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January 18, 2011

Via electronic submission to *www.fdic.gov/regulations/laws/federal*

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Re: Comment on Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and UConsumer Protection Act (“Dodd-Frank”)

Dear Mr. Feldman:

We appreciate the opportunity, on behalf of a number of U.S. and non-U.S. financial institutions, to comment on the second set of questions in the FDIC’s notice of proposed rulemaking relating to Title II of Dodd-Frank (“NPR”).[1] The ability to effectively address the insolvency of a systemically important financial institution is critical to reducing systemic risk in financial markets. The Orderly Liquidation Authority (“OLA”) provisions of Title II offer significant promise of an insolvency regime capable of safely liquidating the world’s largest financial companies without putting taxpayer funds or the economy at risk. But whether OLA actually reduces or creates systemic risk depends largely on the rules promulgated thereunder and the way the FDIC exercises the powers granted to it. This letter identifies some of the key issues that need to be addressed in future rulemaking in order for OLA to fulfill its promise as a powerful tool for reducing systemic risk.

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[1] 75 Fed. Reg. 64173 (Oct. 19, 2010).

This letter supplements our November 16, 2010 letter in which we responded to the first set of questions presented in the NPR. (We have attached a copy of that letter for your convenience.) This firm has also participated in the preparation of the comment letters submitted by The Clearing House Association and the Securities Industry and Financial Markets Association, both of which we endorse in full. We do not generally repeat the points made in those letters; instead, we wish to make a number of points that are not addressed in those letters and to emphasize others that are raised in those letters.

I. Addressing the Cross-Border Aspects of Resolution

Any financial company that enters orderly liquidation under OLA is almost certain to have significant cross-border operations. However, OLA provides regulators with few tools aimed at addressing the crucial but complex issues that arise in resolving a large, multinational family of financial companies. While the FDIC is required to "coordinate, to the maximum extent possible," with appropriate foreign regulators during the resolution of a covered financial company with overseas "assets or operations", the FDIC is not granted the authority to formally recognize the powers or actions of other regulators with jurisdiction over assets or affiliates of the covered financial company. The FDIC cites in the NPR the foreign recognition of the FDIC's authority under OLA to resolve a covered financial company with overseas assets and operations as a key element of coordinating the cross-border resolution of a systemically important financial intuition.[2] This view, however, presumes that the covered financial company at issue is headquartered in the U.S. and that the FDIC is coordinating global resolution efforts. But the FDIC must also stand ready to exercise authority under OLA to assist foreign regulators coordinating the resolution of a systemically important financial institution headquartered overseas.

We encourage the FDIC to exercise its existing authority to address these issues, to the extent possible. Where such authority is lacking, we ask the FDIC to advocate for measures that would enable it to work in closer cooperation with foreign regulators to resolve cross-border financial companies, regardless of where such companies may be headquartered. Possible approaches could include:

- Eliminating state and federal "ring fence" laws;[3]

- Providing for recognition under chapter 15 of the Bankruptcy Code of foreign proceedings in respect of non-U.S. banks, particularly with respect to (1) banks that do not maintain branches in the United States and (2) banks with U.S. branches that are subject to insolvency proceedings in their home country, but in

[2] 75 Fed. Reg. 64173, 64177.

[3] *E.g.*, International Banking Act of 1978, 12 U.S.C. § 3102(j); New York Banking Law § 606 (in each case providing for separate estates for federal and New York branches, respectively, of non-U.S. banks, the proceeds of which are used first to satisfy claims of creditors of the branch before ultimately being returned to the home office of the non-U.S. bank).

respect of which federal and state regulators have declined to exercise authority under applicable "ring fence" laws to liquidate such branches; and

- Providing U.S. regulators the authority to recognize the actions of foreign regulators to resolve systemically important financial institutions, including a foreign regulator's "bail-in" or other recapitalization of such a company or exercise of authority under insolvency regimes similar to OLA.[4]

Coordination between the FDIC and non-U.S. regulators is a difficult and complicated issue, but a vital one. We encourage the FDIC to prioritize these efforts and to continue to champion cooperation among home-country regulators.

II. Determining (and Challenging) the Minimum Recovery Amount

Section 210(a)(7)(B) of Dodd-Frank requires that all creditors receive under OLA at least what they would have received had the covered financial company been liquidated under chapter 7 of the Bankruptcy Code. This "minimum recovery" provision is the primary means by which creditors are assured of fair treatment under OLA notwithstanding the FDIC's significant statutory authority to affect the rights of creditors. Assuring markets that creditors would be no worse off in a liquidation under OLA is a critical step towards making orderly liquidation a credible option for resolving a failing financial company and ensuring that OLA is effective in reducing systemic risk. Without such assurance, creditors will pull short-term funding from and refuse to trade with a systemically important financial institution at the first sign of trouble due to the specter of harsh treatment under OLA.

