

October 16, 2013

TO: Board of Directors

FROM: Bret D. Edwards 
Director
Division of Resolutions and Receiverships

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SUBJECT: Proposed Rule Regarding Restrictions on Sales of Assets of a Covered Financial Company by the Federal Deposit Insurance Corporation

EXECUTIVE SUMMARY

The FDIC is required to prescribe a rule under Section 210(r) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Section 210(r)” of the “Dodd-Frank Act”), 12 USC 5390(r), to prohibit sales of covered financial company assets to individuals or entities who profited or engaged in wrongdoing at the expense of a covered financial company or seriously mismanaged a covered financial company. Staff has drafted a rule (the “proposed rule”) to meet this requirement. The proposed rule would implement the restrictions on sales under Section 210(r) and establish a process through which a prospective purchaser must self-certify that it is not prohibited under Section 210(r) or the proposed rule from purchasing assets of a covered financial company sold by the FDIC.

DISCUSSION

Section 210(r) requires the FDIC to promulgate regulations which, at a minimum, prohibit the sale of an asset of a covered financial company by the FDIC to: (1) any person who has defaulted, or was a member of a partnership or an officer or director of a corporation that has

defaulted, on one or more obligations exceeding \$1,000,000 to such covered financial company, has been found to have engaged in fraudulent activity in connection with such obligation, and proposes to purchase any such asset in whole or in part through the use of financing from the FDIC; (2) any person who participated, as an officer or director of such covered financial company or of any affiliate of such company, in a material way in any transaction that resulted in a substantial loss to such covered financial company; or (3) any person who has demonstrated a pattern or practice of defalcation regarding obligations to such covered financial company.

The proposed rule expands on Section 210(r) by clarifying the scope and applicability of the statutory prohibition, defining important terms, and establishing a mechanism for compliance with the statutory prohibition through a self-certification requirement. A statutory provision similar to Section 210(r) is found in section 11(p) the Federal Deposit Insurance Act (“Section 11(p)” of the “FDI Act”), 12 U.S.C. § 1821(p). The FDIC promulgated a final rule, found at 12 CFR Part 340 (“Part 340”), implementing Section 11(p) in 2000. In general, the proposed rule is modeled upon Part 340, with some differences due largely to the nature of a covered financial company’s assets and to the potential strategies being developed by the FDIC for resolution of a covered financial company, which may involve a transfer of assets to a bridge financial company.

The requirement that a prospective purchaser certify compliance with Section 11(p) as a condition precedent to an asset sale has been in place since the adoption of Part 340 thirteen years ago. The use of the “Purchaser Eligibility Certification” in asset sales has proved to be an effective and efficient mechanism to ensure that eligible purchasers are not precluded from purchasing assets under the FDI Act and Part 340. It has also been used to identify prospective purchasers who are otherwise ineligible pursuant to other FDIC policies (for example,

compliance with the Division of Resolutions and Receiverships' Collection Policy, set forth in DRR Directive System Circular 7220.2).¹ The proposed rule would take the same approach as is taken under Part 340 by requiring a prospective purchaser to certify compliance with Section 210(r) and the proposed rule prior to purchasing assets of a covered financial company from the FDIC. A copy of the Purchaser Eligibility Certificate form that staff expects to use in connection with the proposed rule is attached hereto.²

Like Part 340, the proposed rule explains what it means to participate “in a material way in a transaction that caused a substantial loss to a covered financial company” and what it means to demonstrate a “pattern or practice of defalcation.” Section 210(r) uses these terms to identify prospective purchasers who are prohibited from purchasing assets from the covered financial company, and the proposed rule generally adapts language from Part 340 to define these terms. For example, the proposed rule follows Part 340 in defining what it means for an individual or entity to have participated in a material way in a transaction that caused a substantial loss to a covered financial company. This standard is met where the individual or entity has been adjudicated or alleged in a legal proceeding brought by the FDIC or other agency to have violated the law, breached a written agreement, or breached a fiduciary duty owed to the financial company in connection with the loss. A “substantial loss” is essentially a delinquent outstanding balance, deficiency balance, or unpaid final judgment of \$50,000 or more.

The proposed rule identifies certain prospective purchasers from whom a certification would not be required as a condition precedent to a sale, as does Part 340. Those entities are

¹ This sets forth the policy on sales of failed insured depository institution assets to parties having delinquent obligations to the FDIC. The proposed rule specifically permits development of appropriate policies related to sales of covered financial company assets that might, in the future, be included in a purchaser eligibility certification form.

