

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 380

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 302

Release No. XXXXX ; File No. XXXX

Covered Broker-Dealer Provisions under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act

AGENCY: Federal Deposit Insurance Corporation (“FDIC” or “Corporation”); Securities and Exchange Commission (“SEC” or “Commission” and, collectively with the FDIC, the “Agencies”).

ACTION: Notice of proposed rulemaking.

SUMMARY: The Agencies, in accordance with section 205(h) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), are jointly proposing a rule to implement provisions applicable to the orderly liquidation of covered brokers and dealers under Title II of the Dodd-Frank Act (“Title II”).

DATES: Comments should be received on or before [60 days after publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

FDIC

- **FDIC website:** <http://www.fdic.gov/regulations/laws/federal>. Follow instructions for submitting comments on the FDIC website.
- **FDIC e-mail:** Comments@FDIC.gov. Include “**RIN 3064-AE39**” in the subject line of the message.

- FDIC mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street NW, Washington, DC 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. (Eastern Time).
- 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.

SEC

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number [] on the subject line;
or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549-1090.

All submissions should refer to File Number XX-XX-XX. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the

Commission’s website (<http://www.sec.gov/rules/proposed.shtml>). Comments also are available for website viewing and printing in the Commission’s Public Reference Room, 100 F Street, NE, Washington, D.C. 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

Studies, memoranda or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission’s website. To ensure direct electronic receipt of such notifications, sign up through the “Stay Connected” option at www.sec.gov to receive notifications by email.

FOR FURTHER INFORMATION CONTACT:

FDIC

Peter Miller, Assistant Director, Division of Resolutions and Receiverships, at (917) 320-2589; John Oravec, Senior Resolution Advisor, Office of Complex Financial Institutions, at (202) 898-6612; Elizabeth Falloon, Supervisory Counsel, Legal Division, at (703) 562-6148; Pauline Calande, Senior Counsel, Legal Division, at (202) 898-6744.

SEC

Thomas K. McGowan, Associate Director, at (202) 551-5521; Randall W. Roy, Deputy Associate Director, at (202) 551-5522; Raymond A. Lombardo, Branch Chief, at (202) 551-5755; Jane D. Wetterau, Attorney Advisor, at (202) 551-4483, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

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I. BACKGROUND

Title II of the Dodd-Frank Act¹ provides an alternative insolvency regime for the orderly liquidation of large financial companies that meet specified criteria.² Section 205 of Title II sets forth certain provisions specific to the orderly liquidation of certain large broker-dealers, and paragraph (h) of section 205 requires the Agencies, in consultation with the Securities Investor Protection Corporation (“SIPC”), jointly to issue rules to implement section 205.³

In the case of a broker-dealer, or in which the largest U.S. subsidiary of a financial company⁴ is a broker-dealer, the Board of Governors of the Federal Reserve (“Board”) and the Commission are authorized jointly to issue a written orderly liquidation recommendation to the U.S. Treasury Secretary (“Secretary”). The FDIC must be consulted in such a case.

The recommendation, which may be *sua sponte* or at the request of the Secretary, must contain a discussion regarding eight criteria enumerated in section 203(a)(2)⁵ and be approved by a vote of not fewer than a two-thirds majority of each agency’s governing body then serving.⁶ Based on similar but not identical criteria enumerated in section 203(b), the Secretary would consider the recommendation and (in consultation with the President) determine whether the financial company poses a systemic risk meriting liquidation under Title II.⁷

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Public Law 111–203, 124 Stat. 1376 (2010) and codified at 12 U.S.C. 5301 *et seq.* Title II of the Dodd-Frank Act is codified at 12 U.S.C. 5381-5394.

² See 12 U.S.C. 5384 (pertaining to the orderly liquidation of covered financial companies).

³ See 12 U.S.C. 5385 (pertaining to the orderly liquidation of covered broker-dealers).

⁴ Section 201(a)(11) of the Dodd-Frank Act (12 U.S.C. 5381(a)(11)) (defining financial company).

⁵ See 12 U.S.C. 5383(a)(2)(A) through (G).

⁶ See 12 U.S.C. 5383(a)(1)(B) (pertaining to vote required in cases involving broker-dealers).

⁷ See 12 U.S.C. 5383(b) (pertaining to a determination by the Secretary).

Title II also provides that in any case in which the Corporation is appointed receiver for a covered financial company,⁸ the Corporation may appoint itself as receiver for any covered subsidiary⁹ if the Corporation and the Secretary make the requisite joint determination specified in section 210.¹⁰

A company that is the subject of an affirmative section 203(b) or section 210(a)(1)(E) determination would be considered a covered financial company for purposes of Title II.¹¹ As discussed below, a covered broker or dealer is a covered financial company that is registered with the Commission as a broker or dealer and is a member of SIPC.¹² Irrespective of how the broker-dealer was placed into a Title II resolution, section 205 regarding the liquidation of covered broker-dealers and the proposed rule (if adopted) would always apply to the broker-dealer even if section 210 is invoked.¹³

Upon a determination under section 203 or section 210, a covered financial company would be placed into an orderly liquidation proceeding and the FDIC would be appointed receiver.¹⁴ In the case of a covered broker-dealer, the FDIC would appoint SIPC as trustee for the covered broker-dealer.¹⁵ Although the statute refers to the appointment of SIPC as trustee for the “liquidation of the covered broker-dealer under [the Securities Investor Protection Act

⁸ See 12 U.S.C. 5381(a)(8) (definition of covered financial company).

⁹ See 12 U.S.C. 5381(a)(9) (definition of covered subsidiary). A covered subsidiary of a covered financial company could include a broker-dealer.

¹⁰ See 12 U.S.C. 5390(a)(1)(e).

¹¹ See 12 U.S.C. 5381(a)(8) (definition of covered financial company); 12 U.S.C. 5390(a)(1)(E)(ii) (treatment as covered financial company).

¹² See 12 U.S.C. 5381(a)(7) (definition of covered broker or dealer). For convenience, we hereinafter refer to entities that meet this definition as covered broker-dealers.

¹³ See 12 U.S.C. 5390(a)(1)(E).

¹⁴ See 12 U.S.C. 5384 (pertaining to orderly liquidation of covered financial companies).

¹⁵ See 12 U.S.C. 5385(a) (appointment of SIPC as trustee for the liquidation).

(“SIPA”)]”,¹⁶ the proposed rule simply refers to SIPC as trustee for the covered broker-dealer since the Title II receivership is not a liquidation of the covered broker-dealer under SIPA, but rather an orderly liquidation of the broker-dealer under Title II that incorporates the customer protection provisions of SIPA. The FDIC could utilize a bridge financial company, a bridge broker-dealer,¹⁷ as a means to liquidate the covered broker-dealer, transferring customer accounts and associated customer name securities and customer property to such bridge financial company.¹⁸ In the event that a bridge broker-dealer were created, SIPC, as trustee under SIPA for the covered broker-dealer, would determine claims and distribute assets retained in the receivership of the covered broker-dealer in a manner consistent with SIPA.¹⁹ The transfer of customer property, and advances from SIPC, made to the bridge broker-dealer and allocated to a customer’s account at the bridge broker-dealer would satisfy a customer’s net equity claims against the covered broker-dealer to the extent of the value, as of the appointment date, of such allocated property. SIPC would have no powers or duties with respect to assets and liabilities of the bridge broker-dealer.²⁰ This rulemaking clarifies for purposes of section 205(h):²¹ how the customer protections of SIPA will be integrated with the other provisions of Title II; the roles of the Corporation as receiver and SIPC as trustee for a covered broker-dealer; and the administration of claims in an orderly liquidation of a covered broker-dealer.

¹⁶ 12 U.S.C. 5385(a)(1).

¹⁷ See Section II.A.2 below for a definition of bridge broker or dealer. For convenience, we hereinafter refer to entities that meet that definition as bridge broker-dealers.

¹⁸ See 12 U.S.C. 5390(h)(2)(H) (pertaining to the Corporation’s authority to organize bridge financial companies). See also *infra* section II.D.2 (describing the process of transferring accounts to the bridge broker-dealer).

¹⁹ See 12 U.S.C. 5385(a)(2)(B) (pertaining to the administration by SIPC of assets of the covered broker-dealer not transferred to a bridge broker-dealer).

²⁰ 12 U.S.C. 5385(b)(1).

²¹ 12 U.S.C. 5385(f).

II. PROPOSED RULE

A. Definitions²²

The proposed definitions section would define certain key terms. Consistent with the remainder of the proposed rule, the definitions are designed to help ensure that, as the statute requires, net equity claims of customers against a covered broker-dealer are determined and satisfied in a manner and amount that is at least as beneficial to customers as would have been the case had the covered broker-dealer been liquidated under SIPA without the appointment of the FDIC as receiver and without any transfer of assets or liabilities to a bridge financial company, and with a filing date as of the date on which the FDIC was appointed as receiver.²³ To effectuate the statutory requirement, the definitions in the proposed rule are very similar or identical to the corresponding definitions in SIPA and Title II of the Dodd-Frank Act, and where they differ, it is for purposes of clarity only and not to change or modify the meaning of the definitions under either Act.

1. Definitions Relating to Covered Broker-Dealers

The term covered broker or dealer would be defined as “a covered financial company that is a qualified broker or dealer.”²⁴ Pursuant to section 201(a)(10) of the Dodd-Frank Act, the terms customer, customer name securities, customer property, and net equity in the context of a

²² If adopted, the definitions section would appear in 12 CFR 380.60 for purposes of the Corporation and 17 CFR 302.100 for purposes of the Commission.

²³ See 12 U.S.C. 5385(f)(1) (pertaining to obligations to customers) and 12 U.S.C. 5385(d)(1)(A)-(C) (limiting certain actions of the Corporation that would adversely affect, diminish or otherwise impair certain customer rights).

²⁴ See §§ 380.60(d) and 302.100(d), as proposed. See also 12 U.S.C. 5381(a)(7).

covered broker-dealer will have the same meaning as the corresponding terms in section 16 of SIPA.²⁵

Section 16(2)(A) of SIPA defines customer of a debtor, in pertinent part, as “any person (including any person with whom the debtor deals as principal or agent) who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker or dealer from or for the securities accounts of such person for safekeeping, with a view to sale, to cover consummated sales, pursuant to purchases, as collateral, security, or for purposes of effecting transfer.”²⁶ Section 16(3) of SIPA defines customer name securities as “securities which were held for the account of a customer on the filing date by or on behalf of the debtor and which on the filing date were registered in the name of the customer, or were in the process of being so registered pursuant to instructions from the debtor, but does not include securities registered in the name of the customer which, by endorsement or otherwise, were in negotiable form.”²⁷ Section 16(4) of SIPA defines customer property, in pertinent part, as “cash and securities (except customer name securities delivered to the customer) at any time received, acquired, or held by or for the account of a debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property

²⁵ 12 U.S.C. 5381(a)(10) (“The terms ‘customer’, ‘customer name securities’, ‘customer property’, and ‘net equity’ in the context of a covered broker or dealer, have the same meanings as in section 16 of the Securities Investor Protection Act of 1970 (15 U.S.C. 78111).”); See also 15 U.S.C. 78111 and §§ 380.60 and 302.100, as proposed.

²⁶ 15 U.S.C. 78111(2)(A). See also §§ 380.60(e) and 302.100(e), as proposed (“The term customer of a covered broker or dealer shall have the same meaning as in 15 U.S.C. 78111(2) provided that the references therein to debtor shall mean the covered broker or dealer.”).

²⁷ 15 U.S.C. 78111(3). See also §§ 380.60(f) and 302.100(f), as proposed (“The term customer name securities shall have the same meaning as in 15 U.S.C. 78111(3) provided that the references therein to debtor shall mean the covered broker or dealer and the references therein to filing date shall mean the appointment date.”).

unlawfully converted.”²⁸ Section (16)(11) of SIPA defines net equity as “the dollar amount of the account or accounts of a customer, to be determined by – (A) calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date – (i) all securities positions of such customer (other than customer name securities reclaimed by such customer); and (ii) all positions in futures contracts and options on futures contracts held in a portfolio margining account carried as a securities account pursuant to a portfolio margining program approved by the Commission, including all property collateralizing such positions, to the extent that such property is not otherwise included herein; minus (B) any indebtedness of such customer to the debtor on the filing date; plus (C) any payment by such customer of such indebtedness to the debtor which is made with the approval of the trustee and within such period as the trustee may determine (but in no event more than sixty days after the publication of notice under section (8)(a) [of SIPA]).”²⁹

²⁸ 15 U.S.C. 78III(4). The definition of customer property goes on to include: (1) “securities held as property of the debtor to the extent that the inability of the debtor to meet his obligations to customers for their net equity claims based on securities of the same class and series of an issuer is attributable to the debtor’s noncompliance with the requirements of section 15(c)(3) of the 1934 Act and the rules prescribed under such section”; (2) “resources provided through the use or realization of customers’ debit cash balances and other customer-related debit items as defined by the Commission by rule”; (3) “any cash or securities apportioned to customer property pursuant to section 3(d) [of SIPA]”; (4) “in the case of a portfolio margining account of a customer that is carried as a securities account pursuant to a portfolio margining program approved by the Commission, a futures contract or an option on a futures contract received, acquired, or held by or for the account of a debtor form or for such portfolio margining account, and the proceeds thereof”; and (5) “any other property of the debtor which, upon compliance with applicable laws, rules, and regulations, would have been set aside or held for the benefit of customers, unless the trustee determines that including such property within the meaning of such term would not significantly increase customer property.” See also §§380.60(g) and 302.100(g), as proposed (“The term customer property shall have the same meaning as in 15 U.S.C. 78III(4) provided that the references therein to debtor shall mean the covered broker or dealer.”).

²⁹ 15 U.S.C. 78III(11) (emphasis added). See also §§ 380.60(h) and 302.100(h), as proposed (“The term net equity shall have the same meaning as in 15 U.S.C. 78III(11) provided that the references therein to debtor shall mean the covered broker or dealer and the references therein to filing date shall mean the appointment date.”).

The proposed definition of appointment date is “the date of the appointment of the Corporation as receiver for a covered financial company that is a covered broker or dealer.”³⁰

The appointment date would constitute the filing date as that term is used under SIPA³¹ and, like the filing date under SIPA, is the reference date for the computation of net equity.³²

2. Additional Definitions

In addition to the definitions relating to covered broker-dealers under section 201(a)(10) of the Dodd-Frank Act,³³ the Agencies also propose to define the following terms: (1) bridge broker or dealer;³⁴ (2) Commission;³⁵ (3) qualified broker or dealer;³⁶ (4) SIPA³⁷ and (5) SIPC.³⁸

The term bridge broker or dealer would be defined as “a new financial company organized by the Corporation in accordance with section 210(h) of the Dodd-Frank Act for the

³⁰ See §§ 380.60(a) and 302.100(a), as proposed.

³¹ See §§ 380.60(a) and 302.100(a), as proposed.