Despite the importance of this provision, no means were provided for determining creditors' minimum recoveries or for contesting the FDIC's determination thereof. We urge the FDIC to provide comprehensive rulemaking addressing the determination of minimum recovery amounts and providing a means by which creditors can challenge the FDIC's determination thereof. Such rules should confirm that the minimum recovery provision, at a minimum, assures parity with the Bankruptcy Code and supersedes any other provisions of OLA that may conflict with the Bankruptcy Code's minimum treatment of creditors.[5]

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[4] *See generally* THE GROUP OF TWENTY FINANCE MINISTERS AND CENTRAL BANK GOVERNORS, The G20 Seoul Summit Leaders' Declaration, November 11–12, 2010; BASEL COMMITTEE ON BANKING SUPERVISION, BANK FOR INTERNATIONAL SETTLEMENTS, Report and Recommendations of the Cross-border Bank Resolution Group, March 2010; FINANCIAL STABILITY BOARD, FSF Principles for Cross-border Cooperation on Crisis Management, April 2, 2009.

[5] Consider the example of a creditor who owes $25 to the debtor under one obligation and is owed $100 by the debtor under another. Under the Bankruptcy Code, such a creditor would be entitled to set off the full amount of its $25 obligation to the debtor against the $100 owed to it by the debtor, resulting in a net general unsecured claim of $75 against the debtor. Under OLA, the FDIC might be entitled, under certain circumstances, to transfer the $25 obligation to a third party, free of the creditor's rights of setoff. Such a transfer would result in the creditor having a $100 general unsecured claim against the debtor and a priority claim for the value of the lost setoff rights (in most cases $25). The minimum recovery rules should provide that such a creditor's combined recovery under these two claims would at least equal its $25 recovery through the exercise of setoff rights combined with its recovery in

We note that determining the chapter 7 liquidation value of any company, let alone one of the world's largest, most complex financial companies, is extremely subjective. Valuations vary greatly depending on the methodologies used and the assumptions made regarding timing, discounting, the manner of liquidation and any number of other factors. It is not a case of picking the "correct" methodology and making the "right" assumptions; rather, one must choose among many "correct" methodologies and countless "right" assumptions when performing such calculations, with each decision resulting in materially different valuations.

Because determining the minimum recovery value is so subjective and may play such a significant role in determining creditors' recoveries under OLA, any valuation made by the FDIC is certain to be challenged. Relying on *de novo* review of claims to challenge the FDIC's determination would tie up the FDIC in court for years as creditors individually challenge their recovery. The individual nature of *de novo* review also raises the possibility of inconsistent results, with different courts reaching different conclusions with respect to similarly situated creditors (e.g., different holders of the same series of bonds recovering different amounts in respect of such bonds). Further, because *de novo* review occurs only after final distributions are made, a decision that a creditor was due more than it received would likely require the FDIC to draw on the Orderly Liquidation Fund or borrow from Treasury to satisfy its obligations, which in turn could result in clawbacks from other creditors or assessments on industry.

Accordingly, we strongly urge that the FDIC's rulemaking provide for expedited, collective proceedings in which all affected creditors can participate to challenge the FDIC's determination of minimum recovery values. Ideally, such a process would conclude prior to the final distribution on claims. Such rules should not impede the exercise of the FDIC's authority to transfer assets and liabilities to a third party or bridge financial company; rather, such rules should address how the FDIC determines the amount of final distributions.

III. The Enforceability of Cross-Defaults

The power to enforce contracts of subsidiaries and affiliates of the covered financial company under section 210(c)(16) of Dodd-Frank may be critical to the FDIC's ability to address effectively the failure of large families of financial companies. Absent such power, counterparties to contracts of affiliates guaranteed by the covered financial company could exercise contractual rights to terminate their agreements based on the insolvency of the covered financial company. As a result, otherwise viable affiliates of the covered financial company could become insolvent, leading to a widening collapse of the entire family of companies. In order to prevent the uncontrolled collapse of a systemically important family of financial institutions, section 210(c)(16) recognizes the need of the FDIC to be able to prevent such a cascading failure of companies based on a parent or significant affiliate being placed into orderly liquidation under OLA. However, the power to enforce such contracts is premised on the guaranty of the covered financial company being transferred to a bridge financial company or a third party or "adequate protection" otherwise being provided.

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respect of its $75 claim under the Bankruptcy Code. To the extent that the FDIC's actions with respect to the covered financial company are value-enhancing, this may not be a concern.

The exercise of power under section 210(c)(16) of Dodd-Frank raises very complex issues that can significantly affect the rights of creditors. Accordingly, we urge the FDIC to provide comprehensive rules regarding the exercise of this power.

