarantee, letter of credit, loan commitment, or similar credit obligation of a covered financial company shall be no less than the estimated value of the claim as of the date of the appointment of the FDIC as receiver for the company, as such value is measured based upon the likelihood that such contingent obligation would become fixed and the probable magnitude of the claim.

Insurance Company Subsidiaries. Section 380.5 of the Rule provides that where the FDIC acts as receiver for a direct or indirect subsidiary of an insurance company that is not an insured depository institution or an insurance company itself, the value realized from the liquidation or other liquidation of the subsidiary will be distributed according to the order of priorities set forth in section 210(b)(1) of the Dodd-Frank Act. In order to clarify that such value will be available to the policyholders of the parent insurance company to the extent required by the applicable State laws and regulations, the Rule expressly recognizes the requirement that the receiver remit all proceeds due to the parent insurance company in accordance with the order of priority set forth in section 210(b)(1). The only comment concerning § 380.5 of the Proposed Rule asked for confirmation that an insurance company (and its policyholders) might submit different claims according to its capacity as a shareholder, general creditor, or otherwise in relation to the order of priority. The FDIC does not believe that the rule text creates any uncertainty in this regard and so § 380.5 is unchanged in the Rule.

Liens on Insurance Company Assets. Section 380.6 of the Rule limits the ability of the FDIC to take liens on insurance company assets and assets of the insurance company's covered subsidiaries, under certain circumstances after the FDIC has been appointed receiver. Section 204 of the Dodd-Frank Act permits the FDIC to provide

funding for the orderly liquidation of covered financial companies and covered subsidiaries that the FDIC determines, in its discretion, are necessary or appropriate by, among other things, making loans, acquiring debt, purchasing assets or guaranteeing them against loss, assuming or guaranteeing obligations, making payments, or entering into certain transactions. In particular, pursuant to section 204(d)(4), the FDIC is authorized to take liens “on any or all assets of the covered financial company or any covered subsidiary, including a first priority lien on all unencumbered assets of the covered financial company or any covered subsidiary to secure repayment of any transactions conducted under this subsection.”

Section 203(e) provides that, in general, if an insurance company is a covered financial company, the liquidation or rehabilitation of such insurance company shall be conducted as provided under the laws and requirements of the State. However, a subsidiary or affiliate (including a parent entity) of an insurance company, where such subsidiary or affiliate is not itself an insurance company, will be subject to orderly liquidation under Title II without regard to State law.

The Rule recognizes that the orderly liquidation of such a covered affiliate or subsidiary should not unnecessarily interfere with the liquidation or rehabilitation of the insurance company, and that the interests of the policy holders in the assets of the insurance company should be respected. Accordingly, the Rule provides that the FDIC will avoid taking a lien on some or all of the assets of a covered financial company that is an insurance company or a covered subsidiary or affiliate of an insurance company unless it makes a determination, in its sole discretion, that taking such a lien is necessary for the orderly liquidation of the company (or subsidiary or affiliate) and will not unduly impede

or delay the liquidation or rehabilitation of such insurance company, or the recoveries by its policyholders. The final paragraph of § 380.6 makes clear that no restriction on taking a lien on assets of a covered financial company or any covered subsidiary or affiliate will limit or restrict the ability of the FDIC or the receiver to take a lien on in such assets in connection with the sale of such entities or any of their assets on a financed basis to secure any financing being provided in connection with such sale. Commenters expressed concerns that the language of the Proposed Rule was not sufficiently clear that the power to take a lien on a company's assets was limited to the assets of the company that received the advance of funds. The Rule clarifies the language in this respect. In all other aspects, however, the FDIC believes that the limitations set forth in the Proposed Rule are clear and appropriate and require no changes in the Rule. The determination that taking a lien is necessary for the orderly liquidation of the company (or subsidiary or affiliate) and will not unduly impede or delay the liquidation or rehabilitation of the insurance company or the recoveries by its policyholders should be committed to the discretion of the FDIC. By so providing, the FDIC's rules will best avoid the possibility of harmful delay and help ensure a speedy and orderly liquidation process.