³² See §§ 380.60(a) and 302.100(a), as proposed. See also 12 U.S.C. 5385(a)(2)(C) (“For purposes of the liquidation proceeding, the term filing date means the date on which the Corporation is appointed as receiver of the covered broker or dealer.”); 15 U.S.C. 7811(7) (“The term filing date means the date on which an application for a protective decree is filed under section 5(a)(3), except that – (A) if a petition under title 11 of the United States Code concerning the debtor was filed before such date, the term filing date means the date on which such petition was filed; (B) if the debtor is the subject of a proceeding pending in any court or before any agency of the United States or any State in which a receiver, trustee, or liquidator for such debtor has been appointed and such proceeding was commenced before the date on which such application was filed, the term filing date means the date on which such proceeding was commenced; or (C) if the debtor is the subject of a direct payment procedure or was the subject of a direct payment procedure discontinued by SIPC pursuant to section 10(f), the term filing date means the date on which notice of such direct payment procedure was published under section 10(b).”).

³³ See 12 U.S.C. 5381(a)(10) (“The terms ‘customer’, ‘customer name securities’, ‘customer property’, and ‘net equity’ in the context of a covered broker or dealer, have the same meanings as in section 7811 of title 15.”).

³⁴ See §§ 380.60(b) and 302.100(b), as proposed.

³⁵ See §§ 380.60(c) and 302.100(c), as proposed.

³⁶ See §§ 380.60(i) and 302.100(i), as proposed.

³⁷ See §§ 380.60(j) and 302.100(j), as proposed.

³⁸ See §§ 380.60(k) and 302.100(k), as proposed.

purpose of resolving a covered broker or dealer.”³⁹ The term Commission would be defined as the “Securities and Exchange Commission.”⁴⁰ The term qualified broker or dealer would refer to “a broker or dealer that (A) is registered with the Commission under section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)); and (B) is a member of SIPC,” but is not itself subject to a Title II receivership.⁴¹ This definition is consistent with the statutory definition but is abbreviated for clarity. It is not intended to change or modify the statutory definition. The term SIPA would refer to the “Securities Investor Protection Act of 1970, 15 U.S.C. 78aaa–111.”⁴² The term SIPC would refer to the “Securities Investor Protection Corporation.”⁴³

B. Appointment of Receiver and Trustee for Covered Broker-Dealer⁴⁴

Upon the FDIC’s appointment as receiver for a covered broker-dealer, section 205 of the Dodd-Frank Act specifies that the Corporation “shall appoint . . . [SIPC] to act as trustee for the liquidation under [SIPA] of the covered [broker-dealer].”⁴⁵ The proposed rule deviates from the statutory language in some cases to clarify the orderly liquidation process. For example, the proposed rule would make it clear that SIPC is to be appointed as trustee for the covered broker-dealer but deletes the phrase “for the liquidation under SIPA” since in reality there is no proceeding under SIPA and the covered broker-dealer is being liquidated under Title II. Section

³⁹ See §§ 380.60(b) and 302.100(b), as proposed. See also 15 U.S.C. 5390(h)(2)(H) (setting forth that the FDIC, as receiver for a covered broker or dealer, may approve articles of association for one or more bridge financial companies with respect to such covered broker or dealer).

⁴⁰ See §§ 380.60(c) and 302.100(c), as proposed.

⁴¹ See §§ 380.60(i) and 302.100(i), as proposed.

⁴² See §§ 380.60(j) and 302.100(j), as proposed.

⁴³ See §§ 380.60(k) and 302.100(k), as proposed.

⁴⁴ If adopted, the section about the appointment of receiver and trustee for covered broker-dealers would appear in 12 CFR 380.61 for purposes of the Corporation and 17 CFR 302.101 for purposes of the Commission. The rule text in both CFRs will be identical.

⁴⁵ See 12 U.S.C. 5385(a)(1).

205 of the Dodd-Frank Act also states that court approval is not required for such appointment.⁴⁶ For ease and clarity, the proposed rule would incorporate these statutory roles which are further explained in other sections of the proposed rule.⁴⁷

C. Notice and Application for Protective Decree for Covered Broker-Dealer⁴⁸

Upon the appointment of SIPC as trustee for the covered broker-dealer, Title II requires SIPC, as trustee, promptly to file an application for a protective decree with a federal district court, and SIPC and the Corporation, in consultation with the Commission, jointly to determine the terms of the protective decree to be filed.⁴⁹ Although a SIPA proceeding is conducted under bankruptcy court supervision,⁵⁰ a Title II proceeding is conducted entirely outside of the bankruptcy courts, through an administrative process, with the FDIC acting as receiver.⁵¹ As a result, a primary purpose of filing a notice and application for a protective decree is to give notice to interested parties that an orderly liquidation proceeding has been initiated. The proposed rule on notice and application for protective decree provides additional clarification of the statutory requirement by setting forth the venue in which the notice and application for a protective decree is to be filed. It states that a notice and application for a protective decree is to be filed with the federal district court in which a liquidation of the covered broker-dealer under SIPA is pending, or if no such SIPA liquidation is pending, the federal district court for the

⁴⁶ Id.

⁴⁷ See §§ 380.61 and 302.101, as proposed.

⁴⁸ If adopted, the notice and application for protective decree for the covered broker-dealer section will appear in 12 CFR 380.62 for purposes of the FDIC and 17 CFR 302.102 for purposes of the Commission.

⁴⁹ See 12 U.S.C. 5385(b)(3) (pertaining to the filing of a protective decree by SIPC).

⁵⁰ See 15 U.S.C. 78eee(b).

⁵¹ See 15 U.S.C. 5388 (requiring the dismissal of all other bankruptcy or insolvency proceedings upon the appointment of the Corporation as receiver for a covered financial company).

district within which the covered broker-dealer's principal place of business is located.⁵² This court is a federal district court of competent jurisdiction specified in section 21 or 27 of the Exchange Act, 15 U.S.C. 78u, 78aa.⁵³ It also is the court with jurisdiction over suits seeking de novo judicial claims determinations under section 210(a)(4)(A) of the Dodd-Frank Act.⁵⁴ While the statute grants authority to file the notice and application for a protective decree in any federal court of competent jurisdiction specified in section 21 or 27 or the Securities Exchange Act of 1934, the proposed rule restricts the filing to the courts specified above in order to make it easier for interested parties to know where the protective decree might be filed. The proposed rule also clarifies that if the notice and application for a protective decree is filed on a date other than the appointment date, the filing shall be deemed to have occurred on the appointment date for purposes of the rule.⁵⁵

This proposed section of the rule governing the notice and application for a protective decree would also include a non-exclusive list of notices drawn from other parts of Title II.⁵⁶ The goal would be to inform interested parties that the covered broker-dealer is in orderly liquidation, and to highlight the application of certain provisions of the orderly liquidation authority particularly with respect to applicable stays and other matters that might be addressed in a protective decree issued under SIPA. A notice and application for a protective decree under Title II may, among other things, provide for notice: (1) that any existing case or proceeding

⁵² See §§ 380.62(a) and 302.102(a), as proposed.

⁵³ See 12 U.S.C. 5385(a)(2)(A) (specifying the federal district courts in which the application for a protective decree may be filed).

⁵⁴ See 12 U.S.C. 5390(a)(4)(A) (a claimant may file suit in the district or territorial court for the district within which the principal place of business of the covered financial company is located).

⁵⁵ See §§ 380.62(a) and 302.102(a), as proposed.

⁵⁶ See §§ 380.62(b) and 302.102(b), as proposed.

under the Bankruptcy Code or SIPA would be dismissed, effective as of the appointment date, and no such case or proceeding may be commenced with respect to a covered broker-dealer at any time while the Corporation is the receiver for such covered broker-dealer;⁵⁷ (2) of the revesting of assets, with certain exceptions, in a covered broker-dealer to the extent that they have vested in any entity other than the covered broker-dealer as a result of any case or proceeding commenced with respect to the covered broker-dealer under the Bankruptcy Code, SIPA, or any similar provision of state liquidation or insolvency law applicable to the covered broker-dealer;⁵⁸ (3) of the request of the Corporation as receiver for a stay in any judicial action or proceeding in which the covered broker-dealer is or becomes a party for a period of up to 90 days from the appointment date;⁵⁹ (4) that except with respect to qualified financial contracts (“QFCs”),⁶⁰ no person may exercise any right or power to terminate, accelerate, or declare a default under any contract to which the covered broker-dealer is a party or to obtain possession of or exercise control over any property of the covered broker-dealer or affect any contractual rights of the covered broker-dealer without the consent of the FDIC as receiver of the covered broker-dealer upon consultation with SIPC during the 90-day period beginning from the

⁵⁷ See §§ 380.62(b)(2)(i) and 302.102(b)(2)(i), as proposed. See also 12 U.S.C. 5388(a) (regarding dismissal of any case or proceeding relating to a covered broker-dealer under the Bankruptcy Code or SIPA on the appointment of the Corporation as receiver and notice to the court and SIPA).

⁵⁸ See §§ 380.62(b)(2)(ii) and 302.102(b)(2)(ii), as proposed. See also 12 U.S.C. 5388(b) (providing that the notice and application for a protective decree may also specify that any revesting of assets in a covered broker or dealer to the extent that they have vested in any other entity as a result of any case or proceeding commenced with respect to the covered broker or dealer under the Bankruptcy Code, SIPA, or any similar provision of State liquidation or insolvency law applicable to the covered broker or dealer shall not apply to assets of the covered broker or dealer, including customer property, transferred pursuant to an order entered by a bankruptcy court).

⁵⁹ See §§ 380.62(b)(2)(iii) and 302.102(b)(2)(iii), as proposed. See also 12 U.S.C. 5390(a)(8) (providing for the temporary suspension of legal actions upon request of the Corporation).

⁶⁰ See 12 U.S.C. 5390(c)(8)(D) (defining qualified financial contract as “any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement that the Corporation determines by regulation, resolution, or order to be a qualified financial contract for purposes of this paragraph”).

appointment date⁶¹; and (5) that the exercise of rights and the performance of obligations by parties to QFCs with the covered broker-dealer may be affected, stayed, or delayed pursuant to the provisions of Title II (including but not limited to 12 U.S.C. 5390(c)) and the regulations promulgated thereunder.⁶²

The proposed rule makes clear that the matters listed for inclusion in the notice and application for a protective decree are neither mandatory nor all-inclusive. The items listed are those that the Agencies believe might provide useful guidance to customers and other parties who may be less familiar with the Title II process than with a SIPA proceeding. It is worth noting that the language relating to QFCs is rather general. In certain circumstances it may be worthwhile specifically to highlight the one-day stay provisions in section 210(c)(10) of the Dodd-Frank Act, the provisions relating to the enforcement of affiliate contracts under section 210(c)(16) of the Dodd-Frank Act, and other specific provisions relating to QFCs or other contracts.

D. Bridge Broker-Dealer⁶³

1. Power to Establish Bridge Broker-Dealer; Transfer of Customer Accounts and other Assets and Liabilities

⁶¹ 12 U.S.C. 5390(c)(13)(C)(i) .

⁶² See §§ 380.62(b)(2)(iv) and 302.102(b)(2)(iv), as proposed. See also 12 U.S.C. 5390(c)(8)(F) (rendering unenforceable all QFC walkaway clauses (as defined in 12 U.S.C. 5390(c)(8)(F)(iii)) including those provisions that suspend, condition, or extinguish a payment obligation of a party because of the insolvency of a covered financial company or the appointment of the FDIC as receiver) and 12 U.S.C. 5390(c)(10)(B)(i) (providing that in the case of a QFC, a person who is a party to a QFC with a covered financial company may not exercise any right that such person has to terminate, liquidate, or net such contract solely by reason of or incidental to the appointment of the FDIC as receiver (or the insolvency or financial condition of the covered financial company for which the FDIC has been appointed as receiver) – until 5:00 p.m. (eastern time) on the business day following the appointment, or after the person has received notice that the contract has been transferred pursuant to 12 U.S.C. 5390(c)(9)(A)).

⁶³ If adopted, the bridge broker or dealer section will appear in 12 CFR 380.63 for purposes of the Corporation and 17 CFR 302.103 for purposes of the Commission.

Section 210 of the Dodd-Frank Act sets forth the Corporation's powers as receiver of a covered financial company.⁶⁴ One such power the Corporation has, as receiver, is the power to form bridge financial companies.⁶⁵ Paragraph (a) of this section of the proposed rule states that the Corporation as receiver for a covered broker-dealer, or in anticipation of being appointed receiver for a covered broker-dealer, may organize one or more bridge broker-dealers with respect to a covered broker-dealer.⁶⁶ Paragraph (b) of this section of the proposed rule states that if the Corporation were to establish one or more bridge broker-dealers with respect to a covered broker-dealer, then the Corporation as receiver for such covered broker-dealer shall transfer all customer accounts and all associated customer name securities and customer property to such bridge broker[s]-dealer[s] unless the Corporation, after consultation with the Commission and SIPC, determines that: (1) the transfer of such customer accounts, customer name securities, and customer property to one or more qualified broker-dealers will occur promptly such that the use of the bridge broker[s]-dealer[s] would not facilitate such transfer to one or more qualified broker-dealers; or (2) the transfer of such customer accounts to the bridge broker[s]-dealer[s] would materially interfere with the ability of the FDIC to avoid or mitigate serious adverse effects on financial stability or economic conditions in the United States.⁶⁷ The two conditions in paragraph (b) of the proposed rule are contained in Title II and are provided in the proposed

⁶⁴ 12 U.S.C. 5390.

⁶⁵ See 12 U.S.C. 5390(h)(1)(A) (granting general power to form bridge financial companies). See also 12 U.S.C. 5390(h)(2)(H)(i) (granting authority to organize one or more bridge financial companies with respect to a covered broker-dealer).

⁶⁶ See §§ 380.63 and 302.103, as proposed. See also 12 U.S.C. 5390(h)(2)(H) (granting the Corporation as receiver authority to organize one or more bridge financial companies with respect to a covered broker-dealer).

⁶⁷ See §§ 380.63(b) and 302.103(b), as proposed. See also 12 U.S.C. 5390(a)(1)(O)(i)(I)-(II) (listing the specific conditions under which customer accounts would not be transferred to a bridge financial company if it was organized).

rule for ease and clarity and to make it clear the transfer to a bridge broker-dealer will take place unless a transfer to a qualified broker-dealer is imminent.⁶⁸ The use of the word “promptly” in the proposed rule, in this context, is intended to emphasize the urgency of transferring customer accounts, customer name securities, and customer property either to a qualified broker-dealer or to a bridge broker-dealer as soon as practicable to allow customers the earliest possible access to their accounts.

Paragraph (c) of this section of the proposed rule states that the Corporation as receiver for the covered broker-dealer also may transfer to such bridge broker[s]-dealer[s] any other assets and liabilities of the covered broker-dealer (including non-customer accounts and any associated property) as the Corporation may, in its discretion, determine to be appropriate. Paragraph (c) is based upon the broad authority of the Corporation as receiver to transfer any assets or liabilities of the covered broker-dealer to a bridge financial company in accordance with, and subject to the requirements of, section 210(h)(5) of the Dodd-Frank Act⁶⁹ and is designed to facilitate the receiver’s ability to continue the covered broker-dealer’s operations, minimize systemic risk, and maximize the value of the assets of the receivership.⁷⁰ The transfer

⁶⁸ 12 U.S.C. 5390(a)(1)(O)(i)(I)-(II).