Although there is no parallel under the Bankruptcy Code to section 210(c)(16) of Dodd-Frank, we note that this provision incorporates the concept of "adequate protection" from the Bankruptcy Code. In its rulemaking, the FDIC should address what constitutes "adequate protection" in cases where the guaranty of the covered financial company is not transferred and who determines the adequacy of the protection provided. Such rules should also address how the concept of "adequate protection" applies to obligations "linked to" the covered financial company. We urge the FDIC to address these issues in a way that is consistent with the "adequate protection" provisions of section 210(h)(16)(C) of Dodd-Frank and sections 362(d)(1) and 363(e) of the Bankruptcy Code.

The provisions of section 210(c)(16) of Dodd-Frank also incorporate the principle of creditors being "no worse off" because of the receiver's exercise of power found in the qualified financial contract ("QFC") provisions of the Federal Deposit Insurance Act ("FDIA") and OLA.[6] Under those provisions, the exercise of the FDIC's power to override contractual termination rights is specifically limited to ensure that each creditor is "no worse off" (e.g., the FDIC must transfer all or no QFCs, all transferred QFCs must be transferred to the same party, the transferee must be solvent, etc.), limitations that are not specifically set forth in section 210(c)(16) of Dodd-Frank. In its rulemaking, we urge the FDIC to take an approach that is consistent with these goals and ensures that that creditors of affiliates of the covered financial company are not made worse off because of the FDIC's exercise of authority under section 210(c)(16) of Dodd-Frank. As an example, the rules should provide that, with respect to an affiliate and a particular creditor, rights of setoff in respect of the affiliate will not be impaired. In practice, this would mean exercising authority with respect to all guaranteed obligations or none of them and, if transferring guaranties, transferring all such guaranties to the same party.[7] More generally, the FDIC should clarify what criteria it would use to determine the affiliates in respect of which it would exercise authority under section 210(c)(16) of Dodd-Frank.

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[6] 12 U.S.C. § 1821(e); § 210(c) of Dodd-Frank.

[7] Consider the example of a covered financial company ("CFC") and its subsidiary, SubCo. SubCo has entered into two separately documented QFCs with Creditor. One QFC is in the money $100 to Creditor and the other is in the money $75 to SubCo. Both QFCs are guaranteed by CFC. Ordinarily, Creditor could terminate both transactions based on the insolvency of CFC, the guarantor, and set off the amounts owing under the QFCs, with a result that SubCo would owe Creditor $25.

In our example, though, if the FDIC were able to exercise authority under section 210(c)(16) of Dodd-Frank to transfer the guaranty of the QFC that is in the money $100 to Creditor but not the guaranty of the QFC that is in the money $75 to SubCo, Creditor might only be able to terminate the QFC under which it owes $75 to SubCo; if it does so, Creditor might not be able to set off against the $100 it is owed under the other QFC. If Creditor chooses not to terminate the QFC under which it owes $75 to SubCo, it faces SubCo without the benefit of a guaranty in the event the QFC moves into Creditor's favor. The FDIC should make clear that in this case, among others, Creditor has not received adequate protection.

IV. The Rights of Creditors upon a Default by the FDIC

We ask the FDIC to provide rules clarifying the rights of non-QFC creditors (including secured creditors) upon a default by the FDIC during the 90-day automatic stay under section 210(c)(13)(C) of Dodd-Frank. We believe that obligations under contracts enforced by the FDIC upon which the FDIC defaults should be afforded administrative expense claim status under section 210(b)(1) of Dodd-Frank. In respect of contracts that have been neither enforced nor repudiated, we believe such rules should permit creditors to exercise contractual remedies immediately upon the FDIC's default unless they have been provided adequate assurance of future performance.[8]

V. Treatment of a Bridge Financial Company as a Covered Financial Company

The Clearing House Association, SIFMA and others have called for more clarity regarding the ways in which bridge financial companies can be used during an orderly liquidation and how they will be operated, calls which we echo. In particular, we ask the FDIC to clarify how it will exercise authority under section 210(h)(4) of Dodd-Frank, which permits the FDIC to treat a bridge financial company as a "covered financial company in default at such times and for such purposes" as the FDIC determines appropriate.[9] To the extent this allows the bridge financial company to be placed into receivership, then the receivership rules would apply fully. However, exercising such authority prior to the appointment of a receiver could also have significant consequences, potentially allowing the FDIC to exercise in respect of creditors of the bridge financial company any of its powers as receiver under OLA and the rules promulgated thereunder. Such treatment would affect not only those creditors of the covered financial company that were transferred to the bridge financial company but also creditors that have extended new financing to support the operation of the bridge financial company. We therefore ask the FDIC to clarify by rule whether it may exercise powers under section 210 of Dodd-Frank in circumstances where the bridge financial company is not being placed into orderly liquidation under OLA. If so, we ask that such rules address the exercise of such powers in a comprehensive manner, specifying when a bridge financial company may be treated as a covered financial company, which powers the FDIC can exercise in respect of which creditors, the rights of any affected creditors and the priority afforded any resulting claims.

