January 5, 2011

MEMORANDUM TO: The Board of Directors

FROM: James Wigand
Director
Office of Complex Financial Institutions

Michael H. Krimminger
Acting General Counsel

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

RECOMMENDATION

Staff recommends that the Board of Directors ("Board") issue an interim final rule ("Interim Final Rule"), with request for comment, that would add a new part 380 to title 12 of the Code of Federal Regulations for the purpose of implementing certain orderly liquidation authority provisions of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The Interim Final Rule adopts with certain changes the proposed rule ("Proposed Rule") set out in the Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("NPR") approved by the Board on October 8, 2010, and published in the Federal Register on October 19, 2010. As discussed in more detail in this case memorandum, changes in the Interim Final Rule address provisions of the Proposed Rule concerning the valuation of certain collateral and the treatment of contingent claims. Otherwise, the Interim Final Rule is identical to the Proposed Rule in all material respects.

EXECUTIVE SUMMARY

Title II of the Dodd-Frank Act provides for the appointment of the FDIC as receiver for a financial company for which a determination has been made that the company's failure would pose a significant risk to the financial stability of the United States (a "covered financial company"). If approved by the Board, the Interim Final Rule would be promulgated under section 209,[1] which 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 the orderly liquidation authority provisions of Title II. The Interim Final Rule is intended 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.

The Proposed Rule addressed discrete issues within the following broad areas relating to Title II:

(1) the priority of payment to creditors by defining categories of creditors who shall not receive any additional payments under sections 210(b)(4), (d)(4), or (h)(5)(E);

(2) the authority to continue operations of the covered financial company 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 treatment of claims that are contingent as of the date of the appointment of the receiver; and

[1] Unless the context requires otherwise, all section references in this memorandum are to the Dodd-Frank Act.

(4) the application of proceeds from the liquidation of subsidiaries, by reiterating the current treatment under existing corporate and insolvency law that any remaining shareholder value is paid to the shareholders of any subsidiary and by imposing certain limitations of the authority to take liens on assets of covered subsidiaries in situations where the covered subsidiary is a subsidiary of an insurance company.

The NPR solicited public comments on the Proposed Rule and certain specific questions for a period of 30 days and comments on other key issues involved in the implementation of Title II for a period of 90 days. During the 30-day comment period, 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 NPR, 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. Staff believes that additional comments would be helpful in refining certain aspects of the regulation and therefore recommends that the regulation be issued at this time as an interim final rule, with request for comments. This course 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 regulation, if necessary.

The Interim Final Rule contains the following provisions:

Section 380.1 establishes that the terms "bridge financial company," "Corporation," "covered financial company," "covered subsidiary," "insurance company," and "subsidiary" as used in the Interim Final Rule have the same meanings as in the Dodd-Frank Act.

Section 380.2 would provide that the FDIC shall not exercise its authority to provide for more favorable treatment of some creditors over others similarly situated, or to make additional payments to some creditors but not others within a class at the same level of payment priority, in a manner that would result in holders of long-term senior debt, subordinated debt, or equity interests recovering more than others similarly situated at the same level of payment priority established and due under section 210(b)(1), or other priorities of payment specified by law. This section would also provide that any additional payments to creditors require approval and a determination by the FDIC Board of Directors, by a recorded vote, that the payments or credits are necessary and meet the requirements of Sections 210(b)(4), (d)(4), or (h)(5)(E), as applicable.

The Interim Final Rule would further provide that the authority of the Board to make this decision cannot be delegated to management or staff of the FDIC. By requiring a vote by the Board, the Interim Final Rule would require a decision on the record and ensure 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. Section 380.2 would also clarify 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 Interim Final Rule clarifies the Proposed Rule by specifying that all collateral, including U.S. government securities, will be valued at its fair market value determined as of the date of the appointment of the receiver.

Section 380.3 would provide that personal service agreement will not continue to apply to any employee in connection with a sale or transfer of a subsidiary or the sale or transfer of any particular operations or assets of the covered financial company unless the acquiring party expressly agrees to assume the personal service agreement. The provision for payment of employees does not apply to senior executives or directors of the covered financial company, nor does it impair the ability of the receiver to recover compensation previously paid to senior executives or directors.

Section 380.4 addresses contingent obligations of the covered financial company. The rule text contained in the Proposed Rule was revised in the Interim Final Rule to eliminate any uncertainty that the treatment of contingent claims under Title II would not parallel their treatment under the Bankruptcy Code. Accordingly, § 380.4 would provide that the receiver 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. To the extent the obligation is contingent, the receiver will estimate the value of the claim based upon the likelihood that the claim would become fixed and the probable magnitude thereof. Staff believes that additional comments should be solicited regarding whether the FDIC's rule should designate a specific point in time during the receivership for the valuation of contingent claims.

Section 380.5 would provide that where the FDIC acts as receiver for a direct or indirect subsidiary of an insurance company that is not an insurance company itself, the value realized from the liquidation or other resolution of the subsidiary will be distributed according to the order of priorities set forth in the Dodd-Frank Act.

Section 380.6 would provide 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 such company (or covered subsidiary or affiliate) and will not unduly impede or delay the liquidation or rehabilitation of the insurance company, or the recoveries by its policyholders. The Interim Final Rule adds text to the Proposed Rule clarifying that the FDIC will take a lien only on the assets of the entity to which funds are provided.