⁶⁹ See 12 U.S.C. 5390(h)(5)(A) (providing that the receiver “may transfer any assets and liabilities of a covered financial company”). The statute sets forth certain restrictions and limitations that are not affected by this proposed rule. See, e.g., 12 U.S.C. 5390(h)(1)(B)(ii) (restricting the assumption of liabilities that count as regulatory capital by the bridge financial company) and 12 U.S.C. 5390(h)(5)(F) (requiring that the aggregate liabilities transferred to the bridge financial company may not exceed the aggregate amount of assets transferred).

⁷⁰ See §§ 380.63(f) and 302.103(f), as proposed. See also 12 U.S.C. 5390(h)(5) (granting authority to the Corporation as receiver to transfer assets and liabilities of a covered financial company to a bridge financial company). Similarly, under Title II, the Corporation, as receiver for a covered broker-dealer, may approve articles of association for such bridge broker-dealer. See 12 U.S.C. 5390(h)(2)(H)(i). The bridge broker-dealer would also be subject to the federal securities laws and all requirements with respect to being a member of a self-regulatory organization, unless exempted from any such requirements by the Commission as is necessary or appropriate in the public interest or for the protection of investors. See 12 U.S.C. 5390(h)(2)(H)(ii).

of assets and liabilities to a bridge broker-dealer under the proposed rule would enable the receiver to continue the day-to-day operations of the broker-dealer and facilitate the maximization of the value of the assets of the receivership by making it possible to avoid a forced or other distressed sale of the assets of the covered broker-dealer. In addition, the ability to continue the operations of the covered broker-dealer may help mitigate the impact of the failure of the covered broker-dealer on other market participants and financial market utilities and thereby minimize systemic risk.

Finally, paragraph (c) of this section of the proposed rule clarifies that the transfer to a bridge broker-dealer of any account or property pursuant to this section does not create any implication that the holder of such an account qualifies as a “customer” or that the property so transferred qualifies as “customer property” or “customer name securities” within the meaning of SIPA or within the meaning of the rule. Under Title II, the Corporation may transfer all the assets of a covered broker-dealer to a bridge broker-dealer.⁷¹ Such a transfer of assets may include, for example, securities that were sold to the covered broker-dealer under reverse repurchase agreements. Under the terms of a typical reverse repurchase agreement, it is common for the broker-dealer to be able to use the purchased securities for its own purposes. In contrast, Commission rules specifically protect customer funds and securities and essentially forbid broker-dealers from using customer assets to finance any part of their businesses unrelated to servicing securities customers.⁷² An integral component of the broker-dealer customer protection regime is that, under SIPA, customers have preferred status relative to general

⁷¹ See 12 U.S.C. 5390(h)(2)(H) and 12 U.S.C. 5390(h)(5) (granting authority to the Corporation as receiver to transfer assets and liabilities of a covered broker-dealer).

⁷² See Net Capital Requirements for Brokers and Dealers, Exchange Act Release No. 21651 (Jan. 11, 1985), 50 FR 2690, 2690 (Jan. 18, 1985). See also Broker-Dealers; Maintenance of Certain Basic Reserves, Exchange Act Release No. 9856 (Nov. 10, 1972), 37 FR 25224, 25224 (Nov. 29, 1972).

creditors with respect to customer property and customer name securities.⁷³ Given the preferred status of customers, litigation has arisen regarding whether, consistent with the above example, claims of repo counterparties are “customer” claims under SIPA.⁷⁴ In implementing section 205 of the Dodd-Frank Act, consistent with the statutory directive contained therein,⁷⁵ the Corporation and the Commission are seeking to ensure that customers of the covered broker-dealer under Title II are treated in a manner at least as beneficial as would have been the case had the broker-dealer been liquidated under SIPA.⁷⁶ Accordingly, the Commission and the Corporation are proposing to preserve customer status as would be the case in a SIPA proceeding. Thus, the proposed rule clarifies that moving assets to a bridge financial company as part of a Title II orderly liquidation is not determinative as to whether the holder of such an account qualifies as a “customer” or if the property so transferred qualifies as “customer property” or “customer name securities.” Rather, the status of the account holder and the assets in the orderly liquidation of a covered broker-dealer would depend upon whether the claimant would be a customer under SIPA.⁷⁷

2. Other Provisions with respect to Bridge Broker-Dealer

⁷³ See 15 U.S.C. 78fff(a).

⁷⁴ See, e.g., In re Lehman Brothers Inc., 492 B.R. 379 (Bankr. S.D.N.Y. 2013), aff'd, 506 B.R. 346 (S.D.N.Y. 2014).

⁷⁵ See 12 U.S.C. 5385(f)(1) (pertaining to the statutory requirements with respect to the satisfaction of claims).

⁷⁶ Id.

⁷⁷ See 15 U.S.C. 78lll(2)(B) (SIPA definition of customer). See also 12 U.S.C. 5381(a)(10) (defining customer, customer name securities, customer property, and net equity in the context of a covered broker-dealer as the same meanings such terms have in section 16 of SIPA (15 U.S.C. 78lll)); In re Bernard L. Madoff Inv. Sec. LLC, 654 F.3d 229, 236 (2d Cir. 2011).

The proposed rule addresses certain matters relating to account transfers to the bridge broker-dealer.⁷⁸ The process set forth in this part of the proposed rule is designed to put the customer in the position the customer would have been in had the broker-dealer been liquidated in a SIPA proceeding.⁷⁹ In a SIPA proceeding, the trustee would generally handle customer accounts in two ways. First, a trustee may sell or otherwise transfer to another SIPC member, without the consent of any customer, all or any part of a customer's account, as a way to return customer property to the control of the customer.⁸⁰ Such account transfers are separate from the customer claim process. Customer account transfers are useful insofar as they serve to allow customers to resume trading more quickly and minimize disruption in the securities markets. If it is not practicable to transfer customer accounts, then the second way of returning customer property to the control of customers is through the customer claims process. Under bankruptcy court supervision, the SIPA trustee will determine each customer's net equity and the amount of customer property available for customers.⁸¹ Once the SIPA trustee determines that a claim is a customer claim (an "allowed customer claim"), the customer will be entitled to a ratable share of the fund of customer property. As discussed above, SIPA defines "customer property" to generally include all the customer-related property held by the broker-dealer.⁸² Allowed customer claims are determined on the basis of a customer's net equity,⁸³ which, as described

⁷⁸ See §§ 380.63(d) and 302.103(d), as proposed.

⁷⁹ See 12 U.S.C. 5385(f) (obligations of a covered broker-dealer to customers shall be "satisfied in the manner and in an amount at least as beneficial to the customer" as would have been the case had the actual proceeds realized from the liquidation of the covered broker-dealer been distributed in a proceeding under SIPA).

⁸⁰ See 15 U.S.C. 78fff-2(f).

⁸¹ See generally 15 U.S.C. 78fff.

⁸² See 15 U.S.C. 78lll(4). See Section II.A.1.

⁸³ See 15 U.S.C. 78lll(11).

above, generally is the dollar value of a customer's account on the filing date of the SIPA proceeding less indebtedness of the customer to the broker-dealer on the filing date.⁸⁴ Once the trustee determines the fund of customer property and customer net equity claims, the trustee can establish each customer's pro rata share of the fund of customer property. Customer net equity claims generally are satisfied to the extent possible by providing the customer with the identical securities owned by that customer as of the day the SIPA proceeding was commenced.⁸⁵

Although a Title II orderly liquidation is under a different statutory authority, the process for determining and satisfying customer claims would follow a substantially similar process to a SIPA proceeding. Upon the commencement of a SIPA liquidation, customers' cash and securities held by the broker-dealer are returned to customers on a pro rata basis.⁸⁶ If sufficient funds are not available at the broker-dealer to satisfy customer net equity claims, SIPC advances would be used to supplement the distribution, up to a ceiling of \$500,000 per customer, including a maximum of \$250,000 for cash claims.⁸⁷ When applicable, SIPC will return securities that are registered in the customer's name or are in the process of being registered directly to each customer.⁸⁸ As in a SIPA proceeding, in a Title II liquidation of a covered broker-dealer, the process of determining net equity would thus begin with a calculation of customers' net equity. A customer's net equity claim against a covered broker-dealer would be deemed to be satisfied and discharged to the extent that customer property of the covered broker-dealer, along with property made available through advances from SIPC, is transferred and allocated to the

⁸⁴ Id. See Section II.A.1.

⁸⁵ See 15 U.S.C. 78fff-2(d).

⁸⁶ 15 U.S.C. 8fff-2(b).

⁸⁷ 15 U.S.C. 8fff-3(a).

⁸⁸ 15 U.S.C. 8fff-2(b)(2)

customer's account at the bridge broker-dealer. The bridge broker-dealer would undertake the obligations of the covered broker-dealer only with respect to such property. The Corporation, as receiver, in consultation with SIPC, as trustee, would allocate customer property and property made available through advances from SIPC in a manner consistent with SIPA and with SIPC's normal practices thereunder. The calculation of net equity would not be affected by the assumption of liability by the bridge broker-dealer to each customer in connection with the property transferred to the bridge broker-dealer. The use of the bridge broker-dealer is designed to give customers access to their accounts as quickly as practicable, while ensuring that customers receive assets in the form and amount that they would receive in a SIPA liquidation.⁸⁹

The proposed rule also provides that allocations to customer accounts at the bridge broker-dealer may initially be derived from estimates based upon the books and records of the covered broker-dealer or other information deemed relevant by the Corporation as receiver, in consultation with SIPC as trustee.⁹⁰ This approach is based upon experience with SIPA liquidations where, for example, there were difficulties reconciling the broker-dealer's records with the records of central counterparties or other counterparties or other factors that caused

⁸⁹ This outcome would satisfy the requirements of section 205(f)(1) of the Dodd-Frank Act. See 12 U.S.C. 5385(f)(1) ("Notwithstanding any other provision of this title, all obligations of a covered broker or dealer or of any bridge financial company established with respect to such covered broker or dealer to a customer relating to, or net equity claims based upon, customer property or customer name securities shall be promptly discharged by SIPC, the Corporation, or the bridge financial company, as applicable, by the delivery of securities or the making of payments to or for the account of such customer, in a manner and in an amount at least as beneficial to the customer as would have been the case had the actual proceeds realized from the liquidation of the covered broker or dealer under this title been distributed in a proceeding under [SIPA] without the appointment of the Corporation as receiver and without any transfer of assets or liabilities to a bridge financial company, and with a filing date as of the date on which the Corporation is appointed as receiver.").

⁹⁰ See §§ 380.63(d) and 302.103(d), as proposed. See also 12 U.S.C. 5385(h) (granting the Corporation and the Commission authority to adopt rules to implement section 205 of the Dodd-Frank Act).

delay in verifying customer accounts.⁹¹ This provision of the proposed rule is designed to facilitate access to accounts for the customers at the bridge broker-dealer as soon as is practicable under the circumstances while facilitating the refinement of the calculation of allocations of customer property to customer accounts as additional information becomes available. This process will help ensure both that customers have access to their customer accounts as quickly as practicable and that customer property ultimately will be fairly and accurately allocated.

The proposed rule also states that the bridge broker-dealer undertakes the obligations of a covered broker-dealer with respect to each person holding an account transferred to the bridge broker-dealer, but only to the extent of the property (and SIPC funds) so transferred and held by the bridge broker-dealer with respect to that person's account.⁹² This portion of the proposed rule provides customers of the bridge broker-dealer with the assurance that the securities laws relating to the protection of customer property will apply to customers of a bridge broker-dealer in the same manner as they apply to customers of a broker-dealer which is being liquidated outside of Title II.⁹³ The Agencies believe that such assurances would help to reduce uncertainty regarding the protections that will be offered to customers.

This portion of the proposed rule also provides that the bridge broker-dealer would not have any obligations with respect to any customer property or other property that is not

⁹¹ See, e.g., In re Lehman Brothers Inc., (Bankr. S.D.N.Y 2008), Trustee's Preliminary Investigation Report and Recommendations, available at <http://dm.epiq11.com/LBI/Project#>).

⁹² See §§ 380.63(d) and 302.103(d), as proposed.

⁹³ See also 12 U.S.C. 5390(h)(2)(H)(ii) (stating that the bridge financial company shall be subject to the federal securities laws and all requirements with respect to being a member of a self-regulatory organization, unless exempted from any such requirements by the Commission, as is necessary or appropriate in the public interest or for the protection of investors).

transferred from the covered broker-dealer to the bridge broker-dealer.⁹⁴ A customer's net equity claim remains with the covered broker-dealer and, in most cases, would be satisfied, in whole or in part, by transferring the customer's account together with customer property, to the bridge broker-dealer.⁹⁵ In the event that a customer's account and the associated account property is not so transferred, the customer's net equity claim would be subject to satisfaction by SIPC as the trustee for the covered broker-dealer in the same manner and to the same extent as in a SIPA proceeding.⁹⁶

The bridge broker-dealer section of the proposed rule⁹⁷ also provides that the transfer of assets or liabilities of a covered broker-dealer, including customer accounts and all associated customer name securities and customer property, assets and liabilities held by a covered broker-dealer for non-customer creditors, and assets and liabilities associated with any trust or custody business, to a bridge broker-dealer, would be effective without any consent, authorization, or approval of any person or entity, including but not limited to, any customer, contract party, governmental authority, or court.⁹⁸ This section is based on the Corporation's authority, under three separate statutory provisions of Title II.⁹⁹ The broad language of this paragraph of the proposed rule is intended to give full effect to the statutory provisions of the Dodd-Frank Act

⁹⁴ See §§380.63(d) and 302.103(d), as proposed.

⁹⁵ See §§ 380.63(d) and 302.103(d), as proposed.

⁹⁶ See 12 U.S.C. 5385(f)(2).

⁹⁷ See §§ 380.63(e) and 302.103(e), as proposed.

⁹⁸ See §§ 380.63(e) and 302.103(e), as proposed ; see also 12 U.S.C. 5390(h)(5)(D).

⁹⁹ See 12 U.S.C. 5390(h)(5)(D). See also 12 U.S.C.5390(a)(1)(G); 12 U.S.C. 5390(a)(1)(O). Notably, the power to transfer customer accounts and customer property without customer consent is also found in SIPA. See 15 U.S.C. 78fff-2(f).

regarding transfers of assets and liabilities of a covered financial company,¹⁰⁰ which represent an important recognition by Congress that, in order to ensure the financial stability of the United States following the failure of a covered financial company, the Corporation as receiver must be free to determine which contracts, assets, and liabilities of the covered financial company are to be transferred to a bridge financial company, and to transfer such contracts, assets, and liabilities expeditiously and irrespective of whether any other person or entity consents to or approves of the transfer. The impracticality of requiring the Corporation as receiver to obtain the consent or approval of others in order to effectuate a transfer of the failed company's contracts, assets, and liabilities arises whether the consent or approval otherwise would be required as a consequence of laws, regulations, or contractual provisions, including as a result of options, rights of first refusal, or similar contractual rights, or any other restraints on alienation or transfer. Paragraph (e) would apply regardless of the identity of the holder of the restraint on alienation or transfer, whether such holder is a local, state, federal or foreign government, a governmental department or other governmental body of any sort, a court or other tribunal, a corporation, partnership, trust, or other type of company or entity, or an individual, and regardless of the source of the restraint on alienation or transfer, whether a statute, regulation, common law, or contract. It is the Corporation's view that the transfer of any contract to a bridge financial company would not result in a breach of the contract and would not give rise to a claim or liability for damages. In addition, under section 210(h)(2)(E) of the Dodd-Frank Act, no additional assignment or further assurance is required of any person or entity to effectuate such a transfer of assets or liabilities by

¹⁰⁰ The proposed rule text omits the reference to "further" approvals found in 12 U.S.C. 5390(h)(5)(D). The reference in the statute is to the government approvals needed in connection with organizing the bridge financial company, such as the approval of the articles of association and by-laws, as established under 12 U.S.C. 5390(h). These approvals will already have been obtained prior to any transfer under the proposed rule, making the reference to "further" approvals unnecessary and superfluous.

the Corporation as receiver for the covered broker-dealer. Paragraph (e) of the proposed rule would facilitate the prompt transfer of assets and liabilities of a covered broker-dealer to a bridge broker-dealer and enhance the Corporation's ability to maintain critical operations of the covered broker-dealer. Rapid action to set-up a bridge broker-dealer and transfer assets, including customer accounts and customer property, may be critical to preserving financial stability and to giving customers the promptest possible access to their accounts.