VI. Treatment of Creditors of Bridge Financial Companies

The FDIC should clarify by rule the priority afforded obligations incurred by a bridge financial company under section 210(h)(16). In order to encourage the private sector to finance the operation of a bridge financial company and decrease the reliance on taxpayer funds to finance the resolution of a covered financial company, we recommend that such obligations be

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[8] *Cf.* § 365(b)(1)(C) of the Bankruptcy Code, requiring a bankruptcy trustee to provide "adequate assurance of future performance" before assuming a contract under which a default has occurred.

[9] We note that 12 U.S.C. § 1821(j)(2)(C) provides the FDIC similar authority under the FDIA; rulemaking along the lines proposed above may also be appropriate thereunder.

afforded priority as "administrative expenses" under section 210(b)(1) of Dodd-Frank.[10] Further, we ask the FDIC to clarify that the "administrative expense" priority afforded under section 210(c)(13)(D) of Dodd-Frank applies in cases where the FDIC has transferred to a bridge financial company and subsequently drawn upon a contract to extend credit.

We also ask the FDIC to clarify by rule under what circumstances it would exercise its statutory authority to enforce contracts to extend credit to the covered financial company under section 210(c)(13)(D) of Dodd-Frank, whether or not such contracts have been transferred to a bridge financial company. We note that, under the minimum recovery provisions of OLA, such creditors should be entitled to full repayment of any such obligations incurred, as such creditors would not be required to extend credit under the Bankruptcy Code.[11] The lack of such clarity could impede the development of markets providing standby liquidity to systemically important financial institutions through committed liquidity facilities and related structures, making it more difficult for such institutions to meet the heightened liquidity requirements provided under Title I of Dodd-Frank.

VII. Clarify the Definition of Forward Contract

To avoid confusion and address conflicting case law, the definition of "forward contract" under the Bankruptcy Code was amended to clarify that the parenthetical reference to "commodity contract" was a reference to the statutory definition of "commodity contract" in section 761 of the Bankruptcy Code.[12] Like the definition under the FDIA, the OLA definition of "forward contract" does not specify that the parenthetical reference to "commodity contract" is a reference to the statutory definition thereof. We assume that, in light of the statutory mandate for parity with the Bankruptcy Code, the FDIC and courts would interpret "commodity contract" in a manner consistent with the statutory definition provided in OLA. However, for the avoidance of doubt, we ask the FDIC to clarify by rule that the reference to "commodity contract" in the definition of "forward contract" is a reference to section 210(c)(8)(D)(iii) of Dodd-Frank. Similar rulemaking under the FDIA would also be appropriate.

VIII. Avoiding Transfers; "Defenses" against Avoidance

Many of the Bankruptcy Code powers to avoid transactions were imported into OLA. However, OLA does not specify the manner in which the FDIC may exercise these powers. Under the Bankruptcy Code, avoidance powers are exercised through adversarial proceedings in Federal courts. We ask the FDIC to provide comprehensive rules addressing how it may exercise its avoidance powers under section 201(a)(11) of Dodd-Frank and how putative

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[10] We also encourage the FDIC to clarify the relative priority of creditors who have extended new credit to the bridge financial company and creditors of the failed financial company whose obligations had been transferred to the bridge financial company.

[11] § 365(c)(2) of the Bankruptcy Code.

[12] § 101(25) of the Bankruptcy Code.

transferees or obligees may challenge the FDIC's attempted avoidance prior to the *de novo* review of claims provided under section 210(a)(4) of Dodd-Frank.

We also note that most of the Bankruptcy Code limitations on the exercise of avoidance powers are absent from OLA. Rather, section 210(a)(11)(F) of Dodd-Frank provides that a transferee or obligee from whom the FDIC seeks to avoid a transfer or obligation has the "same defenses" as it would under the Bankruptcy Code.[13] We ask that the FDIC clarify by rule that a putative transferee or obligee may challenge the FDIC's exercise of avoidance powers based on <u>any</u> grounds that could be raised in challenging a similar avoidance action brought under the Bankruptcy Code, including that the FDIC did not have a basis to avoid a transfer or obligation or failed to comply with a condition required to avoid a transfer or obligation, and not just those grounds in the nature of an affirmative defense.