IV. Request for Comments

The FDIC requests comments on any aspect of the Rule that would be helpful in refining the Rule further. In addition, the FDIC specifically requests comments on the following issues:

1. Are there additional ways to reduce moral hazard and increase market discipline and to clarify that all creditors should assume that they will receive no additional

payments and their recovery will be limited to what will be paid according to the order of priorities established under section 210(b)?

2. Subsection 380.2 precludes any “additional payments” under the statute to holders of long term debt, which is defined as debt with a term in excess of 360 days. What are the positive and negative consequences that this may have for market stability? What effect might this have on long term debt and its role in funding for financial companies? Is additional flexibility needed? Are there additional ways to counteract any impression that shorter term debt is not at risk? Does using a term of 360 days adequately distinguish longer term from shorter term debt? Should a different period be used?
3. What additional guidelines would be useful in creating certainty with respect to establishment of fair market value of various types of collateral for secured claims?
4. Should the date of appointment of the receiver be used as the valuation date for all types of collateral, or only government securities or other publicly traded securities?
5. Who should receive the benefit or burden of market fluctuation between the date of appointment of the receiver and the date of payment of a claim? For example, if a claim is for \$100, and the collateral is valued at \$98 on the date of appointment of the receiver, and at \$102 at the date of payment of the claim, should the claimant receive \$98 plus an unsecured claim of \$2, should they receive the full value of their secured claim of \$100, or should they receive the full value of the collateral, i.e., \$102?
6. Should the FDIC designate a specific time during the term of the receivership to estimate contingent claims?

All comments must be received by the FDIC not later than **[Insert date 60 days after publication in the Federal Register]**.

V. Regulatory Analysis and Procedure

A. Paperwork Reduction Act

The Rule establishes internal rules and procedures for the liquidation of a failed systemically important financial company. It does not involve any new collections of information pursuant to the Paperwork Reduction Act (44 U.S.C. 3501 et seq.). Consequently, no information collection has been submitted to the Office of Management and Budget for review.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act requires an agency that is issuing a final rule to prepare and make available a regulatory flexibility analysis that describes the impact of the final rule on small entities. (5 U.S.C. 603(a)). The Regulatory Flexibility Act provides that an agency is not required to prepare and publish a regulatory flexibility analysis if the agency certifies that the final rule will not have a significant impact on a substantial number of small entities.

Pursuant to section 605(b) of the Regulatory Flexibility Act, the FDIC certifies that the Rule will not have a significant impact on a substantial number of small entities. The Rule will clarify rules and procedures for the liquidation of a failed systemically important financial company, which will provide internal guidance to FDIC personnel performing the liquidation of such a company and will address any uncertainty in the financial system as to how the orderly liquidation of such a company would operate. As such, the Rule would not impose a regulatory burden on entities of any size and does not significantly impact small entities.

C. The Treasury and General Government Appropriations Act, 1999--Assessment of Federal Regulations and Policies on Families

The FDIC has determined that the Rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, enacted as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (Public Law 105-277, 112 Stat. 2681).

D. Small Business Regulatory Enforcement Fairness Act

The Office of Management and Budget has determined that the Rule is not a “major rule” within the meaning of the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA)(5 U.S.C. 801 et seq.). As required by SBREFA, the FDIC will file the appropriate reports with Congress and the General Accounting Office so that the Rule may be reviewed.

E. Plain Language

Section 722 of the Gramm-Leach-Bliley Act (Pub. L. 106-102, 113 Stat. 1338, 1471), requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The FDIC has sought to present the Rule in a simple and straightforward manner.

List of Subjects in 12 C.F.R. Part 380

Holding companies, Insurance companies

■ For the reasons stated above, the Board of Directors of the Federal Deposit Insurance Corporation amends title 12 of the Code of Federal Regulations by adding new part 380 as follows:

PART 380 –

Sec.