Paragraph (f) of the bridge broker-dealer provision of the proposed rule provides for the succession of the bridge broker-dealer to the rights, powers, authorities, or privileges of the covered broker-dealer.¹⁰¹ This provision of the proposed rule draws directly from authority provided in Title II and is designed to facilitate the ability of the Corporation as receiver to operate the bridge broker-dealer.¹⁰² Pursuant to paragraph (g) of the bridge broker-dealer provision,¹⁰³ the bridge broker-dealer would also be subject to the federal securities laws and all requirements with respect to being a member of a self-regulatory organization, unless exempted from any such requirements by the Commission as is necessary or appropriate in the public interest or for the protection of investors.¹⁰⁴ This provision of the proposed rule also draws closely upon Title II.¹⁰⁵

Paragraph (h) of the bridge broker-dealer provision of the proposed rule states that at the end of the term of existence of the bridge broker-dealer, any proceeds or other assets that remain after payment of all administrative expenses of the bridge broker-dealer and all other claims

¹⁰¹ See §§ 380.63(f) and 302.103(f), as proposed.

¹⁰² See 12 U.S.C. 5390(h)(2)(H)(i).

¹⁰³ See §§ 380.63(g) and 302.103(g), as proposed.

¹⁰⁴ See 12 U.S.C. 5390(h)(2)(H)(ii).

¹⁰⁵ Id.

against the bridge broker-dealer would be distributed to the Corporation as receiver for the related covered broker-dealer.¹⁰⁶ Stated differently, the residual value in the bridge broker-dealer after payment of its obligations would benefit the creditors of the covered broker-dealer in satisfaction of their claims.

E. Claims of Customers and Other Creditors of a Covered Broker-Dealer¹⁰⁷

The proposed section on the claims of the covered broker-dealer's customers and other creditors would address the claims process for those customers and other creditors as well as the respective roles of the trustee and the receiver with respect to those claims.¹⁰⁸ The proposed section would provide SIPC with the authority as trustee for the covered broker-dealer to make determinations, allocations, and advances in a manner consistent with its customary practices in a liquidation under SIPA.¹⁰⁹ Specifically, the proposed section provides: "The allocation of customer property, advances from SIPC, and delivery of customer name securities to each customer or to its customer account at a bridge broker or dealer, in partial or complete satisfaction of such customer's net equity claims as of the close of business on the appointment date, shall be in a manner, including form and timing, and in an amount at least as beneficial to such customer as would have been the case had the covered broker or dealer been liquidated under SIPA."¹¹⁰ Each customer of a covered broker-dealer would receive cash and securities at

¹⁰⁶ See §§ 380.63(h) and 302.103(h), as proposed. See also 12 U.S.C. 5385(d)(2); 12 U.S.C. 5390(h)(15)(B).

¹⁰⁷ If adopted, the section of the proposed rule on claims of customers and other creditors of a covered broker-dealer will appear in 12 CFR 380.64 for purposes of the Corporation and 17 CFR 302.104 for purposes of the Commission. The rule text in both CFRs will be identical.

¹⁰⁸ See §§ 380.64 and 302.104, as proposed.

¹⁰⁹ See §§ 380.64(a)(4) and 302.104(a)(4), as proposed. See also 15 U.S.C. 78aaa et seq.

¹¹⁰ See §§ 380.64(a)(4) and 302.104(a)(4), as proposed.

least equal in amount and value, as of the appointment date, to what that customer would have received in a SIPA proceeding.¹¹¹

This proposed section further addresses certain procedural aspects of the claims determination process in accordance with the requirements set forth in section 210(a)(2)-(5) of the Dodd-Frank Act.¹¹² The proposed section describes the role of the receiver of a covered broker-dealer with respect to claims and provides for the publication and mailing of notices to creditors of the covered broker-dealer by the receiver in a manner consistent with both SIPA and the notice procedures applicable to covered financial companies generally under section 210(a)(2) of the Dodd-Frank Act.¹¹³ The proposed section provides that the notice of the Corporation's appointment as receiver must be accompanied by notice of SIPC's appointment as trustee.¹¹⁴ In addition, the Corporation, as receiver, would consult with SIPC, as trustee, regarding procedures for filing a claim including the form of claim and the filing instructions, to facilitate a process that is consistent with SIPC's general practices.¹¹⁵ The claim form would include a provision permitting a claimant to claim customer status, if applicable, but the inclusion of any such claim to customer status on the claim form would not be determinative of customer status under SIPA.

The proposed rule would set the claims bar date as the date following the expiration of the six-month period beginning on the date that the notice to creditors is first published.¹¹⁶ The

¹¹¹ See 15 U.S.C. 78aaa *et seq.*

¹¹² 12 U.S.C. 5390(a)(2)-(5).

¹¹³ See §§ 380.64(b) and 302.104(b), as proposed. See also 12 U.S.C. 5390(a)(2).

¹¹⁴ See §§ 380.64(b)(1) and 302.104(b)(1), as proposed (“The Corporation as receiver shall coordinate with SIPC as trustee to post the notice on SIPC’s Web site at www.sipc.org. . .”).

¹¹⁵ See §§ 380.64(b)(2) and 302.104(b)(2), as proposed.

¹¹⁶ See §§ 380.64(b)(3) and 302.104(b)(3), as proposed (discussing claims bar date).

claims bar date in the proposed rule is consistent with section 8(a) of SIPA, which provides for the barring of claims after the expiration of the six-month period beginning upon publication.¹¹⁷ The six-month period is also consistent with section 210(a)(2)(B)(i) of the Dodd-Frank Act, which requires that the claims bar date be no less than ninety days after first publication.¹¹⁸ As required by section 210(a)(3)(C)(i) of the Dodd-Frank Act, the proposed rule provides that any claim filed after the claims bar date shall be disallowed, and such disallowance shall be final, except that a claim filed after the claims bar date would be considered by the receiver if (i) the claimant did not receive notice of the appointment of the receiver in time to file a claim before the claim date, and (ii) the claim is filed in time to permit payment of the claim, as provided by section 210(a)(3)(C)(ii) of the Dodd-Frank Act.¹¹⁹ This exception for late-filed claims due to lack of notice to the claimant would serve a similar purpose (i.e., to ensure a meaningful opportunity for claimants to participate in the claims process) as the “reasonable, fixed extension of time” that may be granted to the otherwise applicable six-month deadline under SIPA to certain specified classes of claimants.¹²⁰

Section 8(a)(3) of SIPA provides that a customer who wants to assure that its net equity claim is paid out of customer property must file its claim with the SIPA trustee within a period of time set by the court (not exceeding 60 days after the date of publication of the notice provided in section 8(a)(1) of SIPA) notwithstanding that the claims bar date is later.¹²¹ The proposed rule conforms to this section of SIPA by providing that any claim for net equity filed more than 60

¹¹⁷ See 15 U.S.C. 78fff-2(a).

¹¹⁸ See 12 U.S.C. 5390(a)(2)(B)(i).

¹¹⁹ See §§ 380.64(b)(3) and 302.104(b)(3), as proposed. See also 12 U.S.C. 5390(a)(3)(C)(i)–(ii).

¹²⁰ See 15 U.S.C. 78fff-2(a)(3).

¹²¹ See 15 U.S.C. 78fff-2(a)(3) and 15 U.S.C. 78fff-2(a)(1).

days after the notice to creditors is first published need not be paid or satisfied in whole or in part out of customer property and, to the extent such claim is paid by funds advanced by SIPC, it would be satisfied in cash or securities, or both, as SIPC, the trustee, determines is most economical to the receivership estate.¹²²

Under the proposed rule, the Corporation as receiver would be required to notify a claimant whether it allows a claim within the 180-day period¹²³ as such time period may be extended by written agreement,¹²⁴ or the expedited 90-day period,¹²⁵ whichever would be applicable. The process established for the determination of claims by customers of a covered broker-dealer for customer property or customer name securities would constitute the exclusive process for the determination of such claims.¹²⁶ This process corresponds to the SIPA provision that requires that customer claims to customer property be determined pro rata based on each customer's net equity applied to all customer property as a whole.¹²⁷ While the Dodd-Frank Act provides for expedited treatment of certain claims within 90 days, given that all customers may have preferred status with respect to customer property and customer name securities, no one customer's claim, or group of customer claims, would be treated in an expedited manner ahead of other customers' claims. Consequently, the concept of expedited relief would not apply to customer claims.¹²⁸ The receiver's determination to allow or disallow a claim in whole or in part would utilize the determinations made by SIPC, as trustee, with respect to customer status,

¹²² See §§ 380.64(b)(3) and 302.104(b)(3), as proposed. See also 15 U.S.C. 78fff-2(a)(3).

¹²³ See §§ 380.64(c) and 302.104(c), as proposed. See also 12 U.S.C. 5390(a)(3)(A)(i).

¹²⁴ See 15 U.S.C. 5390(a)(3)(A).

¹²⁵ See §§ 380.64(c) and 302.104(c), as proposed. See also 12 U.S.C. 5390(a)(5)(B).

¹²⁶ See §§ 380.64(c) and 302.104(c), as proposed.

¹²⁷ See 15 U.S.C. 78fff-2.

¹²⁸ See §§ 380.64(c) and 302.104(c), as proposed.

claims for net equity, claims for customer name securities, and whether property held by the covered broker-dealer qualifies as customer property.¹²⁹ A claimant may seek a de novo judicial review of any claim that is disallowed in whole or in part by the receiver, including but not limited to any claim disallowed in whole or part based upon any determination made by SIPC.¹³⁰

F. Additional Proposed Sections

In addition to the previously discussed proposed sections, the Agencies propose to include sections in the proposed rule addressing: (1) the priorities for unsecured claims against a covered broker-dealer;¹³¹ (2) the administrative expenses of SIPC;¹³² and (3) QFCs.¹³³ The Dodd-Frank Act sets forth special priorities for the payment of claims of general unsecured creditors of a covered broker-dealer, which would be addressed in the proposed section on priorities for unsecured claims against a covered broker-dealer.¹³⁴ The priorities for unsecured claims against a covered broker-dealer include claims for unsatisfied net equity of a customer and certain administrative expenses of the receiver and SIPC.¹³⁵ The priorities set forth in the

¹²⁹ Id.

¹³⁰ See §§ 380.64(d) and 302.104(d), as proposed (“The claimant may seek a judicial determination of any claim disallowed, in whole or in part, by the Corporation as receiver, including any claim disallowed based upon any determination(s) made by SIPC as trustee . . . by the appropriate district or territorial court of the United States. . . .”). See also 12 U.S.C. 5390(a)(4)-(5).

¹³¹ If adopted, the priorities for unsecured claims against a covered broker-dealer section will appear in 12 CFR 380.65 for purposes of the Corporation and 17 CFR 302.105 for purposes of the Commission. The rule text in both CFRs will be identical.

¹³² If adopted, the SIPC administrative expenses section will appear in 12 CFR 380.66 for purposes of the Corporation and 17 CFR 302.106 for purposes of the Commission. The rule text in both CFRs will be identical.

¹³³ If adopted, the QFC section will appear in 12 CFR 380.67 for purposes of the Corporation and 17 CFR 302.107 for purposes of the Commission. The rule text in both CFRs will be identical.

¹³⁴ See 12 U.S.C. 5390(b)(6) (providing the priority of expenses and unsecured claims in the orderly liquidation of SIPC members).

¹³⁵ See §§ 380.65 and 302.105, as proposed.

proposed rule express the cumulative statutory requirements set forth in Title II.¹³⁶ First, the priorities provide that the administrative expenses of SIPC as trustee for a covered broker-dealer would be reimbursed pro rata with administrative expenses of the receiver for the covered broker-dealer.¹³⁷ Second, the amounts paid by the Corporation as receiver to customers or SIPC would be reimbursed on a pro rata basis with amounts owed to the United States, including amounts borrowed from the U.S. Treasury for the orderly liquidation fund.¹³⁸ Third, the amounts advanced by SIPC for the satisfaction of customer net equity claims would be reimbursed subsequent to amounts owed to the United States, but before all other claims.¹³⁹

Title II provides that SIPC is entitled to recover administrative expenses incurred in performing its responsibilities under section 205 on an equal basis with the Corporation.¹⁴⁰ Title II also sets forth a description of the administrative expenses of the receiver.¹⁴¹ In order to provide additional clarity as to the types of administrative expenses that SIPC would be entitled to recover in connection with its role as trustee for the covered broker-dealer, the proposed rule provides that SIPC, in connection with its role as trustee for the covered broker-dealer, has the authority to “utilize the services of private persons, including private attorneys, accountants, consultants, advisors, outside experts and other third party professionals.” The section further provides SIPC with an allowed administrative expense claim with respect to any amounts paid

¹³⁶ See 12 U.S.C. 5390(b)(6) (providing the priority of expenses and unsecured claims in the orderly liquidation of SIPC members). See also §§ 380.65 and 302.105, as proposed.

¹³⁷ See §§ 380.65(a) and 302.105(a), as proposed. See also 12 U.S.C. 5390(b)(6)(A).

¹³⁸ See §§ 380.65(b) and 302.105(b), as proposed. See also 12 U.S.C. 5390(b)(6)(B); 12 U.S.C. 5390(n) (establishing the “orderly liquidation fund” available to the Corporation to carry out the authorities granted to it under Title II).

¹³⁹ See §§ 380.65(c) and 302.105(c), as proposed. See also 12 U.S.C. 5390(b)(6)(C).

¹⁴⁰ See 12 U.S.C. 5390(b)(6)(A). The regulation governing the Corporation’s administrative expenses in its role as receiver under Title II is located at 12 CFR 380.22.

¹⁴¹ See 12 U.S.C. 5381(a)(1).

by SIPC for services provided by these persons if those services are “practicable, efficient and cost-effective.”¹⁴² The proposed definition of administrative expenses of SIPC conforms to both the definition of administrative expenses of the Corporation as receiver and the costs and expenses of administration reimbursable to SIPC as trustee in the liquidation of a broker-dealer under SIPA.¹⁴³ Specifically, the proposed definition includes “the costs and expenses of such attorneys, accountants, consultants, advisors, outside experts and other third parties, and other proper expenses that would be allowable to a third party trustee under 15 U.S.C. 78eee(b)(5)(A), including the costs and expenses of SIPC employees that would be allowable pursuant to 15 U.S.C. 78fff(e).”¹⁴⁴ The proposed definition excludes advances from SIPC to satisfy customer claims for net equity because the Dodd-Frank Act specifies that those advances are treated differently than administrative expenses with respect to the priority of payment.¹⁴⁵

Lastly, the proposed section on QFCs states that QFCs are governed in accordance with Title II.¹⁴⁶ Paragraph (b)(4) of section 205 of the Dodd-Frank Act states: “Notwithstanding any provision of [SIPA] . . . the rights and obligations of any party to a qualified financial contract (as the term is defined in section 210(c)(8)) to which a covered broker or dealer for which the Corporation has been appointed receiver is a party shall be governed exclusively by section 210,

¹⁴² See §§ 380.66(a) and 302.106(a), as proposed.