IX. Securitizations

We urge the FDIC to promulgate rules recognizing state law and Bankruptcy Code case law concepts of "true sale" and corporate separateness in the context of securitizations.[14] While the FDIC has recently promulgated rules under the FDIA addressing these issues, we note that the treatment of securitizations under those rules differs significantly from their treatment under the Bankruptcy Code.[15] Accordingly, we urge the FDIC to adopt rules regarding the treatment of securitizations under OLA that are consistent with Bankruptcy Code treatment of securitizations.

X. Fair Treatment of Non-U.S. Creditors

We urge the FDIC to adopt a rule that it will not exercise powers under OLA in a way that discriminates against non-U.S. creditors, especially when exercising its authority to treat similarly situated creditors differently. The perception that the FDIC would favor U.S creditors to the detriment of non-U.S. creditors in an orderly liquidation of a covered financial company would only encourage other jurisdictions to implement ring fences or other measures

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[13] Section 210(a)(11)(F) provides:

> (F) DEFENSES—Subject to the other provisions of this title—
>
> (i) a transferee or obligee from which the Corporation seeks to recover a transfer or to avoid an obligation under subparagraph (A), (B), (C), or (D) shall have the same defenses available to a transferee or obligee from which a trustee seeks to recover a transfer or avoid an obligation under sections 547, 548, and 549 of the Bankruptcy Code; and
>
> (ii) the authority of the Corporation to recover a transfer or avoid an obligation shall be subject to subsections (b) and (c) of section 546, section 547(c), and section 548(c) of the Bankruptcy Code.

[14] The FDIC's letter of January 14, 2011 to the American Securitization Forum is helpful in this regard, and we look forward to participating in the rulemaking process referred to therein.

[15] 12 C.F.R. Part 360.6.

designed to protect local creditors. A rule providing for the fair treatment of non-U.S. creditors would support the FDIC's efforts to promote cooperation and seek the formal recognition in foreign jurisdictions of its actions under OLA. Further, such a rule would be consistent with the treatment of non-U.S. creditors under the Bankruptcy Code, which treats U.S. and non-U.S. creditors equally.

XI. The Treatment of Broker-Dealers

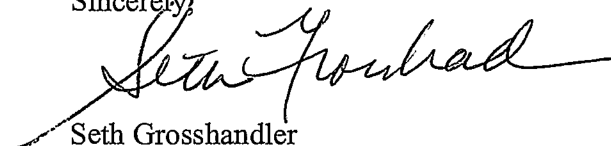
OLA provides for the liquidation of a covered broker-dealer in proceedings governed by both OLA and the Securities Investor Protection Act ("SIPA"), administered by both the FDIC and the Securities Investor Protection Corporation. However, OLA fails to address many of the details of the interplay between the two regimes and agencies. When conducting the joint rulemaking with the SEC required under section 205(h) of Dodd-Frank, we urge the FDIC to ensure that the resulting rules clarify how notice will be provided to customers and potentially affected creditors, how protection of customer property will be ensured, how the FDIC will determine whether to retain customer accounts in the covered broker-dealer or transfer them to a bridge financial company and how any of these processes will be different from current procedures under SIPA. Such rulemaking will be necessary to promote investor confidence in broker-dealers potentially subject to OLA.

XII. The Treatment of Clearing Organizations and FCMs

Similarly, the treatment of clearing organizations and futures commission merchants ("FCMs") should be clarified by rule. While section 210(m) of Dodd-Frank makes the relevant subchapters of chapter 7 of the Bankruptcy Code applicable to the liquidation under OLA of each such entity, the interplay between these Bankruptcy Code provisions and OLA is not entirely clear. The FDIC's rules should provide that the rules promulgated under the applicable Bankruptcy Code provisions will apply in an orderly liquidation under OLA, particularly the 17 C.F.R. Part 190 rules applicable to FCMs. The Dodd-Frank provisions requiring the clearing of certain derivatives only heightens the need for rules regarding these issues.

We appreciate this opportunity to comment on the FDIC's proposed rulemaking. If you have any questions, please do not hesitate to contact me at (212) 225-2542, John C. Murphy, Jr. at (202) 974-1580 or Knox L. McIlwain at (212) 225-2245.

Sincerely,



Seth Grosshandler

Attachment

cc: John C. Murphy, Esq.
Knox L. McIlwain, Esq.

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November 16, 2010

Via electronic submission to *www.fdic.gov/regulations/laws/federal*.