² This form will be submitted to the Office of Management and Budget once the Board has had the opportunity to consider and approve the proposed rule.

states or political subdivisions of a state, federal agencies or instrumentalities such as the Government National Mortgage Association, and federally-regulated government-sponsored enterprises such as the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation. The proposed rule, however, would add another type of entity to this list: bridge financial companies established by the FDIC to resolve a covered financial company. Because of the nature of bridge financial companies, including their organizational purpose and the fact that they are subject to strict governmental control or oversight, it is reasonable to presume compliance without requiring self-certification.

Because Section 210(r) applies only to the sale of assets of the covered financial company “by the FDIC,” it does not restrict sales of assets by the bridge financial company or the bridge financial company’s subsidiaries. Although day-to-day operations of the bridge financial company will be conducted by staff of the bridge financial company under the direction of its board of directors (who are appointed by the FDIC), the FDIC is expected to retain control over certain major actions that likely will include sales not in the ordinary course of business, such as a sale of a material subsidiary or business line. This will allow the FDIC to restrict the persons prohibited from buying covered financial company assets under Section 210(r) and the proposed rule (officers and directors who engaged in fraudulent activity or caused substantial losses to a covered financial company, for example) from buying certain significant assets, such as material subsidiaries and business lines, after the transfer of such assets to a bridge financial company. Although applying the restrictions to bridge financial company assets is beyond the express scope of the statute, Section 210(r) provides that the FDIC shall prescribe regulations that “at a minimum” prohibit the sale of assets of a covered financial company by the FDIC to

the prohibited purchasers described in the Act. Thus, Congress granted the FDIC discretion to impose stricter standards for prohibiting asset sales than required by statute.

The proposed rule also clarifies that the prohibitions of the statute do not apply to certain types of transactions involving marketable securities and other financial instruments. These clarifications are based upon prior experience with respect to the use of the Purchaser Eligibility Certification in sales of assets of an insured depository institution by the FDIC, and they are intended to eliminate ambiguity or doubt in certain situations. For instance, the statutory restrictions cannot apply to, and no purchaser eligibility certification would be required for, a sale where the seller of an asset has no direct relationship with that purchaser and has no control over selection of the purchaser. For example, sales of securities on an exchange or through a clearinghouse do not fit within the statute's proscriptive intent because there is no mechanism allowing a seller to direct the sale of an asset to a specific buyer. Nor would the buyer be able to select the FDIC as the seller and would therefore not be able to determine whether it must comply with Section 210(r) and the proposed rule.

The proposed rule also provides clarification regarding the applicability of Section 210(r) to judicial or trustee's sales of property securing an obligation to the FDIC as receiver for a covered financial company. Such sales are not conducted or controlled by the FDIC. Rather, the court or the trustee conducts the sale in accordance with applicable law and selects the purchaser. Therefore, the proposed rule removes any doubt about whether such sales are outside the scope of the restriction. At the same time, the rule makes clear that sales of collateral that are conducted by the FDIC outside of any judicial process would be subject to the prohibition because the FDIC controls the sale of the collateral to the purchaser.

Two other clarifications of the statutory prohibition were included in Part 340 and repeated in the proposed rule. The first is a clarification that, in sales of covered financial company assets to a securitization trust or other entity, only the initial sale to the underwriter would be subject to Section 210(r) and the proposed rule; subsequent sales of the securities would not be subject to the restriction. The other is that Section 210(r) and the proposed rule would not apply to the sale or transfer of an asset if the sale or transfer resolves or settles claims or obligations asserted by the FDIC against the person with whom the FDIC is settling.

Although Part 340 contains an express exception for investments of receivership funds by the FDIC pursuant to the Liquidation Investment Policy,³ that exception was not included in the proposed rule because the policy does not apply to covered financial company receiverships. Moreover, investment of receivership funds would be limited to marketable securities that would be sold in a manner which, as discussed above, falls outside the scope of applicability.

Like Part 340, the proposed rule expands upon the statutory prohibition by restricting the sale of assets of any covered financial company to any prohibited purchaser, including prospective purchasers who are also prohibited from purchasing assets of a failed insured depository institution under Section 11(p) and Part 340, while the statute only prohibits the sale of assets of a particular covered financial company to an individual who has caused a substantial loss to that particular covered financial company. Staff recommends the broader prohibition because it promotes accountability and because it is consistent with the position taken in Part 340 that a prohibited purchaser of *any* FDIC receivership is prohibited from purchasing assets from any other FDIC receivership.

³ The FDIC's Liquidation Investment Policy cites sections 11(d) and 13(d) of the FDI Act as its legal basis. It is accessible at <http://fdic01.prod.fdic.gov/division/dof/financial/liqinvestpolicy.html>.