DISCUSSION

The Dodd-Frank Act was enacted on July 21, 2010. Title II of the Dodd-Frank Act provides for the appointment of the FDIC as receiver of a financial company for which a determination has been made that the company's failure would pose a significant risk to the financial stability of the United States (a "covered financial company"). While it is not expected that the FDIC will be appointed as receiver for a covered financial company in the near future, it is important for the FDIC to have rules in place in a timely manner in order to address any uncertainty in the financial system as to how the orderly liquidation process would be implemented. The Interim Final Rule would be promulgated under section 209, which 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. The Interim Final Rule is intended 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. The Interim Final Rule addresses discrete issues within the following broad areas: (1) the priority of payment to creditors, by defining categories of creditors who will not receive additional payments under sections 210(b)(4), (d)(4), or (h)(5)(E) of the Dodd-Frank Act, and by confirming protection of secured claims up to the full value of the collateral and specifying the valuation of collateral and the treatment of any unsecured portion of the claims; (2) the authority to continue operations of the covered financial company 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 treatment of claims that are contingent as of the date of the appointment of the receiver; and (4) the application of proceeds from the liquidation of subsidiaries, by reiterating the current treatment under existing corporate and insolvency law that any remaining shareholder value is paid to the shareholders of any subsidiary and by imposing certain limitations of the authority to take liens on assets of covered subsidiaries in situations where the covered subsidiary is a subsidiary of an insurance company.

Section-by-Section Analysis

Definitions. Section 380.1 of the Interim Final Rule would define the terms "bridge financial company," "Corporation," "covered financial company," "covered subsidiary," and "insurance company" to have 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. The FDIC has long had authority under the Federal Deposit Insurance Act to continue operations after the closing of failed insured banks if necessary to maximize the value of the assets in order to achieve the "least costly" resolution or to prevent "serious adverse effects on economic conditions or financial stability." 12 U.S.C. §§ 1821(d) and 1823(c). 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 Interim Final 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 Interim Final Rule would define certain categories of creditors who never satisfy this requirement. Specifically, this section would put 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 Interim Final Rule would focus 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 are essential for its continued operation and orderly liquidation.

The treatment of long-term unsecured senior debt under the Interim Final 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 Interim Final 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 Interim Final Rule would distinguish 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 Interim Final 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 Interim Final Rule would require a decision on the record and ensure 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 the Proposed Rule makes it more likely that short-term debt holders will receive additional payments. Under the standards of the Dodd-Frank Act, and the Interim Final Rule, that concern is unwarranted. Short-term debt holders are highly unlikely to meet the criteria set forth in the statute for permitting payment of additional amounts. In virtually all cases, holders of shorter-term debt 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.

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 Interim Final Rule expressly acknowledges the potential importance 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. In some cases, such lines of credit may be an integral part of key operations and be essential to help the FDIC maximize the value of the failed company's assets and operations. In such cases, it may be more efficient to continue such lines of credit and, if appropriate, reduce the demands for funding from the Orderly Liquidation Fund.

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. In order clarify the valuation of all collateral, staff recommends 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, Staff agrees 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. Staff recommends that the Interim Final Rule request comments on this issue. The Interim Final Rule makes revisions that clarify that the FDIC will use the fair market value of collateral as of the date that the FDIC was appointed as receiver and to eliminate 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.

Personal Services Agreements. Section 380.3 of the Interim Final 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 Interim Final Rule would provide 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.[2] The Interim Final 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 Interim Final Rule also would clarify 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. Subparagraph (e) of § 380.3 would clarify that the provision for payment of employees does not apply to senior executives or directors of the covered financial company,[3] 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

---

[2] 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)).

[3] 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 Interim Final Rule to the definition that is adopted in the regulation that is adopted pursuant to section 213(d).

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 Interim Final 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 Interim Final Rule in response to comments recommending that the rule eliminate any ambiguity regarding the treatment of contingent claims. The revised text strengthens the Interim Final 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 Interim Final Rule in order to more precisely follow the text of section 210(c)(3)(E) of the Dodd-Frank Act, which it would 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 would affirm 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 would provide 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. Staff recommends that additional comments be solicited regarding whether the receiver should designate a specific time during the term of the receivership to estimate contingent claims.

Paragraph (b) of § 380.4 would implement 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 Interim Final Rule would provide 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 Interim Final Rule would expressly recognize 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. Staff does not believe that the text of the rule creates any uncertainty in this regard and does not recommend any change to the text of the Proposed Rule.

Liens on Insurance Company Assets. Section 380.6 of the Interim Final Rule would limit 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, either by the appropriate State regulatory agency, or by the FDIC if such regulatory agency has not filed the appropriate judicial action in the appropriate State court within sixty (60) days of the date of the determination that such insurance company satisfied the requirements for appointment of a receiver under section 202(a). 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 Interim Final Rule would recognize 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 Interim Final Rule would provide 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 would make 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 Interim Final Rule would clarify the language in this respect. In all other aspects, however, Staff believes that the limitations set forth in the Proposed Rule are clear and appropriate and require no changes in the Interim Final Rule, and that 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.

STAFF CONTACTS:

Marc Steckel
Associate Director
Division of Insurance and Research
202-898-3618

R. Penfield Starke
Senior Counsel
Receivership Policy Unit
703-562-2422