¹⁴³ See §§ 380.66(a) and 302.106(a), as proposed. See also 12 U.S.C. 5381(a)(1) (defining administrative expenses of the receiver); 15 U.S.C. 78eee(5) (providing for compensation for services and reimbursement of expenses).

¹⁴⁴ See §§ 380.66(a) and 302.106(a), as proposed. See also 15 U.S.C. 78eee(b)(5)(A); 15 U.S.C. 78fff(e).

¹⁴⁵ See §§ 380.66(b) and 302.106(b), as proposed (defining the term administrative expenses of SIPC). See also 12 U.S.C. 5390(b)(6)(C) (stating SIPC’s entitlement to recover any amounts paid out to meet its obligations under section 205 and under SIPA).

¹⁴⁶ See §§ 380.67 and 302.107, as proposed.

including the limitations and restrictions contained in section 210(c)(10)(B).”¹⁴⁷ Paragraph (c)(8)(A) of section 210 states that, “no person shall be stayed or prohibited from exercising – (i) any right that such person has to cause the termination, liquidation, or acceleration of any qualified financial contract with a covered financial company which arises upon the date of appointment of the Corporation as receiver for such covered financial company or at any time after such appointment; (ii) any right under any security agreement or arrangement or other credit enhancement related to one or more qualified financial contracts described in clause (i); or (iii) any right to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with one or more contracts or agreements described in clause (i), including any master agreement for such contracts or agreements.”¹⁴⁸ Paragraph (c)(10)(B)(i)(I)-(II) of section 210 provides in pertinent part that a person who is a party to a QFC with a covered financial company may not exercise any right that such person has to terminate, liquidate, or net such contract under paragraph (c)(8)(A) of section 210 solely by reason of or incidental to the appointment under Title II of the Corporation as receiver for the covered financial company: (1) until 5:00 p.m. eastern time on the business day following the date of the appointment; or (2) after the person has received notice that the contract has been transferred pursuant to paragraph (c)(9)(A) of section 210.¹⁴⁹ The proposed rule reflects these statutory directives and states: “The rights and obligations of any party to a qualified financial contract to which a covered broker or dealer is a party shall be governed exclusively by 12

¹⁴⁷ See 12 U.S.C. 5385(b)(4) (“Notwithstanding any provision of [SIPA]. . . the rights and obligations of any party to a qualified financial contract. . . to which a covered broker or dealer . . . is a party shall be governed exclusively by section 210 [of the Dodd-Frank Act]”).

¹⁴⁸ See 12 U.S.C. 5390(c)(8)(A).

¹⁴⁹ See 12 U.S.C. 5390(c)(10)(B).

U.S.C. 5390, including the limitations and restrictions contained in 12 U.S.C. 5390(c)(10)(B), and any regulations promulgated thereunder.”¹⁵⁰

III. REQUESTS FOR COMMENTS

A. In General

The Agencies generally request comment on the proposal to implement Title II’s orderly liquidation of covered broker-dealers provisions. The Agencies invite interested persons to submit written comments on any aspect of the proposed rule, in addition to the specific requests for comment. Further, the Agencies invite comment on other matters that might have an effect on the proposed rule contained in this release, including any competitive impact.

B. Requests for Comment on Certain Specific Matters

In addition to the general request for comments, the Agencies request comment with respect to the following specific questions:

1. In light of section 205(f)(1)’s requirement that customers in a section 205 orderly liquidation receive distributions that are at least as beneficial as what they would have received in a SIPA liquidation, are there any circumstances in which the application of the proposed rule would result in delivery or distributions to customers of securities or cash, in connection with net equity claims, customer property or customer name securities, in a manner and in an amount less than such customers would receive if the covered broker-dealer were subject to a SIPA liquidation? If yes, what are those circumstances? Please be specific.
2. Would an orderly liquidation of a broker-dealer under the approach described in the proposed rule have any unintended or adverse impact(s) on customers or other classes of

¹⁵⁰ See §§ 380.67 and 302.107, as proposed.

claimants? If yes, what are those impacts? Are there other approach(es) that might be consistent with the requirements of the Dodd-Frank Act and have fewer such impacts? What are the other approach(es) that might eliminate or minimize such unintended or adverse impact(s), and how would they do so? Please be specific. What would be the costs or benefits associated with such alternative approaches?

3. Would an orderly liquidation of a broker-dealer under the approach described in the proposed rule have any unintended or adverse impact(s) on market participants generally? If yes, what are those impacts? Are there other approach(es) that might be consistent with the requirements of the Dodd-Frank Act and have fewer such impacts? What are the other approach(es) that might eliminate or minimize such unintended or adverse impact(s), and how would they do so? Please be specific. What would be the costs or benefits associated with such alternative approaches?
4. Are there any matter(s) with respect to the orderly liquidation of a covered broker-dealer under Title II of the Dodd-Frank Act that are not currently addressed in the proposed rule, but that should be addressed in a rulemaking under section 205(h) of the Dodd-Frank Act, 12 U.S.C. 5385(h)? If yes, what are those matters, why should they be addressed, and how? Please be specific.
5. Does the proposed rule clearly address the roles of the FDIC as receiver and SIPC as trustee for the covered broker-dealer in a Title II orderly liquidation? If not, how could the proposed rule be made clearer?
6. Does the proposed rule clearly address the treatment of customers and other classes of claimants and creditors in a Title II orderly liquidation of a covered broker-dealer? Does the proposed rule clearly address the claims bar date and the 60-day filing deadline for

- payment of net equity claims out of customer property? If not, in what respects could the proposed rule be made clearer and how?
7. Are the priorities for the allocation of customer property and other assets of the covered broker-dealer clearly addressed by the proposed rule? If not, in what respects could they be made clearer and how?
 8. Are the standards for judicial review of a claim that is disallowed, in whole or in part, clearly addressed by the proposed rule? If not, in what respects could the proposed rule be made clearer and how?
 9. Are the matters listed for inclusion in the protective decree appropriate? Are there any other matters not mentioned that should be included in the protective decree, and if so, why? Could the provision of the protective decree clarifying that, if a protective decree were filed on a date other than the appointment date, the protective decree's filing date would be deemed be the appointment date, cause harm to customers, other claimants, creditors, shareholders, or other interested parties? If so, how? Are there alternative approaches that would not have such impacts? If yes, please describe in detail and provide information about associated costs or benefits.
 10. Would customers be harmed by their inability to seek determinations of their claims within the expedited 90-day period (as provided by section 210(a)(5)(B) of the Dodd-Frank Act) rather than within six-months (as provided by section 210(a)(3)(A)(i) of the Dodd-Frank Act)? If so, how? If customers were permitted to seek expedited determinations of their claims, would that allow them to "jump ahead" of other similarly-situated claimants? Would that be appropriate?
 11. What are the expected costs to covered broker-dealers as a result of this proposed rule?

12. Are there any costs or benefits of the proposed rule for customers or other creditors of covered broker-dealers, or market participants generally, that are not described above?

Please describe.

13. What are the proposed rule's implications for systemic risk?

14. Are there any anticipated consequences of the proposed rule that are not otherwise described in this release? Please be specific.

IV. PAPERWORK REDUCTION ACT

The proposed rule would clarify the process for the orderly liquidation of a covered broker-dealer under Title II of the Dodd-Frank Act. The proposed rule addresses only the process to be used in the liquidation of the covered broker-dealer and does not create any new, or revise any existing, collection of information pursuant to the Paperwork Reduction Act.¹⁵¹ Consequently, no information has been submitted to the Office of Management and Budget for review.

The Agencies request comment on the assertion that the proposed rule will not create any new, or revise any existing, collection of information pursuant to the Paperwork Reduction Act.

V. ECONOMIC ANALYSIS

A. Introduction and General Economic Considerations

The Commission and the Corporation are jointly proposing this rule to implement provisions applicable to the orderly liquidation of covered broker-dealers pursuant to section 205(h) of the Dodd-Frank Act in manner that protects market participants by clearly establishing expectations and equitable treatment for customers and creditors of failed broker-dealers, as well

¹⁵¹

44 U.S.C. 3501 *et seq.*

as other market participants. The Commission and the Corporation are mindful of the costs and benefits of their respective rules. The following economic analysis seeks to identify and consider the benefits and costs – including the effects on efficiency, competition, and capital formation – that would result from the proposed rule. Overall, the Commission and the Corporation preliminarily believe that the primary benefit of the proposed rule is to codify additional details regarding the process for orderly liquidation of failed broker-dealers which will provide additional structure and enable consistent application of the process. Importantly, the proposed rule does not affect the set of options available to the Commission and the Corporation, nor does it affect the range of possible outcomes. The detailed analysis of costs and benefits regarding the proposed rule is discussed below.

The Dodd-Frank Act specifically provides that the FDIC may be appointed receiver for a systemically important broker-dealer for purposes of the orderly liquidation of the company using the powers and authorities granted to the FDIC under Title II of the Act.¹⁵² Section 205 of the Dodd-Frank Act sets forth a process for the orderly liquidation of covered broker-dealers that is an alternative to the process under SIPA, but that process incorporates many of the customer protection features of SIPA into a Title II orderly liquidation. Congress recognized that broker-dealers are different from other kinds of systemically important financial companies in several ways, not the least of which is how customers of a broker-dealer are treated in an insolvency proceeding relating to the broker-dealer.¹⁵³ Section 205 of the Dodd-Frank Act is intended to address situations where the failure of a large broker-dealer could have broader impacts on the stability of the United States financial system. The financial crisis of 2008 and the ensuing

¹⁵² See 12 U.S.C. 5382, 12 U.S.C. 5383, and 12 U.S.C. 5384.

¹⁵³ See 12 U.S.C. 5385 (orderly liquidation of covered brokers and dealers).

economic recession resulted in the failure of many financial entities. Liquidity problems that initially began at a small set of firms quickly spread as uncertainty about which institutions were solvent increased, triggering broader market disruptions, including a general loss of liquidity, distressed asset sales, and system-wide redemption runs by some participants.¹⁵⁴ The proposed rule seeks to implement the orderly liquidation provisions of the Dodd-Frank Act in a manner that is designed to help reduce both the likelihood and the severity of financial market disruptions that could result from the failure of a covered broker-dealer.

In the case of a failing broker-dealer, the broker-dealer customer protection regime is primarily composed of SIPA and the Exchange Act, as administered by SIPC and the Commission. Among other Commission financial responsibility rules, Rule 15c3-3 specifically protects customer funds and securities held by a broker-dealer and essentially forbids broker-dealers from using customer assets to finance any part of their businesses unrelated to servicing securities customers.¹⁵⁵ With respect to SIPA, and as a general matter, in the event that a broker-dealer enters into a SIPA liquidation, customers' cash and securities held by the broker-dealer are returned to customers on a pro-rata basis.¹⁵⁶ If the broker-dealer does not have sufficient funds to satisfy customer net equity claims, SIPC advances may be used to supplement the distribution, up to a ceiling of \$500,000 per customer, including a maximum of \$250,000 for cash claims.¹⁵⁷ When applicable, SIPC or a SIPA trustee will return securities that are registered

¹⁵⁴ See Brunnermeir, M. (2009), Deciphering the Liquidity and Credit Crunch 2007-2008, Journal of Economic Perspectives 23, 77-100.

¹⁵⁵ See Net Capital Requirements for Brokers and Dealers, Exchange Act Release No. 21651 (Jan. 11, 1985), 50 FR 2690, 2690 (Jan. 18, 1985). See also Broker-Dealers; Maintenance of Certain Basic Reserves, Exchange Act Release No. 9856 (Nov. 10, 1972), 37 FR 25224, 25224 (Nov. 29, 1972).

¹⁵⁶ See 15 U.S.C. 78fff-2(b).

¹⁵⁷ See 15 U.S.C. 78fff-3(a).

in the customer's name, or are in the process of being registered, directly to each customer.¹⁵⁸

An integral component of the broker-dealer customer protection regime is that, under SIPA, customers have preferred status relative to general creditors with respect to customer property and customer name securities.¹⁵⁹ SIPC or a SIPA trustee may sell or transfer customer accounts to another SIPC member in order for the customers to regain access to their accounts in an expedited fashion.¹⁶⁰

Title II of the Dodd-Frank Act supplemented the customer protection regime for broker-dealers. As described above in more detail, in the event a covered broker-dealer fails,¹⁶¹ Title II provides the FDIC with a broader set of tools to help ensure orderly liquidation, including the ability to transfer all assets and liabilities held by a broker-dealer— not just customer assets — to another broker-dealer, as well as the ability to borrow from the U.S. Treasury.¹⁶² Upon the commencement of an orderly liquidation under Title II, the FDIC is appointed the receiver of the broker-dealer and SIPC is appointed as the trustee for the liquidation process. The FDIC is given

¹⁵⁸ See 15 U.S.C. 78fff-2(c).

¹⁵⁹ See 15 U.S.C. 78fff(a).

¹⁶⁰ See 15 U.S.C. 78fff-2(f).

¹⁶¹ To facilitate their customer business and to finance their proprietary trading activities, broker-dealers often enter into short-term borrowing arrangements, including repurchase and securities lending agreements. Such financing arrangements can have maturities as short as a day, requiring broker-dealers to continuously refinance their positions. Broker-dealers are therefore subject to liquidity risk in the event that short-term lenders and counterparties refuse to finance their positions or seek less favorable terms for the broker-dealer, such as higher haircuts on collateral. Doubts about a broker-dealer's viability can lead a broker-dealer's customers to move their accounts from the broker-dealer, placing additional strains upon the broker-dealer's liquidity position. Such doubts can, in turn, lead to a general "run" against the broker-dealer, both in its secured financing activities and withdrawals of customer accounts. The ability of the Corporation under Title II to provide financing to the broker-dealer and to allow the broker-dealer to continue its operations may help to address the liquidity stress at the broker-dealer and reduce the potential risk to other market participants.