The proposed rule is substantively similar to Part 340 but improves that formula in several ways to implement the statutory imperative. Staff believes that a revision to Part 340 should follow this rulemaking effort if the Board of Directors so desires.

RECOMMENDATION

It is recommended that the Board of Directors approve the publication of the attached Federal Register notice of proposed rulemaking for a 60-day public comment period.

Staff Contacts

Legal Division: Elizabeth Falloon, Supervisory Counsel, (703) 562–6148; Shane Kiernan, Counsel, (703) 562-2632.

Division of Resolutions and Receiverships: Marc Steckel, Deputy Director, (202) 898-3618; Craig C. Rice, Senior Capital Markets Specialist, (202) 898-3501.

Office of Complex Financial Institutions: Charlton R. Templeton, Senior Resolution Planning & Implementation Specialist, (202) 898-6774.

ATTACHMENTS

A – Resolution

B – Model Purchaser Eligibility Certificate form

C – Federal Register Notice

Attachment B

Model Purchaser Eligibility Certificate for Sales of Covered Financial Company Assets

Federal Deposit Insurance Corporation
**COVERED FINANCIAL COMPANY ASSET SALES
PURCHASER ELIGIBILITY CERTIFICATION**

INSTRUCTIONS: Please provide instructions for completing this form.

The purpose of the Purchaser Eligibility Certification is to identify Prospective Purchasers who are not eligible to purchase assets of a covered financial company from the Federal Deposit Insurance Corporation under the laws and regulations governing such sales. Completion of the Purchaser Eligibility Certification, **without modification**, is a prerequisite to any such purchase.

DEFINITIONS

Associated Person. An Associated Person of a Prospective Purchaser who is an individual is (1) the Prospective Purchaser's spouse or dependent child or any member of the immediate household, (2) a partnership in which the Prospective Purchaser is or was a general or limited partner or a limited liability company of which the Prospective Purchaser is or was a member, or (3) a corporation of which the Prospective Purchaser is or was an officer or director. An Associated Person of a Prospective Purchaser that is an entity is (1) any individual or entity that, acting individually or in concert with one or more individuals or entities, owns or controls 25 percent or more of the Prospective Purchaser; or (2) a manager or general partner of the Prospective Purchaser.

Covered Financial Company. The term "covered financial company" means (a) a financial company for which a determination has been made under 12 U.S.C. § 5383(b) and (b) does not include an insured depository institution.

FDIC. FDIC means the Federal Deposit Insurance Corporation, whether acting in its corporate capacity or as receiver.

Prospective Purchaser. A Prospective Purchaser is any individual or entity that has made or intends to make an offer to purchase assets of a Covered Financial Company from the FDIC. For all purposes of this Certification, an "entity" includes any entity with a legally independent existence, including, without limitation, a trustee; the beneficiary of at least a 25% share of the proceeds of a trust; a partnership; a limited liability company; a corporation; an association; or any other organization or society.

Substantial Loss. A Substantial Loss is (i) any debt or duty to pay money owed to the FDIC or a Covered Financial Company, including any guarantee of any such debt or duty, that is delinquent for ninety (90) or more days and on which there remains an outstanding balance of more than \$50,000 (including principal, interest, late fees, legal fees, post-judgment interest, and any other amount due under the terms of the contract that created the obligation); (ii) an unpaid final judgment in excess of \$50,000 regardless of whether it becomes forgiven in whole or in part in a bankruptcy proceeding; (iii) a deficiency balance following a foreclosure of collateral in excess of \$50,000, regardless of whether it becomes forgiven in whole or in part in a bankruptcy proceeding; or (iv) any loss in excess of \$50,000 evidenced by an IRS Form 1099-C (Information Reporting for Cancellation of Debt).

ELIGIBILITY CERTIFICATION

The undersigned hereby certifies that all of the following statements are true, correct and complete when made and will be true at closing of the sale.

PRIVACY ACT STATEMENT

The Federal Deposit Insurance Act (12 U.S.C. §§1819, 1821, and 1823) and Executive Order 9397 authorizes the collection of this information. The FDIC will use this information in the marketing of assets, to identify qualified potential purchasers and to solicit bids for assets. Submitting this information to the FDIC is voluntary. Failure to submit all of the information requested could result in your inability to bid on or purchase assets held by the FDIC. The information provided by individuals is protected by the Privacy Act, 5 USC §552a. The information may be furnished to third parties as authorized by law and in accordance with any of the other routine uses described in the FDIC Potential Bidders List (FDIC-30-64-0019) System of Records. A complete copy of this System of Records is available at <http://www.fdic.gov/regulations/laws/rules/2000-4050.html#fdic200030--64--0019>. If you have questions or concerns about the collection or use of the information, you may contact the FDIC's Chief Privacy Officer at Privacy@fdic.gov.