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Re: Comment on Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")

Dear Mr. Feldman:

We appreciate the opportunity, on behalf of a number of U.S. and non-U.S. financial institutions, to comment on the notice of proposed rulemaking relating to Title II of Dodd-Frank.[1] We applaud the FDIC's efforts to provide clarity regarding Orderly Liquidation Authority ("OLA") and promote its harmonization with the Bankruptcy Code. This letter addresses certain areas where the FDIC's proposed rules, in our view, do not provide the desired clarity or could result in the treatment of creditors that diverges from the treatment under the Bankruptcy Code. We believe that the issues identified below could have serious adverse market

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[1] 75 Fed. Reg. 64173 (Oct. 19, 2010).

consequences and have, in certain instances, proposed alternative language below which we believe addresses these issues.

The Valuation of Collateral

The issues surrounding the valuation of collateral are extremely complex, implicating numerous provisions of OLA. These issues are of great significance to both qualified financial contract ("QFC") creditors and non-QFC creditors and could limit the availability of secured financing for both healthy and weak financial companies. Due to the complexity of the issues and their significance to the market, we recommend that the FDIC strike proposed rule § 380.2(c). Instead, we urge the FDIC to address the treatment of secured creditors "holistically" and not merely the bifurcation of claims into secured and unsecured. If the FDIC considers it necessary to address when it may or may not make additional payments to undersecured creditors in this rulemaking, we suggest that it make clear that proposed rule § 380.2(c) is for that purpose only.

Collateral valuations under OLA affect secured creditors in several ways. First, they affect the amount of a secured creditor's residual unsecured claim or, alternatively, the receiver's claim to excess. In this case the receiver will always want collateral to have a higher valuation.[2] For example, with respect to a $100 claim and collateral valued at either $80 or $90, the receiver will prefer the $90 valuation so as to reduce the creditor's residual claim against the assets of the covered financial company.

Second, collateral valuations affect the amount that may be clawed back from a secured creditor under section 210(o)(1)(D)(i) of Dodd-Frank if secured obligations are transferred (and a payment is made to the transferee) and the collateral is valued at less than the claim. In this case, the receiver will want collateral to have a lower valuation. In the hypothetical above, the receiver will prefer the $80 collateral valuation so as to increase the "additional payment" made to the creditor that may be clawed back.

Third, the timing of the collateral valuation relative to the disposition of the collateral can greatly affect the parties' rights. For example, if collateral is valued as of the date the receiver is appointed, but the creditor receives its value at some later date when the collateral's value has changed, either the creditor or receiver would be benefitted by such valuation, to the detriment of the other. Which party is benefited and which is harmed depends on whether the collateral has increased or decreased in value in the interim, and whether the issue is a creditor's residual claim, the receiver's right to excess or a clawback assessment. For non-QFC creditors, these timing issues are intertwined with the operation of the stays on collateral foreclosure under sections 210(c)(13)(C) and 210(q)(1)(B) of Dodd-Frank, which are not addressed in the proposed rule.[3]

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[2] For the creditor, a lower valuation would be preferred if the creditor can retain the collateral, while a higher valuation would be preferred if the creditor is selling the collateral to a third party.

[3] Under section 210(q) of Dodd-Frank, the FDIC's consent is required before exercising remedies in respect of collateral. Under the mirror provision of the Federal Deposit Insurance Act, on which section 210(q) was modeled,

Due to the complexity of these issues, we recommend that the FDIC delay this part of the rulemaking so that it can implement rules addressing all aspects of the issues implicated. At the very least, if the FDIC does implement rules regarding the treatment of secured creditors, we recommend that the FDIC make clear that further rulemaking will address any remaining issues. Further, any rule needs to be consistent with the statutory mandate that creditors (including secured creditors) receive at least what they would have received in a liquidation under the Bankruptcy Code.

We note the following issues that should be addressed in any final rule addressing the treatment of secured creditors:

- Clarify the time at which collateral is valued, and the effect of sections 210(c)(13)(C) and 210(q)(1)(B) of Dodd-Frank on such timing.

- Clarify who makes the initial collateral valuation, how such valuation should be made and how the valuation may be challenged. The inclusion of these details in the final rule will make OLA's implementation more predictable and help creditors plan accordingly.

- Clarify when any rules relating to collateral valuation apply. For instance, rules regarding the valuation of collateral for purposes of determining claims should not apply to the valuation of collateral held with respect to secured obligations transferred to a bridge financial company (except with respect to clawback rights). In the case of the proposed rules, we recommend that the FDIC clarify that it will not treat a bridge financial company to which secured obligations have been transferred as a covered financial company under section 210(h)(4) of Dodd-Frank for purpose of proposed rule § 380.2(c), and will instead abide by the contractual collateral valuation provisions of such transferred obligation.