¹⁶² Under a SIPA liquidation, the Commission is authorized to make loans to SIPC should SIPC lack sufficient funds. In addition, to fund these loans, the Commission is authorized to borrow up to \$2.5 billion from the U.S. Treasury. See 15 U.S.C. 78ddd(g)-(h).

the authority to form and fund a bridge broker-dealer,¹⁶³ which would facilitate a quick transfer of customer accounts to a solvent broker-dealer and therefore would accelerate reinstated access to customer accounts.¹⁶⁴ By granting the FDIC the ability to transfer any asset or liability to the bridge broker-dealer as it deems necessary, the orderly liquidation proceeding allows the Corporation to extend relief to certain creditors to reduce the destabilizing effects these creditors may cause if they run on a large broker-dealer.¹⁶⁵ To further reduce the run risk the failed broker-dealer may be facing, Title II imposes an automatic one-business day stay on certain activities by the counterparties to QFCs, so as to provide the FDIC an opportunity to inform counterparties that the covered broker-dealer's liabilities were transferred to and assumed by the bridge broker-dealer.¹⁶⁶

The proposed rule is designed to implement the provisions of section 205, so that an orderly liquidation can be carried out for certain broker-dealers with efficiency and the intended benefits of orderly liquidation, as established by the Dodd-Frank Act, on the overall economy can be realized. Specifically, the proposed rule implements the framework for the liquidation of covered broker-dealers. The framework includes definitions for the key terms such as customer, customer property, customer name securities, net equity, and bridge broker-dealer. It sets forth three major processes regarding the orderly liquidation – the process of initiating the orderly liquidation (including the appointment of receiver and trustee and the notice and application for protective decree), the process of account transfers to the bridge broker-dealer, and the claims

¹⁶³ See §§ 380.63 and 302.103, as proposed (regarding the FDIC's power to "organize one or more bridge brokers or dealers with respect to a covered broker or dealer").

¹⁶⁴ See Section II.D.2 on the FDIC's power to transfer accounts to bridge broker-dealer.

¹⁶⁵ See Section II.E on the claims of customers and other creditors of a covered broker-dealer.

¹⁶⁶ See Section II.F on the additional proposed sections that relate to qualified financial contracts.

process for customers and other creditors. While establishing orderly liquidation generally, section 205 does not specifically provide the details of such processes.

The proposed rule provides several clarifications to the provisions in the statute. For example, under Title II, the FDIC has authority to transfer any assets without obtaining any approval, assignment, or consents.¹⁶⁷ The proposed rule further provides that the transfer to a bridge broker-dealer of any account, property or asset is not determinative of customer status, nor that the property so transferred qualifies as customer property or customer name securities.¹⁶⁸ The proposed rule also provides clarifications on terms such as the venue for filing the application for a protective decree and the filing date.¹⁶⁹

In addition, the proposed rule clarifies the process for transferring assets to the bridge broker-dealer, which should help expedite customer access to their respective accounts. For example, the proposed rule provides that allocations to customer accounts at the bridge broker-dealer may initially be derived from estimates based upon the books and records of the covered broker-dealer or other information deemed relevant by the Corporation in consultation with SIPC.¹⁷⁰ This means that customers may potentially access their accounts more expeditiously, before the time-consuming record reconciliation process concludes.

Therefore, overall, the Commission and the Corporation preliminarily believe that the primary benefit of the proposed rule is to codify additional details regarding the process for the orderly liquidation of covered broker-dealers, which will provide additional structure and enable

¹⁶⁷ See §§ 380.63 and 302.103, as proposed.

¹⁶⁸ These determinations would be made by SIPC in accordance with SIPA. See §§ 380.64(a)(1) and 302.104, as proposed (explaining “SIPC, as trustee for a covered broker or dealer, shall determine customer status . . .”).

¹⁶⁹ See §§ 380.62 and 302.102, as proposed.

¹⁷⁰ See §§ 380.63(d) and 302.103(d), as proposed.

consistent application of the process. Importantly, the proposed rule does not affect the set of options available to the Commission and the Corporation upon failure of a covered broker-dealer, nor does it affect the range of possible outcomes. In the absence of the proposed rule, the Commission, the Board and the Secretary¹⁷¹ could still determine that an orderly liquidation under Title II is appropriate, and the FDIC would still have broad authority to establish a bridge broker-dealer and transfer all assets and liabilities held by the failed entity. However, in the absence of the proposed rule, uncertainty could arise regarding the definitions (e.g., the applicable filing date or the nature of the application for a protective decree) and the claims process, which could cause delays in the process and undermine the goals of the statute. By establishing a uniform process for the orderly resolution of a broker-dealer, the proposed rule should improve the orderly liquidation process while implementing the statutory requirements, so that orderly liquidations can be carried out with efficiency and predictability. Such efficiency and predictability should generally ease implementation burdens and conserve resources that otherwise would have to be expended resolving delays in the claims process or in connection with any potential litigation that could arise from delays. The discussion below elaborates on the likely costs and benefits of the proposed rule and its potential impact on efficiency, competition and capital formation, as well as potential alternatives.

B. Economic Baseline

To assess the economic impact of the proposed rule, the Commission and the Corporation are using section 205 of the Dodd-Frank Act as the economic baseline. Section 205 sets forth provisions specific to the orderly liquidation of certain large broker-dealers and paragraph (h)

¹⁷¹ See 12 U.S.C. 5383(a)(1)(B).

directs the Commission and the Corporation, in consultation with SIPC, jointly to issue rules to fully implement the section.¹⁷² Although no implementing rules are in place, section 205 of the Dodd-Frank Act was self-effectuating, meaning that the statutory requirements are in effect. Therefore, the appropriate baseline is the orderly liquidation authority in place pursuant to section 205, without any implementation rules issued by the Agencies. As outlined in Title II of the Dodd-Frank Act, irrespective of how the broker-dealer was placed into a Title II resolution, section 205 regarding the liquidation of broker-dealers and the proposed rule (if adopted) would always apply to the covered broker-dealer even if section 210 is invoked.

1. SIPC's Role

Section 205 provides that upon the appointment of the FDIC as receiver for a covered broker-dealer, the FDIC shall appoint SIPC as trustee for the liquidation of the covered broker-dealer under SIPA without need for any approval.¹⁷³ Upon its appointment as trustee, SIPC shall promptly file with a federal district court an application for protective decree, the terms of which will jointly be determined by SIPC and the Corporation, in consultation with the Commission.¹⁷⁴ Section 205 also provides that SIPC shall have all of the powers and duties provided by SIPA, except with respect to assets and liabilities transferred to the bridge broker-dealer.¹⁷⁵ The determination of claims and the liquidation of assets retained in the receivership of the covered broker-dealer and not transferred to the bridge financial company shall be administered under SIPA.¹⁷⁶

¹⁷² 12 U.S.C. 5385(h).

¹⁷³ 12 U.S.C. 5385(a).

¹⁷⁴ See 12 U.S.C. 5385(a)(2).

¹⁷⁵ 12 U.S.C. 5385. See also §§ 380.64(a) and 302.104(a), as proposed (regarding SIPC's role as trustee).

¹⁷⁶ Id.

2. The Corporation's Power to Establish Bridge Broker-Dealers

Section 205 of the Dodd-Frank Act does not contain specific provisions regarding bridge broker-dealers. However, section 210 of the Dodd-Frank Act provides that, in connection with an orderly liquidation, the FDIC has the power to form one or more bridge financial companies, which includes the power to form bridge broker-dealers with respect to a covered broker-dealer.¹⁷⁷ Under Title II, the FDIC has the authority to transfer any asset or liability held by the covered financial company without obtaining any approval, assignment, or consent with respect to such transfer.¹⁷⁸ It is further provided that any customer of a covered broker-dealer whose account is transferred to a bridge financial company shall have all rights and privileges under section 205(f) of the Dodd-Frank Act and SIPA that such customer would have had if the account was not transferred.¹⁷⁹

3. Satisfaction of Customer Claims

Section 205(f) of the Dodd-Frank Act requires that all obligations of a covered broker-dealer or bridge broker-dealer to a customer relating to, or net equity claims based on, customer property or customer name securities must be promptly discharged in a manner and in an amount at least as beneficial to the customer as would have been the case had the broker-dealer been liquidated in a SIPA proceeding.

C. Benefits, Costs and Effects on Efficiency, Competition, and Capital Formation

1. Anticipated Benefits

¹⁷⁷ See 12 U.S.C. 5390(h)(1)(A). See also 12 U.S.C. 5390(h)(2)(H).

¹⁷⁸ 12 U.S.C. 5390(a)(1)(G).

¹⁷⁹ See 12 U.S.C. 5390(h)(2)(H)(iii).

a. Overall Benefits

The key benefit of the proposed rule is that it creates a more structured framework to implement section 205 of the Dodd-Frank Act, so that the orderly liquidation of a covered broker-dealer can be carried out with efficiency and predictability if the need arises. As discussed in the economic baseline, section 205 provides parameters for the orderly liquidation of covered broker-dealers, while the proposed rule implements these statutory parameters. The proposed rule first provides definitions for certain key terms including customer, customer property, customer name securities, net equity, and bridge broker-dealer, among others.¹⁸⁰ It then sets forth three major processes regarding the orderly liquidation: the process of initiating the orderly liquidation,¹⁸¹ the process of account transfers to the bridge broker-dealer,¹⁸² and the claims process for customers and other creditors.¹⁸³

First, besides incorporating the statutory requirement of appointing SIPC as the trustee for covered broker-dealers, the proposed rule provides a more detailed process for notice and application for protective decree. It provides clarification for the venue in which the notice and application for a decree is to be filed.¹⁸⁴ It clarifies the definition of the filing date if the notice and application is filed on a date other than the appointment date.¹⁸⁵ And finally, it also includes

¹⁸⁰ See §§ 380.60 and 302.100, as proposed.

¹⁸¹ See §§ 380.61, 380.62, 302.101 and 302.102, as proposed.

¹⁸² See §§ 380.63 and 302.103, as proposed.

¹⁸³ See §§ 380.64 and 302.104, as proposed.

¹⁸⁴ See §§ 380.62(a) and 302.102, as proposed.

¹⁸⁵ Id.

a non-exclusive list of notices drawn from other parts of Title II to inform the relevant parties of the initiation of the orderly liquidation process and what they should expect.¹⁸⁶

Second, the proposed rule sets forth the process to establish one or more bridge broker-dealers and to transfer accounts, property, and other assets held by a covered broker-dealer to such bridge broker-dealers, pursuant to Title II of Dodd-Frank Act.¹⁸⁷ Section 205 of the Act does not specifically provide for such a process. The proposed rule specifies that the Corporation may transfer any account, property, or asset held by a covered broker-dealer (including customer and non-customer accounts, property and assets) to a bridge broker-dealer as the Corporation deems necessary, based on the FDIC's authority under Title II to transfer any assets without obtaining any approval, assignment, or consents.¹⁸⁸ The transfer to a bridge broker-dealer of any account, property or asset is not determinative of customer status.¹⁸⁹ The determinations of customer status are to be made by SIPC as trustee in accordance with SIPA.¹⁹⁰ As discussed above, given the preferred status of customers, litigation has been brought on customer status under SIPA (e.g., repo counterparties' claims of customer status under SIPA).¹⁹¹ Since the Corporation may transfer both customer and non-customer accounts, property and assets held by a covered broker-dealer to a bridge broker-dealer according to the statute, in the absence of the proposed rule, some non-customer creditors may mistakenly interpret under the baseline scenario that such a transfer confers customer status (especially since in a SIPA

¹⁸⁶ See §§ 380.62(b) and 302.102(b), as proposed.

¹⁸⁷ See §§ 380.63 and 302.103, as proposed.

¹⁸⁸ See §§ 380.63(e) and 302.103(e), as proposed.

¹⁸⁹ See §§ 380.64(a) and 302.104(a), as proposed.

¹⁹⁰ See §§ 380.64(a) and 302.104(a) as proposed.

¹⁹¹ See, e.g., *In re Lehman Brothers Inc.*, 492 B.R. 379 (Bankr. S.D.N.Y. 2013), *aff'd*, 506 B.R. 346.

proceeding only customer assets are transferred). To the extent that such mistaken beliefs may arise from the statutory provisions, litigation over customer status could arise. The clarification in the proposed rule stresses that customer status is determined by SIPC separately from the decision to transfer an asset to a bridge broker-dealer, and could thus help prevent confusion concerning whether other creditors whose assets have also been transferred should be treated as customers. This clarification may mitigate a potential increase in litigation costs, although the economic benefit of such mitigation is likely to be *de minimis*.

Regarding the account transfers to bridge broker-dealers, in addition to the provisions on the specifics of a transfer (e.g., the calculation of customer net equity, the assumption of the net equity claim by the bridge broker-dealer and the allocation of customer property), the proposed rule further provides that allocations to customer accounts at the bridge broker-dealer may initially be derived from estimates based upon the books and records of the covered broker-dealer or other information deemed relevant by the Corporation in consultation with SIPC.¹⁹² Given that it could be time-consuming to reconcile the broker-dealer's records with the records of other parties, this provision may speed up the allocation of customer property to the customer accounts at the bridge broker-dealer, thus providing customers quicker access to their accounts.

Third, the proposed rule also addresses the claims process for customers and other creditors.¹⁹³ The proposed rule implements the statute's requirement that the trustee's allocation shall be in an amount and manner, including form and timing, at least as beneficial as such customer would have received under a SIPA proceeding, as required by section 205(f).¹⁹⁴ In

¹⁹² See §§ 380.63(d) and 302.103(d), as proposed.

¹⁹³ See §§ 380.64 and 302.104, as proposed.

¹⁹⁴ See §§ 380.64(a)(4) and 302.104(a)(4), as proposed.

addition, it further addresses certain procedural aspects of the claims determination process, such as the publication and mailing of notices to creditors, the notice of the appointment of the FDIC and SIPC, the claims bar date, and expedited relief.

In summary, the proposed rule would provide interested parties with details on the implementation of the orderly liquidation process. By providing for a uniform process, the proposed rule could improve the orderly liquidation process, so that the orderly liquidation can be carried out with efficiency and predictability. Under the baseline scenario, in absence of the proposed rule, uncertainty may arise because various parties may interpret the statutory requirements differently. For example, under the baseline, the repo counterparties of the broker-dealer may not understand that the transfer of the rights and obligations under their contracts to the bridge broker-dealer is not determinative of customer status, because such a transfer to another broker-dealer is only available for customers under a SIPA proceeding. That is, repo counterparties of the broker-dealer may mistakenly believe that the transfer of rights and obligations implies customer status. Accordingly, the proposed rule provides that the transfer of accounts to a bridge broker-dealer is not determinative of customer status, and that such status is determined by SIPC in accordance with SIPA. Uncertainty regarding such matters could result in litigation and delays in the claims process if orderly liquidation were to be commenced with respect to a covered broker-dealer; therefore, the structure provided by the proposed rule could conserve resources that otherwise would have to be expended in settling such litigation and resolving delays that may arise, and create a more efficient process for enabling orderly liquidation. Moreover, under the baseline scenario, uncertainties about process and how customer and creditor claims would be handled could continue to encourage these claimants to reduce exposure if doubts about a broker-dealer's viability arise – for customers, by withdrawing

free credit balances; for creditors, by reducing repo and derivatives exposure. Such uncertainties, if they were to persist, could undermine the broader benefits that orderly liquidation could provide to financial stability. In this sense, the processes set forth by the proposed rule could help realize the economic benefits of section 205.

b. Benefits to Affected Parties

The Commission and the Corporation believe that the proposed rule provides benefits comparable to those under the baseline scenario to relevant parties such as customers, creditors, and counterparties. To the extent that it provides additional guidance on procedural matters, the proposed rule may reduce potential uncertainty, thereby providing for an efficient and predictable orderly liquidation process. Therefore, the Commission and the Corporation preliminarily believe the proposed rule will improve the orderly liquidation process and provide benefits beyond the statute, although such benefits are likely to be incremental.