ESTIMATED REPORTING BURDEN

[INSERT]

- A. Officers or Directors of Failed Institutions.** Neither the Prospective Purchaser nor any of its Associated Persons has ever participated as an officer or director of a financial company that has become a Covered Financial Company or of an affiliate of such company in a material way in one or more transactions that have caused a Substantial Loss to a Covered Financial Company. A Prospective Purchaser has participated in a “material way in one or more transactions that have caused a Substantial Loss to a Covered Financial Company” if, in connection with such Substantial Loss, the Prospective Purchaser has been found in a final determination by a court or administrative tribunal, or is alleged in a judicial or administrative action brought by the FDIC or a primary financial regulatory agency or by any component of the government of the United States or of any state (i) to have violated any law, regulation or order issued by a federal or state regulatory agency, or breached or defaulted on a written agreement with a federal or state regulatory agency, or breached a written agreement with a Covered Financial Company; or (ii) to have breached a fiduciary duty owed to a Covered Financial Company.
- B. Removal or Prohibition from Participation in the Affairs of a Covered Financial Company.** Neither the Prospective Purchaser nor any of its Associated Person(s) has been removed from, or prohibited from participating in the affairs of, a financial company pursuant to any final enforcement action by the FDIC or any primary financial regulatory agency.
- C. Pattern or Practice of Defalcation.** Neither the Prospective Purchaser nor any of its Associated Person(s) has engaged in more than one transaction with the intent to cause a loss, or with reckless disregard for whether such transactions would cause a loss, to any Covered Financial Company, where the transactions, in the aggregate, caused a Substantial Loss to one or more Covered Financial Companies.
- D. Convicted of Certain Crimes.** Neither the Prospective Purchaser nor any of its Associated Person(s) (1) has been convicted of committing or conspiring to commit any offense under Section 215, 656, 657, 1005, 1006, 1007, 1008, 1014, 1032, 1341, 1343 or 1344 of Title 18 of the United States Code affecting any Covered Financial Company; *and* (2) has defaulted on any debt or duty to pay money (including any guaranty) owed to the FDIC or any Covered Financial Company to such an extent that a judgment has been rendered in favor of the FDIC or the property securing the debt has been foreclosed on.
- E. Prohibited from Purchasing Insured Depository Institution Assets.** Neither the Prospective Purchaser nor any of its Associated Person(s) are prohibited from purchasing the assets of a failed insured depository institution from the FDIC under 12 U.S.C. 1821(p) or 12 C.F.R. Part 340.
- F. If Seller Financing Is Used.** Neither the Prospective Purchaser nor any of its Associated Persons (1) has defaulted on any debts or duties to pay money (including any guaranty) to the FDIC or a Covered Financial Company that, in the aggregate, exceed \$1,000,000, to such an extent that a judgment has been rendered in favor of the FDIC or the property securing the debt has been foreclosed on; *and* (2) has made any fraudulent misrepresentations in connection with any of these debts or duties to pay money. *This representation is not required, and has no effect, if the Prospective Purchaser does not finance any portion of the purchase price through financing offered by the FDIC.*
- G. Transactions Structured to Circumvent this Certification.** Neither the identity nor form of the Prospective Purchaser, nor any aspect of the contemplated transaction, has been created or altered with the intent, in whole or in part, to allow an individual or entity who otherwise would be ineligible to purchase assets from the FDIC to benefit directly or indirectly from the proposed transaction.

PROSPECTIVE PURCHASER INFORMATION

Name of Prospective Purchaser

Tax ID Number or SSN

Please Check Applicable Box:

 Individual Partnership LLC Corporation Trust Other (*specify*)Physical Street Address (*for overnight delivery*)

City

State or Province

Country

ZIP Code

Contact Person and Title

Telephone Number

Fax Number

Email Address

IN WITNESS WHEREOF, the undersigned has executed this Certification as of this

_____ day of _____

PROSPECTIVE PURCHASER

[Print Name of Prospective Purchaser]_____
[Signature]_____
[Print Name and Title of Authorized Signatory]

Notice Concerning Legal Action

Any person who knowingly or willfully makes false or fraudulent statements or disclosures in connection with this Certification will be referred to the Office of Inspector General and/or the appropriate law enforcement officials for investigation and legal enforcement and may be subject to fines and/or imprisonment (18 U.S.C. §§ 1001, 1007 and 1014).