380.1 Definitions.

380.2 Treatment of similarly situated claimants.

380.3 Treatment of personal service agreements.

380.4 Provability of claims based on contingent obligations.

380.5 Treatment of covered financial companies that are subsidiaries of insurance companies.

380.6 Limitation on liens on assets of covered financial companies that are insurance companies or covered subsidiaries of insurance companies.

Authority: 12 U.S.C. 5301 et seq.

§ 380.1 Definitions

(a) For purposes of this part, the following terms are defined as follows: (1) the term “bridge financial company” means a new financial company organized by the Corporation in accordance with 12 U.S.C. 5390(h) for the purpose of resolving a covered financial company.

(2) The term “Corporation” means the Federal Deposit Insurance Corporation.

(3) The term “covered financial company” means (1) a financial company for which a determination has been made under 12 U.S.C. 5383(b) and (2) does not include an insured depository institution.

(4) The term “covered subsidiary” means a subsidiary of a covered financial company, other than (1) an insured depository institution; (2) an insurance company; or (3) a covered broker or dealer.

(5) The term “insurance company” means any entity that is (1) engaged in the business of insurance; (2) subject to regulation by a State insurance regulator; and (3) covered by a State law that is designed to specifically deal with the rehabilitation, liquidation or insolvency of an insurance company.

§ 380.2 Treatment of similarly situated claimants.

(a) For the purposes of this section, the term “long-term senior debt” means senior debt issued by the covered financial company to bondholders or other creditors that has a term of more than 360 days. It does not include partially funded, revolving or other open lines of credit that are necessary to continuing operations essential to the receivership or any bridge financial company, nor to any contracts to extend credit enforced by the receiver under 12 U.S.C. 5390(c)(13)(D).

(b) In applying any provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act permitting the Corporation to exercise its discretion, upon appropriate determination, to make payments or credit amounts, pursuant to 12 U.S.C. 5390(b)(4), (d)(4), or (h)(5)(E) to or for some creditors but not others similarly situated at the same level of payment priority, the Corporation shall not exercise such authority in a manner that would result in the following recovering more than the amount established and due under 12 U.S.C. 5390(b)(1), or other priorities of payment specified by law:

- (1) Holders of long-term senior debt who have a claim entitled to priority of payment at the level set out under 12 U.S.C. 5390(b)(1)(E);
- (2) Holders of subordinated debt who have a claim entitled to priority of payment at the level set out under 12 U.S.C. 5390(b)(1)(F);
- (3) Shareholders, members, general partners, limited partners, or other persons who have a claim entitled to priority of payment at the level set out under 12 U.S.C. 5390 (b)(1)(H); or

(4) Other holders of claims entitled to priority of payment at the level set out under 12 U.S.C. 5390(b)(1)(E) unless the Corporation, through the affirmative vote of a majority the members of the Board of Directors then serving, and in its sole discretion, specifically determines that additional payments or credit amounts to such holders are necessary and meet all of the requirements under 12 U.S.C. 5390(b)(4), (d)(4), or (h)(5)(E), as applicable.

The authority of the Board to make the foregoing determination cannot be delegated.

(c) Proven claims secured by a legally valid and enforceable or perfected security interest or security entitlement in any property or other assets of the covered financial company shall be paid or satisfied in full to the extent of such collateral, but any portion of such claim which exceeds an amount equal to the fair market value of such property or other assets shall be treated as an unsecured claim and paid in accordance with the priorities established in 12 U.S.C. 5390(b) and otherwise applicable provisions. Such fair market value shall be determined as of the date the Corporation was appointed receiver of the covered financial company.

§ 380.3 Treatment of personal service agreements.

(a) Definitions. (1) The term “personal service agreement” means a written agreement between an employee and a covered financial company, covered subsidiary or a bridge financial company setting forth the terms of employment. This term also includes an agreement between any group or class of employees and a covered financial company, covered subsidiary or a bridge financial company, including, without limitation, a collective bargaining agreement.

(2) The term “senior executive” means for purposes of this section, any person who participates or has authority to participate (other than in the capacity of a director) in major policymaking functions of the company, whether or not: the person has an official title; the title designates the officer an assistant; or the person is serving without salary or other compensation. The chairman of the board, the president, every vice president, the secretary, and the treasurer or chief financial officer, general partner and manager of a company are considered executive officers, unless the person is excluded, by resolution of the board of directors, the bylaws, the operating agreement or the partnership agreement of the company, from participation (other than in the capacity of a director) in major policymaking functions of the company, and the person does not actually participate therein.

(b)(1) If before repudiation or disaffirmance of a personal service agreement, the Corporation as receiver of a covered financial company, or the Corporation as receiver of a bridge financial company accepts performance of services rendered under such agreement, then:

(i) The terms and conditions of such agreement shall apply to the performance of such services; and

(ii) Any payments for the services accepted by the Corporation as receiver shall be treated as an administrative expense of the receiver.

(2) If a bridge financial company accepts performance of services rendered under such agreement, then the terms and conditions of such agreement shall apply to the performance of such services.

(c) No party acquiring a covered financial company or any operational unit, subsidiary or assets thereof from the Corporation as receiver or from any bridge financial company shall be bound by a personal service agreement unless the acquiring party expressly assumes the personal services agreement.

(d) The acceptance by the Corporation as receiver for a covered financial company, by any bridge financial company or the Corporation as receiver of a bridge financial company of services subject to a personal service agreement shall not limit or impair the authority of the Corporation as receiver to disaffirm or repudiate any personal service agreement in the manner provided for the disaffirmance or repudiation of any agreement under 12 U.S.C. 5390.

(e) Paragraph (b) of this section shall not apply to any personal service agreement with any senior executive or director of the covered financial company or covered subsidiary, nor shall it in any way limit or impair the ability of the receiver to recover compensation from any senior executive or director of a failed financial company under 12 U.S.C. 5390.

§ 380.4 Provability of claims based on contingent obligations.

(a) The Corporation as receiver shall not disallow a claim based on an obligation of the covered financial company solely because the obligation is contingent. To the extent the obligation is contingent, the receiver shall estimate the value of the claim, as such value is measured based upon the likelihood that such contingent obligation would become fixed and the probable magnitude thereof.

(b) If the receiver repudiates a contingent obligation of a covered financial company consisting of a guarantee, letter of credit, loan commitment, or similar credit

obligation, the actual direct compensatory damages for repudiation shall be no less than the estimated value of the claim as of the date the Corporation was appointed receiver of the covered financial company, as such value is measured based upon the likelihood that such contingent claim would become fixed and the probable magnitude thereof.

§ 380.5 Treatment of covered financial companies that are subsidiaries of insurance companies.

The Corporation shall distribute the value realized from the liquidation, transfer, sale or other disposition of the direct or indirect subsidiaries of an insurance company, that are not themselves insurance companies, solely in accordance with the order of priorities set forth in 12 U.S.C. 5390(b)(1).

§ 380.6 Limitation on liens on assets of covered financial companies that are insurance companies or covered subsidiaries of insurance companies.

(a) In the event that the Corporation makes funds available to a covered financial company that is an insurance company or is a covered subsidiary or affiliate of an insurance company or enters into any other transaction with respect to such covered entity under 12 U.S.C. 5384(d), the Corporation will exercise its right to take liens on some or all assets of the covered entities receiving such funds to secure repayment of any such transactions only when the Corporation, in its sole discretion, determines that:

(1) Taking such lien is necessary for the orderly liquidation of the entity;

and

(2) Taking such lien will not either unduly impede or delay the liquidation or rehabilitation of such insurance company, or the recovery by its policyholders.

(b) This section shall not be construed to restrict or impair the ability of the Corporation to take a lien on any or all of the assets of any covered financial company or covered subsidiary or affiliate in order to secure financing provided by the Corporation or

the receiver in connection with the sale or transfer of the covered financial company or covered subsidiary or affiliate or any or all of the assets of such covered entity.

By order of the Board of Directors.

Dated at Washington D.C., this 11th day of January, 2011.

FEDERAL DEPOSIT INSURANCE CORPORATION

Robert E. Feldman
Executive Secretary