The Commission and the Corporation preliminarily believe that the proposed rule will be beneficial to customers.¹⁹⁵ The proposed rule states that the bridge broker-dealer will undertake the obligations of a covered broker-dealer with respect to each person holding an account transferred to the bridge broker-dealer, providing customers with transferred accounts assurance that they will receive the same legal protection and status as a customer of a broker-dealer that is subject to a liquidation outside of Title II.¹⁹⁶ Further, under the proposed rule, the transfer of non-customer assets to a bridge broker-dealer would not imply customer status for these assets,

¹⁹⁵ See Section II.D.1 discussing the preferred status of customer claims. See also §§ 380.65(a)(1) and 302.105(a)(1), as proposed (explaining that “SIPC . . . shall determine customer status . . .”).

¹⁹⁶ See §§ 380.63(d) and 302.103(d), as proposed (“With respect to each account transferred to the bridge broker or dealer pursuant to paragraph (b), the bridge broker or dealer shall undertake the obligations of a broker or dealer only with respect to property transferred to and held by the bridge broker or dealer and allocated to the account as provided in section 380.64(a)(3) [for purposes of the FDIC and section 302.104(a)(3) for purposes of the SEC], including any customer property and any advances from SIPC.”).

which could thereby reduce any incentive to not move assets based upon fears of prejudging customer status. Finally, the proposed rule would provide that allocations to customer accounts at the bridge broker-dealer may initially be derived from estimates based on the books and records of the covered broker-dealer.¹⁹⁷ This provision could help facilitate expedited customer access to their respective accounts, as customers would not have to wait for a final reconciliation of the broker-dealer's records with other parties' records.¹⁹⁸

The Commission preliminarily believes the proposed rule will yield benefits to both secured and unsecured creditors, as it clarifies the manner in which creditor claims could be transferred to a bridge broker-dealer. Creditors thus could potentially receive benefits from financing provided by the Corporation to the bridge broker-dealer.

2. Anticipated Costs

While the proposed rule is designed to ensure that an orderly liquidation under Title II would be at least as beneficial to customers as would be the case in a SIPA liquidation, orderly liquidation does entail different treatment of QFC counterparties. Under SIPA, certain QFC counterparties may exercise specified contractual rights regardless of an automatic stay.¹⁹⁹ In contrast, Title II imposes an automatic one-day stay on certain activities by QFC

¹⁹⁷ See §§ 380.63(d) and 302.103(d), as proposed.

¹⁹⁸ See §§ 380.63(e) and 302.103(e), as proposed. See also 15 U.S.C. 78eee(b)(2)(C)(i)-(ii).

¹⁹⁹ See 15 U.S.C. 78eee(b)(2)(C)(i)-(ii). See also Letter from Michael E. Don, Deputy General Counsel of SIPC to Robert A. Portnoy, Deputy Executive Director and General Counsel of the Public Securities Association, dated February 4, 1986 (repurchase agreements); Letter from Michael E. Don to J. Eugene Marans, Cleary, Gottlieb, Steen & Hamilton, dated August 29, 1988 (securities lending transactions); Letter from Michael E. Don to James D. McLaughlin, Director of the American Bankers Association, dated October 30, 1990 (securities lending transactions secured by cash collateral or supported by letters of credit); Letter from Michael E. Don to John G. Macfarlane, III, Chairman, Repo Committee, Public Securities Association, dated February 19, 1991 (securities lending transactions secured by cash collateral or supported by letters of credit); Letter from Michael E. Don, President of SIPC to Seth Grosshandler, Cleary, Gottlieb, Steen & Hamilton, dated February 14, 1996 (repurchase agreements falling outside the Code definition of "repurchase agreement"); and Letter from Michael E. Don to Omer Oztan, Vice President and Assistant General Counsel of the Bond Market Association, dated June 25, 2002 (repurchase agreements).

counterparties,²⁰⁰ which may limit the ability of these counterparties to terminate contracts or exercise any rights against collateral. As proposed, the stay would remain in effect if the QFC contracts are transferred to a bridge broker-dealer. While these provisions may impose costs, they are a consequence of the statute and are already in effect.

In addition, as discussed above, the proposed rule could benefit customers by allowing the allocations to customer accounts at the bridge broker-dealer to be derived from estimates based on the books and records of the covered broker-dealer. Such a process may accelerate customers' access to their accounts, as they would not have to wait for a final account reconciliation to access their accounts. As provided for in the proposed rule, the calculation of allocations of customer property to customer accounts would be refined as additional information becomes available. The Commission and the Corporation preliminarily believe that initial allocations will be made conservatively, which with the backstop of the availability of SIPC advances to customers in accordance with the requirements of SIPA, should minimize the possibility of an over-allocation to any customer. To the extent that initial estimates are excessive, it is possible that customer funds may need to be reallocated after customers initially gain access to their accounts, which could result in costs for customers. Essentially, the proposed rule trades off expedited access to customer funds with the possibility of subsequent reallocation. We currently lack data concerning the impact or costs that might be associated with this possibility. The costs associated with all of these factors may vary significantly depending on broker-dealer systems and the specific events. For these reasons, we are unable to quantify

²⁰⁰ See §§ 380.67 and 302.107, as proposed (“The rights and obligations of any party to a qualified financial contract to which a covered broker or dealer is a party shall be governed exclusively by 12 U.S.C. 5390, including the limitations and restrictions contained in 12 U.S.C. 5390(c)(10)(B), and any regulations promulgated thereunder.”).

the costs associated with these factors at this time. However, as noted above, the Commission and the Corporation preliminarily believe initial allocations will be made conservatively, which would minimize the possibility of an over-allocation to any customer and mitigate potential costs and uncertainty associated with allocation refinements.

3. Effects on Efficiency, Competition, and Capital Formation

The Commission and the Corporation have preliminarily assessed the effects arising from the proposed rule on efficiency, competition, and capital formation. As discussed above, the Agencies preliminarily believe the primary economic benefit of the proposed rule will be that it provides details to implement section 205 of the Dodd-Frank Act, so that the orderly liquidation of a covered broker-dealer can be carried out with greater efficiency and predictability if the need arises. This structure could reduce uncertainty about treatment of customer and creditor claims in an orderly liquidation, conserving resources and creating a more efficient process relative to orderly liquidation under the baseline. In addition, uncertainty about treatment of claims could encourage customers and creditors to reduce exposure to a broker-dealer facing financial distress, exacerbating liquidity problems. By reducing uncertainty, the proposed rule may reduce incentives for claimants to rush to reduce exposures. In such a scenario, broker-dealers may find it easier to recover from moderate financial distress and to sustain a sufficient capital position to provide financial intermediation services. Furthermore, for sufficiently large broker-dealers with many creditor and counterparty relationships throughout the financial system, positive perceptions about the ability of those broker-dealers to recover from moderate financial distress may stave off aggregate financial sector runs, and thus preserve financial sector capital and the availability of financial intermediation services.

Beyond these identified potential effects, the Commission and the Corporation preliminarily believe that the additional effects of the proposed rule on efficiency, competition, and capital formation will be linked to the existence of an orderly liquidation process itself, which is part of the baseline, and is an option available to regulatory authorities today. Our analysis of the effects of an orderly liquidation process on efficiency, competition, and capital formation focuses on those effects that derive from the process and structure created by the proposed rule, but not those that are due to the underlying statute, which is part of the economic baseline. By establishing a structured framework, the proposed rule sets clearer expectations for relevant parties, and therefore could help reduce potential uncertainty and contribute to market efficiency and liquidity as described above. Relative to the baseline scenario, where orderly liquidation exists as an option for regulatory authorities but without the framework provided in the proposed rule, having a structured process in place as a response to a potential crisis could also allow broker-dealers to more readily attract funding, thus facilitating capital formation.

D. Alternatives Considered

As described above, Title II of the Dodd-Frank Act establishes a process by which a covered broker-dealer would be placed into orderly liquidation. Furthermore, orderly liquidation is available as an option to regulators today, and the proposed rule does not affect the set of options available to the Commission and the Corporation, nor does it affect the range of possible outcomes. As an alternative to this proposed rule, the Commission and the Corporation could rely on statutory provisions alone to achieve similar outcomes. However, the Commission and the Corporation preliminarily believe that relying on the statute alone, without a rule implementing section 205 of the Dodd-Frank Act, would result in orderly liquidations, if any, that are less efficient and less predictable, and that would fail to achieve the benefits of the

proposed rule described above. In particular, the absence of the provisions of the proposed rule outlining the process for notice and application for a protective decree, the process for establishing a bridge broker-dealer, and the process governing the transfer of accounts, property, and other assets held by the covered broker-dealer to the bridge broker-dealer, could lead to inconsistent application of the statutory provisions. Such inconsistency could cause delays in the liquidation process and increase the likelihood of litigation over issues such as customer status, increasing costs for customers and creditors without corresponding benefits.

E. Request for Comment

In addition to the general requests for comment, the Commission and the Corporation request comment with respect to the following specific questions:

1. As an alternative to the proposed rule, should the Commission and the Corporation instead rely on the statute alone to implement orderly liquidations of covered broker-dealers? Why?
2. Are there additional alternative processes to implement section 205 of the Dodd-Frank Act that the Commission and the Corporation should consider? If so, what are they and what would be the associated costs or benefits of these alternative approaches?

VI. REGULATORY ANALYSIS AND PROCEDURES

A. Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (“RFA”)²⁰¹ requires an agency publishing a notice of proposed rulemaking to prepare and make available for public comment a regulatory flexibility

²⁰¹ 5 U.S.C. 601 *et seq.*

analysis that describes the impact of the proposed rule on small entities.²⁰² The RFA provides that an agency is not required to prepare and publish a regulatory flexibility analysis if the agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities.²⁰³

Pursuant to section 605(b) of the RFA, the Agencies certify that the proposed rule, if adopted, will not have a significant economic impact on a substantial number of small entities. Under Small Business Administration size standards defining small entities, broker-dealers are generally considered small entities if their annual receipts do not exceed \$38.5 million.²⁰⁴ If adopted, the proposed rule will clarify rules and procedures for the orderly liquidation of a covered broker-dealer under Title II of the Dodd-Frank Act. A covered broker-dealer is a broker-dealer that is subject to a systemic risk determination by the Secretary pursuant to section 203 of the Dodd-Frank Act, 12 U.S.C. 5383, and thereafter is to be liquidated under Title II of the Dodd-Frank Act. The Agencies do not believe that a broker-dealer that would be considered a small entity for purposes of the RFA would ever be the subject of a systemic risk determination by the Secretary. Therefore, the Agencies are not aware of any small entities that would be affected by the proposed rule. As such, the proposed rule, if adopted, would not affect, and would impose no burdens on, small entities.

**B. The Treasury and General Government Appropriations Act, 1999 –
Assessment of Federal Regulations and Policies on Families**

The FDIC has determined that the proposed rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act,

²⁰² 5 U.S.C. 603(a).

²⁰³ 5 U.S.C. 605(b).

²⁰⁴ 13 CFR 121.201.

enacted as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999.²⁰⁵

C. Plain Language

Section 722 of the Gramm-Leach-Bliley Act²⁰⁶ requires 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 proposed rule in a simple and straightforward manner but nevertheless invites comment on whether the proposal is clearly stated and effectively organized, and how the Agencies might make the proposed text easier to understand.

VII. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (“SBREFA”), the Commission and the Corporation request comment on the potential effect of the proposed rule on the United States economy on an annual basis. The Commission and the Corporation also request comment on any potential increases in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation based on the proposed rule. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VIII. STATUTORY AUTHORITY

The proposed rule is being promulgated pursuant to section 205(h) of the Dodd-Frank Act. Section 205(h) of the Act requires the Corporation and the Commission, in consultation with SIPC, jointly to issue rules to implement section 205 of the Act concerning the orderly liquidation of covered broker-dealers.

²⁰⁵ Public Law 105–277, 112 Stat. 2681.

²⁰⁶ Public Law 106–102, 113 Stat. 1338, 1471.

List of Subjects

Bankruptcy, Brokers, Claims, Customers, Dealers, Financial companies, Orderly liquidation.

Federal Deposit Insurance Corporation

12 CFR Part 380

Authority and Issuance

For the reasons stated in the proposing preamble, the Federal Deposit Insurance Corporation proposes to amend 12 CFR Part 380 as follows:

PART 380-ORDERLY LIQUIDATION AUTHORITY

1. The authority citation for part 380 is revised to add 12 U.S.C. 5385(h) to the list of authorities cited.
2. Sections 380.60 through 380.67 are designated under a new subpart D and the heading for new subpart D is added to read as follows:

Subpart D—Orderly Liquidation of Covered Brokers or Dealers

3. Sections 380.60 through 380.67 are added to read as follows:

§ 380.60 Definitions.

For purposes of this subpart D, the following terms shall have the following meanings:

- (a) *Appointment date.* The term *appointment date* means the date of the appointment of the Corporation as receiver for a covered financial company that is a covered broker or dealer. This date shall constitute the *filing date* as that term is used in SIPA.

- (b) *Bridge broker or dealer.* The term *bridge broker or dealer* 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 broker or dealer.
- (c) *Commission.* The term *Commission* means the Securities and Exchange Commission.
- (d) *Covered broker or dealer.* The term *covered broker or dealer* means a covered financial company that is a qualified broker or dealer.
- (e) *Customer.* The term *customer* of a covered broker or dealer shall have the same meaning as in 15 U.S.C. 78lll(2) *provided that* the references therein to *debtor* shall mean the covered broker or dealer.
- (f) *Customer name securities.* The term *customer name securities* shall have the same meaning as in 15 U.S.C. 78lll(3) *provided that* the references therein to *debtor* shall mean the covered broker or dealer and the references therein to *filing date* shall mean the appointment date.
- (g) *Customer property.* The term *customer property* shall have the same meaning as in 15 U.S.C. 78lll(4) *provided that* the references therein to *debtor* shall mean the covered broker or dealer.
- (h) *Net equity.* The term *net equity* shall have the same meaning as in 15 U.S.C. 78lll(11) *provided that* the references therein to *debtor* shall mean the covered broker or dealer and the references therein to *filing date* shall mean the appointment date.
- (i) *Qualified broker or dealer.* The term *qualified broker or dealer* means a broker or dealer that (A) is registered with the Commission under Section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)); and (B) is a member of SIPC.
- (j) *SIPA.* The term *SIPA* means the Securities Investor Protection Act of 1970, 15 U.S.C. 78aaa-III.
- (k) *SIPC.* The term *SIPC* means the Securities Investor Protection Corporation.

§ 380.61 Appointment of receiver and trustee for covered broker or dealer.

Upon the appointment of the Corporation as receiver for a covered broker or dealer, the Corporation shall appoint SIPC to act as trustee for the covered broker or dealer.

§ 380.62 Notice and application for protective decree for covered broker or dealer.

