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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

[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]

[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

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

[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.

[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 not 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.

*   *   *

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

Seth Grosshandler

cc: John C. Murphy
Knox L. McIlwain