If the FDIC chooses to move forward with the proposed rule § 380.2(c), we strongly urge that the second sentence be struck. As drafted, this sentence would produce unintended and arbitrary results and create a significant disincentive for taking U.S. Treasury and agency collateral, contrary to the FDIC's apparent goal.[4] Valuing U.S. Treasuries differently than the market does will produce either a windfall for or unfair punishment of creditors, depending on whether the market value of U.S. Treasuries is above or below par at the time a financial company enters receivership and whether the issue is a creditor's residual claim, the receiver's right to excess or a clawback assessment. Any such windfall would effectively "bail out" certain creditors, depleting assets of the covered financial company available to distribute to other creditors, and could be contrary to Dodd-Frank's statutory mandates. These effects would

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the FDIC issued a policy statement granting advance consent to the exercise of remedies. The FDIC should include similar advance consent as part of the final rules.

[4] We also note that the proposed rule, as drafted, provides that the claim secured by the collateral will be valued at par. The provision as drafted would value a $100 claim secured by $1 in U.S. Treasuries at $100. Presumably this was not the FDIC's intent.

be entirely arbitrary and would therefore discourage creditors from taking U.S. Treasuries and agencies as collateral.

There are many ways that the FDIC could encourage taking high-quality, liquid collateral besides the proposed rule. For example, the FDIC could create a safe harbor protecting the disposition of U.S. Treasury collateral from challenge as being commercially unreasonable. This could be coupled with a statement in the implementing release that the FDIC reserves the right to challenge the disposition of other collateral on the grounds that it was commercially unreasonable under applicable state law. Unlike the proposed rule, such a safe harbor would encourage the use of high-quality, liquid collateral, but would do so in a way that does not punish creditors for providing financing secured by less liquid collateral.

The Treatment and Definition of Contingent Claims

The proposed rule is an important and helpful step toward promoting parity with treatment under the Bankruptcy Code. However, there are certain technical points that we would like to bring to your attention.

- Final rule § 380.4 should provide that a "claim based on a contingent obligation of the financial company shall be provable against the receiver", rather than "may be provable". This will eliminate any ambiguity with respect to whether such claims are provable.

- Whether a claim is contingent for purposes of rule § 380.4 should not be determined with respect to the time at which the receiver has been appointed. Under section 502(c) of the Bankruptcy Code, the fixing of a contingent claim (i.e., the occurrence of the contingency) is recognized for purpose of determining the claim amount so long as doing so would not "unduly delay the administration" of the bankruptcy proceeding.[5] In light of the statutory mandate that creditors receive no less than they would have in a liquidation under the Bankruptcy Code, the FDIC should take a similar approach with respect to contingent claims that become fixed after the appointment of the receiver.[6] Accordingly, we believe that proposed rule § 380.4(a) should be revised as follows

  > (a) This section ~~only~~ applies only to contingent obligations of the covered financial company consisting of ~~a~~ guarantee, letter of credit, loan commitment, or similar credit ~~obligation~~ obligations that ~~becomes~~ become due and

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[5] 11 U.S.C. § 502(c)(1).

[6] For example, if the covered financial company had issued a letter of credit that became drawable (for reasons unrelated to the covered financial company, its affiliates or their financial condition) after the appointment of the receiver, the claim should not be treated as contingent but as fixed and provable in full, so long as claims were still being processed by the receiver.

payable upon the occurrence of a specified future event (other than the mere passage of time), which:

> (1) is not under the control of either the covered financial company or the party to whom the obligation is owed; and
>
> (2) has not occurred ~~as of the date of the appointment of the receiver~~ prior to final distributions on claims generally.[7]

- Rule § 380.4 (rather than just the preamble) should address claims that are not "contingent". We applaud the FDIC's statement in the preamble that it holds the view that a guarantee or letter of credit is no longer contingent if the principal obligor thereunder becomes insolvent.

  This view is consistent with the Bankruptcy Code treatment of such claims and we urge the FDIC to include it in the final rule. To further harmonize such a rule with the analogous treatment of creditors under the Bankruptcy Code, we suggest that it address all situations in which a guarantee, letter of credit, loan commitment or similar obligation becomes drawable and provide that resulting claims may be proven for the drawable amount.

  We also recommend that the rule address claims under guarantees arising out of "cross default" provisions in transactions with affiliates. The insolvency of a guarantor that results in an acceleration of the underlying obligation would normally (as a contractual matter) make the guarantee drawable and thus the claim thereunder no longer "contingent". However, section 210(c)(16) of Dodd-Frank permits the receiver to make unenforceable such "cross defaults" if it transfers the guarantee to a third party or otherwise provides "adequate protection".[8] Thus, the rule should provide that a claim under a guarantee of the covered financial company is no longer contingent (because it is drawable) if the receiver has neither exercised its authority to transfer such guarantee to a bridge financial company or third party nor provided "adequate protection". This approach would harmonize the contingent claims provisions and the "anti-cross default" provisions by providing the beneficiary of the guarantee with a non-contingent claim, a successor guarantor or adequate protection of its rights under the guarantee.

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[7] In effect, there will be a safe harbor of at least 90 days for contingent claims to become fixed, since final distributions on claims generally cannot be made prior to the statutorily provided 90-day minimum claims period.

[8] Rules will also be required to define what "adequate protection" means, clarifying what, other than transferring a guarantee to a bridge financial company or successor, would constitute "adequate protection" with respect to guarantees of subsidiary obligations that have been enforced under section 210(c)(16).

Accordingly, we propose the following as new rule § 380.4(d):

> (d) A claim in respect of an obligation of the covered financial company consisting of a guarantee, letter of credit, loan commitment, or similar obligation, including upon repudiation thereof, is not a contingent claim and shall be provable to the extent of the amount due and payable thereunder if:
>
> > (1) the obligation becomes due and payable prior to the final distribution on claims generally; and
> >
> > (2) the receiver has not exercised its authority to transfer or otherwise provided adequate protection in respect of such obligation pursuant to 12 U.S.C. § 5390(c)(16).

We suggest that the adopting release articulate that the rule is designed, in part, to address when claims under a covered financial company's guarantee of an affiliate's obligations (whether under QFCs or non-QFCs) become fixed and proveable in full, including on the insolvency of or other default by the affiliate.

If the FDIC chooses not to address the definition of claims that are <u>not</u> contingent claims, we recommend that it indicate in the preamble to any final rules that subsequent rulemakings will address this issue.

- In accordance with our recommendations above regarding when a claim is contingent or fixed, rule § 380.4(c) should be revised by striking the words "as of the date of the receiver's appointment". Doing so would allow the provisions of rule § 380.4(a) and proposed rule § 380.4(d) to define when a claim is contingent and thus should be estimated under § 380.4(c).

Treatment of Unsecured Creditors

We strongly urge that the FDIC not constrain its statutory authority to make payments or credit amounts to creditors pursuant to sections 210(b)(4), (d)(4) or (h)(5)(E) of Dodd-Frank. Under OLA, providing payments, crediting amounts and transferring liabilities to a bridge institution or a successor are the FDIC's principal tools for addressing systemic risk and calming markets. Given that the nature of future crises is unknowable, it is simply not prudent to limit the FDIC's ability to address systemic risk in the future based on the experience of this last crisis. Nor is it necessary in light of the FDIC's authority to claw back payments under section 210(o)(1)(D)(i) of Dodd-Frank.

Furthermore, making distinctions between long-term and short-term creditors raises very complicated issues. If made in advance, such distinctions could create unintended market consequences and unduly interfere with the FDIC's ability to exercise its powers in a manner that strikes the right balance among financial stability, value maximization, loss minimization, creditor fairness and market discipline.

However, if the FDIC does opt to limit its ability to make payments or credit amounts to creditors, we recommend the following be addressed in the final rule:

- The rule should provide that the FDIC would not exercise its powers in a way that discriminates against non-U.S. creditors. Alternatively, a clear statement to this effect should be included in the preamble. Such an approach would be consistent with the fair treatment of creditors mandated by OLA.

- The rule should prohibit payments or credits only in respect of regulatory capital instruments, which are, by definition, expected to absorb losses.

- The rule should clarify that a creditor's status under rule § 380.2(a) as a "holder of long-term senior debt" (or, in accordance with our suggestion above, a holder of regulatory capital) should only preclude payments or credits to the creditor in respect of such long-term debt (or regulatory capital instrument). For example, if a creditor holds both long-term and short-term bonds (or both regulatory capital instruments and non-regulatory capital instruments), the rule should only preclude payments or credits in respect of the long-term bonds (or the regulatory capital instruments). Accordingly, we propose the words "in such capacity" be inserted where appropriate in each of the clauses of the proposed rule § 380.2(b)(1)-(4).

- The rule should provide that equity or rights to equity (such as warrants) of a bridge financial company issued to creditors of the covered financial company should not be considered a "payment" for the purpose of this rule. Giving creditors equity or warrants in a bridge financial company is consistent with the mandate to maximize the value of assets of the failed financial company and could provide more parity with the Bankruptcy Code.

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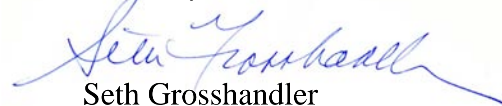
We appreciate this opportunity to comment on its notice of proposed rulemaking. If you have any questions, please do not hesitate to contact me at (212) 225-2542, John C. Murphy, Jr. at (202) 974-1580 or Knox L. McIlwain at (212) 225-2245.

Sincerely,



Seth Grosshandler

cc: John C. Murphy
Knox L. McIlwain