- (a) SIPC and the Corporation, upon consultation with the Commission, shall jointly determine the terms of a notice and application for a protective decree that will be filed promptly with the Federal district court for the district within which the principal place of business of the covered broker or dealer is located; *provided that* if a case or proceeding under SIPA with respect to such covered broker or dealer is then pending, then such notice and application for a protective decree will be filed promptly with the Federal district court in which such case or proceeding under SIPA is pending. If such notice and application for a protective decree is filed on a date other than the appointment date, such filing shall be deemed to have occurred on the appointment date for the purposes of this subpart D.
- (b) A notice and application for a protective decree may, among other things, provide for notice
- (1) Of the appointment of the Corporation as receiver and the appointment of SIPC as trustee for the covered broker or dealer; and
 - (2) That the provisions of Title II of the Dodd-Frank Act and any regulations promulgated thereunder may apply, including without limitation the following:
 - (i) Any existing case or proceeding with respect to a covered broker or dealer under the Bankruptcy Code or SIPA shall be dismissed effective as of the appointment date and no such case or proceeding may be commenced with respect to a covered broker or dealer at any time while the Corporation is receiver for such covered broker or dealer;
 - (ii) The revesting of assets in a covered broker or dealer to the extent that they have vested in any entity other than the covered broker or dealer as a result of any case or proceeding commenced with respect to the covered broker or dealer under the Bankruptcy Code, SIPA, or any similar provision of State liquidation or insolvency law applicable to the covered broker or dealer; *provided that* any such revesting shall not apply to assets held by the covered broker or dealer, including customer property, transferred prior to the appointment date pursuant to an order entered by the bankruptcy court presiding over the case or proceeding with respect to the covered broker or dealer;
 - (iii) The request of the Corporation as receiver for a stay in any judicial action or proceeding (other than actions dismissed in accordance with paragraph (b)(i) of this section) in which the covered broker or dealer is or becomes a party for a period of up to 90 days from the appointment date;
 - (iv) Except as provided in paragraph (b)(v) of this section with respect to qualified financial contracts, no person may exercise any right or power to terminate, accelerate or declare a default under any contract to which the covered broker or dealer is a party (and

no provision in any such contract providing for such default, termination or acceleration shall be enforceable), or to obtain possession of or exercise control over any property of the covered broker or dealer or affect any contractual rights of the covered broker or dealer without the consent of the Corporation as receiver of the covered broker or dealer upon consultation with SIPC during the 90-day period beginning from the appointment date; and

(v) The exercise of rights and the performance of obligations by parties to qualified financial contracts with the covered broker or dealer may be affected, stayed, or delayed pursuant to the provisions of Title II of the Dodd-Frank Act (including 12 U.S.C. 5390(c)) and the regulations promulgated thereunder.

§ 380.63 Bridge broker or dealer.

- (a) The Corporation, as receiver for one or more covered brokers or dealers or in anticipation of being appointed receiver for one or more covered broker or dealers, may organize one or more bridge brokers or dealers with respect to a covered broker or dealer.
- (b) If the Corporation establishes one or more bridge brokers or dealers with respect to a covered broker or dealer, then, subject to paragraph (d) of this section, the Corporation as receiver for such covered broker or dealer shall transfer all customer accounts and all associated customer name securities and customer property to such bridge brokers or dealers unless the Corporation determines, after consultation with the Commission and SIPC, that:
- (1) The customer accounts, customer name securities, and customer property are likely to be promptly transferred to one or more qualified brokers or dealers such that the use of a bridge broker or dealer would not facilitate such transfer to one or more qualified brokers or dealers; or
 - (2) The transfer of such customer accounts to a bridge broker or dealer would materially interfere with the ability of the Corporation to avoid or mitigate serious adverse effects on financial stability or economic conditions in the United States.
- (c) The Corporation, as receiver for such covered broker or dealer, also may transfer any other assets and liabilities of the covered broker or dealer (including non-customer accounts and any associated property and any assets and liabilities associated with any trust or custody business) to such bridge brokers or dealers as the Corporation may, in its discretion, determine to be appropriate in accordance with, and subject to the requirements of, 12 U.S.C. 5390(h), including 12 U.S.C. 5390(h)(1) and 5390(h)(5), and any regulations promulgated thereunder.
- (d) In connection with customer accounts transferred to the bridge broker or dealer pursuant to paragraph (b) of this section, claims for net equity shall not be transferred but shall remain

with the covered broker or dealer. Customer property transferred from the covered broker or dealer, along with advances from SIPC, shall be allocated to customer accounts at the bridge broker or dealer in accordance with § 380.64(a)(3). Such allocations initially may be based upon estimates, and such estimates may be based upon the books and records of the covered broker or dealer or any other information deemed relevant in the discretion of the Corporation as receiver, in consultation with SIPC, as trustee. Such estimates may be adjusted from time to time as additional information becomes available. With respect to each account transferred to the bridge broker or dealer pursuant to paragraph (b) or (c) of this section, the bridge broker or dealer shall undertake the obligations of a broker or dealer only with respect to property transferred to and held by the bridge broker or dealer, and allocated to the account as provided in §380.64(a)(3), including any customer property and any advances from SIPC. The bridge broker or dealer shall have no obligations with respect to any customer property or other property that is not transferred from the covered broker or dealer to the bridge broker or dealer. The transfer of customer property to such an account shall have no effect on calculation of the amount of the affected account holder's net equity, but the value, as of the appointment date, of the customer property and advances from SIPC so transferred shall be deemed to satisfy any such claim, in whole or in part.

- (e) The transfer of assets or liabilities held by a covered broker or dealer, including customer accounts and all associated customer name securities and customer property, assets and liabilities held by a covered broker or dealer for any non-customer creditor, and assets and liabilities associated with any trust or custody business, to a bridge broker or dealer, shall be effective without any consent, authorization, or approval of any person or entity, including but not limited to, any customer, contract party, governmental authority, or court.
- (f) Any succession to or assumption by a bridge broker or dealer of rights, powers, authorities, or privileges of a covered broker or dealer shall be effective without any consent, authorization, or approval of any person or entity, including but not limited to, any customer, contract party, governmental authority, or court, and any such bridge broker or dealer shall upon its organization by the Corporation immediately and by operation of law —
 - (1) Be established and deemed registered with the Commission under the Securities Exchange Act of 1934;
 - (2) Be deemed to be a member of SIPC; and
 - (3) Succeed to any and all registrations and memberships of the covered broker or dealer with or in any self-regulatory organizations.
- (g) Except as provided in paragraph (f) of this section, the bridge broker or dealer shall be

subject to applicable Federal securities laws and all requirements with respect to being a member of a self-regulatory organization and shall operate in accordance with all such laws and requirements and in accordance with its articles of association; provided, however, that the Commission may, in its discretion, exempt the bridge broker or dealer from any such requirements if the Commission deems such exemption to be necessary or appropriate in the public interest or for the protection of investors.

- (h) At the end of the term of existence of a bridge broker or dealer, any proceeds that remain after payment of all administrative expenses of such bridge broker or dealer and all other claims against such bridge broker or dealer shall be distributed to the receiver for the related covered broker or dealer.

§ 380.64 Claims of customers and other creditors of a covered broker or dealer.

(a) *Trustee's role.*

- (1) SIPC, as trustee for a covered broker or dealer, shall determine customer status, claims for net equity, claims for customer name securities, and whether property of the covered broker or dealer qualifies as customer property. SIPC, as trustee for a covered broker or dealer, shall make claims determinations in accordance with SIPA and with paragraph (a)(3) of this section, but such determinations, and any claims related thereto, shall be governed by the procedures set forth in paragraph (b) of this section.
- (2) SIPC shall make advances in accordance with, and subject to the limitations imposed by, 15 U.S.C. 78fff-3. Where appropriate, SIPC shall make such advances by delivering cash or securities to the customer accounts established at the bridge broker or dealer.
- (3) Customer property held by a covered broker or dealer shall be allocated as follows: (i) first, to SIPC in repayment of advances made by SIPC pursuant to 12 U.S.C. 5385(f) and 15 U.S.C. 78fff-3(c)(1), to the extent such advances effected the release of securities which then were apportioned to customer property pursuant to 15 U.S.C. 78fff(d); (ii) second, to customers of such covered broker or dealer, or in the case that customer accounts are transferred to a bridge broker or dealer, then to such customer accounts at a bridge broker or dealer, who shall share ratably in such customer property on the basis and to the extent of their respective net equities; (iii) third, to SIPC as subrogee for the claims of customers; and (iv) fourth, to SIPC in repayment of advances made by SIPC pursuant to 15 U.S.C. 78fff-3(c)(2).
- (4) The determinations and advances made by SIPC as trustee for a covered broker or dealer under this subpart D shall be made in a manner consistent with SIPC's customary practices under SIPA. The allocation of customer property, advances from SIPC, and delivery of customer name securities to each customer or to its customer account at a

bridge broker or dealer, in partial or complete satisfaction of such customer's net equity claims as of the close of business on the appointment date, shall be in a manner, including form and timing, and in an amount at least as beneficial to such customer as would have been the case had the covered broker or dealer been liquidated under SIPA. Any claims related to determinations made by SIPC as trustee for a covered broker or dealer shall be governed by the procedures set forth in paragraph (b) of this section.

(b) *Receiver's role.* Any claim shall be determined in accordance with the procedures set forth in 12 U.S.C. 5390(a)(2)-(5) and the regulations promulgated by the Corporation thereunder, provided however, that –

(1) *Notice requirements.* The notice of the appointment of the Corporation as receiver for a covered broker or dealer shall also include notice of the appointment of SIPC as trustee. The Corporation as receiver shall coordinate with SIPC as trustee to post the notice on SIPC's public Web site in addition to the publication procedures set forth in § 380.33.

(2) *Procedures for filing a claim.* The Corporation as receiver shall consult with SIPC, as trustee, regarding a claim form and filing instructions with respect to claims against the Corporation as receiver for a covered broker or dealer, and such information shall be provided on SIPC's public Web site in addition to the Corporation's public Web site. Any such claim form shall contain a provision permitting a claimant to claim status as a customer of the broker or dealer, if applicable.

(3) *Claims bar date.* The Corporation as receiver shall establish a claims bar date in accordance with 12 U.S.C. 5390(a)(2)(B)(i) and any regulations promulgated thereunder by which date creditors of a covered broker or dealer, including all customers of the covered broker or dealer, shall present their claims, together with proof. The claims bar date for a covered broker or dealer shall be the date following the expiration of the six-month period beginning on the date a notice to creditors to file their claims is first published in accordance with 12 U.S.C. 5390(a)(2)(B)(i) and any regulations promulgated thereunder. Any claim filed after the claims bar date shall be disallowed, and such disallowance shall be final, as provided by 12 U.S.C. 5390(a)(3)(C)(i) and any regulations promulgated thereunder, except that a claim filed after the claims bar date shall be considered by the receiver as provided by 12 U.S.C. 5390(a)(3)(C)(ii) and any regulations promulgated thereunder. In accordance with section 8(a)(3) of SIPA, 15 U.S.C. 78fff-2(a)(3), any claim for net equity filed more than sixty days after the date the notice to creditors to file claims is first published need not be paid or satisfied in whole or in part out of customer property and, to the extent such claim is paid by funds advanced by SIPC, it shall be satisfied in cash or securities, or both, as SIPC, as trustee, determines is most economical to the receivership estate.

(c) *Decision period.* The Corporation as receiver of a covered broker or dealer shall notify a claimant whether it allows or disallows the claim, or any portion of a claim or any claim of a security, preference, set-off, or priority, within the 180-day period set forth in 12 U.S.C. 5390(a)(3)(A) and any regulations promulgated thereunder (as such 180-day period may be extended by written agreement as provided therein) or within the 90-day period set forth in 12 U.S.C. 5390(a)(5)(B) and any regulations promulgated thereunder, whichever is applicable. In accordance with paragraph (a) of this section, the Corporation, as receiver, shall issue the notice required by this paragraph (c), which shall utilize the determination made by SIPC, as trustee, in a manner consistent with SIPC's customary practices in a liquidation under SIPA, with respect to any claim for net equity or customer name securities. The process established herein for the determination, within the 180-day period set forth in 12 U.S.C. 5390(a)(3)(A) and any regulations promulgated thereunder (as such 180-day period may be extended by written agreement as provided therein), of claims by customers of a covered broker or dealer for customer property or customer name securities shall constitute the exclusive process for the determination of such claims, and any procedure for expedited relief established pursuant to 12 U.S.C. 5390(a)(5) and any regulations promulgated thereunder shall be inapplicable to such claims.

(d) *Judicial review.* The claimant may seek a judicial determination of any claim disallowed, in whole or in part, by the Corporation as receiver, including any claim disallowed based upon any determination(s) of SIPC as trustee made pursuant to § 380.64(a), by the appropriate district or territorial court of the United States in accordance with 12 U.S.C. 5390(a)(4) or (5), whichever is applicable, and any regulations promulgated thereunder.

§ 380.65 Priorities for unsecured claims against a covered broker or dealer.

Allowed claims not satisfied pursuant to § 380.63(d), including allowed claims for net equity to the extent not satisfied after final allocation of customer property in accordance with § 380.64(a)(3), shall be paid in accordance with the order of priority set forth in § 380.21 subject to the following adjustments:

(a) Administrative expenses of SIPC incurred in performing its responsibilities as trustee for a covered broker or dealer shall be included as administrative expenses of the receiver as defined in § 380.22 and shall be paid *pro rata* with such expenses in accordance with § 380.21(c).

(b) Amounts paid by the Corporation to customers or SIPC shall be included as amounts owed to the United States as defined in § 380.23 and shall be paid *pro rata* with such amounts in accordance with § 380.21(c).

(c) Amounts advanced by SIPC for the purpose of satisfying customer claims for net equity shall

be paid following the payment of all amounts owed to the United States pursuant to § 380.21(a)(3) but prior to the payment of any other class or priority of claims described in § 380.21(a)(4) through (11).

§ 380.66 Administrative expenses of SIPC.

(a) In carrying out its responsibilities, SIPC, as trustee for a covered broker or dealer, may utilize the services of third parties, including private attorneys, accountants, consultants, advisors, outside experts, and other third party professionals. SIPC shall have an allowed claim for administrative expenses for any amounts paid by SIPC for such services to the extent that such services are available in the private sector, and utilization of such services is practicable, efficient, and cost effective. The term *administrative expenses of SIPC* includes the costs and expenses of such attorneys, accountants, consultants, advisors, outside experts, and other third party professionals, and other expenses that would be allowable to a third party trustee under 15 U.S.C. 78eee(b)(5)(A), including the costs and expenses of SIPC employees that would be allowable pursuant to 15 U.S.C. 78fff(e).

(b) The term *administrative expenses of SIPC* shall not include advances from SIPC to satisfy customer claims for net equity.

§ 380.67 Qualified Financial Contracts.

The rights and obligations of any party to a qualified financial contract to which a covered broker or dealer is a party shall be governed exclusively by 12 U.S.C. 5390, including the limitations and restrictions contained in 12 U.S.C. 5390(c)(10)(B), and any regulations promulgated thereunder.

[“THIS SIGNATURE PAGE RELATES TO THE ISSUANCE OF THE JOINT NOTICE OF PROPOSED RULEMAKING TITLED “COVERED BROKER-DEALER PROVISIONS UNDER TITLE II OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT”]

Dated this 17th day of February, 2016

By order of the Board of Directors

Federal Deposit Insurance Corporation

Robert E. Feldman,

Executive Secretary

[SEAL]

Billing Code 6714-01-P

Securities and Exchange Commission

17 CFR Part 302

Authority and Issuance

For the reasons stated in the proposing release, the Securities and Exchange Commission proposes to amend 17 CFR 302 as follows:

Add Part 302 as follows:

PART 302-ORDERLY LIQUIDATION OF COVERED BROKERS OR DEALERS

1. The authority citation for part 302 should refer to 12 U.S.C. 5385(h).
2. Sections 302.100 through 302.107 are added to read as follows: