The Clearing House℠

January 11, 2011

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

Re: Further Comments on Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act – 12 CFR Part 380

Dear Mr. Feldman:

The Clearing House Association L.L.C. ("**The Clearing House**")[1] respectfully submits this additional comment letter in response to the Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**" or the "**Act**") published by the Federal Deposit Insurance Corporation (the "**FDIC**") in the *Federal Register* (the "**NPR**").[2]

As we discussed in our November 18, 2010, comment letter to you (our "**prior letter**"), we recognize the extensive effort reflected in the NPR, its detailed preamble and the questions provided, and we appreciate the FDIC's attention to providing predictability to parties dealing with companies that may be subject to the Dodd-Frank liquidation provisions ("**covered financial companies**").[3] We are supplementing our prior comments with these additional

[1] Established in 1853, The Clearing House is the nation's oldest banking association and payments company. It is owned by the world's largest commercial banks, which collectively employ 1.4 million people in the United States and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the U.S. *See* The Clearing House's web page at www.theclearinghouse.org.

[2] 75 Fed. Reg. 64173 (Oct. 19, 2010).

[3] In this letter we use the term "covered financial companies" to include both those companies that actually are subject to a Dodd-Frank liquidation proceeding and those that may be subject to such a proceeding in the event of their failure.

responses to the NPR.

For ease of reference, we have included the text of the questions below and provided our responses following each question. As we explained in our prior letter, all of our comments are based on the key concerns that, to the maximum extent possible, (1) creditors be treated no more severely under the Dodd-Frank liquidation authority than under pre-existing insolvency law, primarily the Bankruptcy Code,[4] (2) the regulations adopted by the FDIC under Title II reduce the risk that an institution will fail and, at a minimum, should not enhance the likelihood of failure, and (3) the regulations permit parties dealing with large financial companies to predict with confidence how their claims will be treated if their counterparty becomes subject to the Dodd-Frank liquidation authority. All of these criteria must be met if the liquidation authority is to meet its overall objective of preventing systemic risk and eliminating bail-outs.

Executive Summary

The Clearing House recognizes the crucial role that the Dodd-Frank liquidation authority would play in any future economic crisis. We firmly believe that the FDIC must have the ability to conduct a unified, coordinated, and comprehensive proceeding with respect to a financial institution as a whole if its failure would put the U.S. economy at risk. However, if the liquidation authority is to play this crucial role, it is essential that Title II of the Act, together with the FDIC's implementing regulations, provide a complete and coherent framework for the liquidation of the world's most complex financial institutions. It is equally essential that Title II not subject covered financial companies to new risks that increase the likelihood that the companies will fail. Furthermore, the liquidation framework must provide certainty to creditors dealing with covered financial companies to ensure functioning, efficient markets in which these companies play a vital part. At the same time, the new liquidation authority must maintain market discipline and avoid competitive inequities by preventing expectations of any bail-outs.

To further these goals, it is critical that the FDIC provide clear confirmation that it stands fully behind the statutory mandate that creditors and counterparties of a covered financial company fare no worse in a Dodd-Frank liquidation than they would in a Chapter 7 bankruptcy proceeding. When a covered financial company is on the verge of collapse, this "floor," combined with a well-defined process for filing and determining claims, will be the best defense against systemwide panic and contagion.

Furthermore, the regulations implementing Title II must be fully coordinated with the other terms and goals of the Act and the vast array of regulations that the various Federal regulatory agencies are adopting to govern the conduct of business under the Act, particularly the heightened regulatory regime for systemically significant financial institutions ("**SIFIs**"). The regulations must also take into account the developing law governing the liquidation of foreign

[4] Title 11 of the United States Code.

subsidiaries as well as those relating to broker-dealer and futures commission merchant ("**FCM**") subsidiaries. Clearly, this cannot all be achieved at once, as all of these developments will continue for several years. However, the regulatory scheme implementing the Act's liquidation authority must be designed to avoid conflict and ensure coordination, wherever possible, with the other goals of the Act and the other efforts under way to achieve them.

Title II[5] itself, and the FDIC's recent proposal, have raised deep uncertainty among market participants.[6] Some of this arises from the history of the implementation of the conservatorship and receivership systems under the Federal Deposit Insurance Act (the "**FDIA**"), which formed the basis for much of Title II. Under the FDIA, the FDIC has applied—or attempted to apply—novel interpretations of the FDIA in ways that have sometimes unsettled creditors of insured depository institutions ("**IDIs**").[7] Although the FDIC has generally sought to allay serious market concerns arising from these efforts,[8] market participants have been left with significant uncertainty as to their legal rights until the FDIC's response to the problem has

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[5] Title and section numbers refer to corresponding portions of the Act in the form in which it was enacted or as proposed in the NPR unless the context otherwise requires.

[6] *See, e.g.,* Harvey R. Miller and Maurice Horowitz*, One Way that Dodd-Frank's Liquidation Authority Could Achieve Parity with the Bankruptcy Code*, Harvard Business Law Review Online Volume 1 (2010); C. Boyden Gray, *Dodd-Frank, the Real Threat to the Constitution*, Washington Post, Dec. 31, 2010, at A17; Thecla Fabian, *FDIC Proposes Rule to Handle Creditors in Nonbank Liquidations Under Dodd-Frank*, 95 Banking Rep. 672 (Oct. 19, 2010); Jenna Greene, *FDIC's New Power to Dissolve Companies Raises Concerns*, The National Law Journal (Sep. 7, 2010); Michael A. Rosenthal, Testimony to the House Judiciary Comm. (Nov. 17, 2009); Peter J. Wallison, *What's Missing from the Financial Rules Bill? You Can't Ignore the Marketplace* (Apr. 20, 2010) (avail. at http://roomfordebate.blogs.nytimes.com/2010/04/20/whats-missing-in-the-financial-rules-bill/). *See also generally* the comment letters submitted by the American Bankers Association, Cleary Gottlieb Steen & Hamilton LLP, the Committee on Capital Markets Regulation, The Financial Services Roundtable, The Securities Industry and Financial Markets Association and the Managed Funds Association in response to the NPR, available on the FDIC's website at http://www.fdic.gov/regulations/laws/federal/2010/.

[7] *See, e.g., North Arkansas Medical Center v. Barrett,* 962 F.2d 780 (8th Cir. 1992) (invalidating, at the behest of the FDIC, security interests granted by an IDI because of, among other things, failure to satisfy the "contemporaneousness" requirement of 12 U.S.C. § 1823(e), which had not previously been applied in this manner by the FDIC or the courts); *Sahni v. American Diversified Partners*, 83 F.3d 1054, 1057 (9th Cir. 1996), *Bender v. CenTrust Mortgage Corp.*, 833 F. Supp. 1540, 1543-44 (S.D. Fla. 1992), *Victor Hotel Corp. v. FCA Mortgage Corp.*, 928 F.2d 1077, 1081 (11th Cir. 1991) *Garret v. Coastal Fin. Management Co.*, 765 F. Supp. 351, 352 (S.D. Tex. 1990), rev'd on other grounds, 938 F.2d 591 (5th Cir. 1991) (all relating to the FDIC's efforts to extend its powers to permit it to invalidate transactions entered into by non-banking entities owned by IDIs); *Philadelphia Gear Corp. v. FDIC*, 427 U.S. 426 (1986) and *FDIC v. Liberty Nat. Bank & Trust Co.*, 806 F.2d 961 (10th Cir. 1986) (relating to FDIC efforts to avoid "contingent" claims); *FDIC v. Panelfab Puerto Rico, Inc*., 739 F.2d 26, 30 (1st Cir. 1984) (relating to FDIC's effort to overcome contractual provision permitting cancellation of the contract, by extending application of 12 U.S.C. § 1823(e)); *O'Melveny & Myers v. FDIC*, 512 U.S. 79 (1994) (overruling FDIC's attempt to rely on "Federal common law" to govern the tort liability of attorneys who provided services to a failed IDI).

[8] *See, e.g.,* Statement of Policy Regarding Treatment of Security Interests After Appointment of the Federal Deposit Insurance Corporation as Conservator or Receiver, 58 Fed. Reg. 16833 (Mar. 31, 1993) (avail. at www.fdic.gov/regulations/laws/rules/5000-3500.html); FDIC Statement of Policy on Qualified Financial Contracts (Dec. 12, 1989) (avail. at www.fdic.gov/regulations/laws/rules/5000-1100.html); Statement of Policy Regarding Treatment of Collateralized Letters of Credit After the Appointment of the Federal Deposit Insurance Corporation as Conservator or Receiver (May 18, 1995) (avail. at www.fdic.gov/regulations/laws/rules/5000-3900.html).

been made clear.[9] In the context of the failure of a covered financial company—which, by definition, would occur during a period of extraordinary market turmoil—market participants may be forced to protect themselves from such uncertainty by acting in a manner that runs counter to the survival of the troubled financial company or, still worse, that threatens the financial system as a whole. Through the rulemaking process, the FDIC can and should prevent this type of uncertainty and thereby enhance economic stability.

In addition, it is not clear how some of the powers that operate smoothly under the FDIA will be applied under Title II. For example, as complex as the operation of a bridge bank for a single banking entity may be, the establishment of a bridge entity (a "**bridge**") for a family of disparate financial companies within a holding company will raise operational and legal questions that are even more challenging. Given the anticipated central role of bridges in the Title II liquidation process, and the new challenges that they will pose in this context, advance guidance as to how they will be operated is essential.

Providing the certainty that the market requires will not interfere with the FDIC's flexibility to determine which of its powers it will exercise in resolving a covered financial company. For example, under Title II the agency can choose to effect a straightforward liquidation, to sell all or part of the covered financial company to an existing viable financial institution, or to establish a bridge for all or part of the covered financial company. Ensuring that creditors can predict *in advance* what rights they will have under each of the alternative paths that the FDIC may take (including a set of minimum rights that they would have under any FDIC approach) does not constrain the FDIC from making its choice as it sees fit under the circumstances. Indeed, this predictability is an essential underpinning of systemic financial stability. Creating or prolonging uncertainty in the enforceability of legal rights will undermine economic stability.

In short, the FDIC's rules under Title II will determine whether this new regime fulfills its purpose of reducing systemic risk while mitigating the likelihood of bail-outs, or instead heightens systemic risk by exacerbating uncertainty among creditors dealing, directly or indirectly, with covered financial companies. Creating this regulatory regime is not a 90-day exercise. On the contrary, some of the regulations that must be coordinated with the liquidation authority will not be proposed, much less adopted, within that time. Understanding all the ramifications of the Act on existing and future businesses is only beginning. Rapidly implementing Title II, while important, is not as critical as ensuring that implementation does not actually increase systemic risk.

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[9] *See* Statement of Policy Regarding Treatment of Security Interests After Appointment of the Federal Deposit Insurance Corporation as Conservator or Receiver, *supra* n. 8 (observing the "concern" that the *North Arkansas Medical Center* decision prompted among "those who have entered into or propose to enter into secured deposit or credit transactions with" a federally insured depository institution); Statement of Policy Regarding Treatment of Collateralized Letters of Credit After the Appointment of the Federal Deposit Insurance Corporation as Conservator or Receiver, *supra* n. 8 (explaining that the regulation was being issued in response to, inter alia, "the need for market certainty and stability").

Undoubtedly, the single aspect of the Rule that could best provide the necessary certainty would be explicit FDIC confirmation of the principle embodied in Section 210(a)(7)(B), which provides that a creditor of a covered financial company shall, in no event, receive less than the creditor would have received if the company had instead gone through a proceeding under Chapter 7 of the Bankruptcy Code (the "**Minimum Recovery**"). This section does not limit or override the FDIC's flexibility in adopting any of the procedures or authorities granted to it by Title II, but it does assure all creditors that they will obtain the Minimum Recovery irrespective of the FDIC's resolution approach.

Accordingly, we urge the FDIC to act quickly to provide certainty with respect to this issue and the other high-priority items mentioned below, but to coordinate its remaining rulemaking efforts under Title II with those interrelated endeavors of the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission (the "**SEC**"), the Commodity Futures Trading Commission (the "**CFTC**"), state insurance regulators and international regulators to ensure that all of these efforts to craft resolution regimes that promote stability and reduce moral hazard do not work at cross purposes. This letter addresses the Minimum Recovery and some of the other issues that we have identified to date. However, this list represents only a first round of issues that we believe the FDIC should consider. The FDIC should take the time necessary to ensure that it crafts a lasting liquidation and resolution framework that enhances the efficiency, function and discipline of U.S. financial markets.

Responses to NPR Questions

1. What other specific areas relating to the FDIC's orderly liquidation authority under Title II would benefit from additional rulemaking?

We urge the FDIC to address the following topics in the regulations it adopts under Title II. Some of these rulemakings are mandated by the Act; others are necessary to achieve the goals of Title II. We note below those areas in which we believe that coordination with other regulators will be key to furthering the Act's purposes.

As we note above, the FDIC would substantially enhance the predictability of its orderly liquidation authority, reduce creditor concerns, and thereby enhance market stability by establishing the procedures by which the Minimum Recovery provision of Section 210(a)(7) will be implemented. If the FDIC simply declares explicitly that it would in all events honor the Minimum Recovery mandate, substantial benefit would ensue.

Further certainty regarding the application of the Minimum Recovery provision should be provided by specifying the procedures that the FDIC will use to calculate the Minimum Recovery, both with respect to determining the assets that would have been available for distribution and to determining the amount of any particular claim. These procedures should specify the manner in which creditors, acting individually or in appropriate groups, classes or types, could provide input to or challenge the calculation of the value of the failed institution's assets, the value of the creditors' claim, or the value of a class or type of claim generally. For example, the FDIC could establish a special claims division (the "**SCD**") that would be

responsible for processing, on an expedited basis, all claims that an FDIC-designated recovery was less than the Minimum Recovery. Another option could be binding arbitration, with a neutral arbitrator acceptable to both the claimant and the FDIC, whether in lieu of or after the SCD process.

In taking these actions, the FDIC would be carrying out Congress's clear mandate and achieving Congress's objectives. Section 210(a)(7) provides:

> A creditor shall, in no event, receive less than the amount that the creditor is entitled to receive under [Chapter 7 of the Bankruptcy Code]. (*Emphasis added.*)

As another significant matter, we note that banking regulators are currently working to develop regulations relating to "living wills," which major financial institutions are working diligently to prepare. Large IDI holding companies, with their regulators, are undertaking intensive efforts to evaluate their corporate and business operations to ensure that safety and soundness, regulatory mandates, and client and counterparty interests are appropriately addressed under both domestic and foreign law. This undertaking will prove to be one of the best sources of information for the FDIC and other regulators in developing requirements for the conduct of business by large, complex financial institutions. In addition, these efforts will yield valuable insight and data to inform the challenges that the FDIC would face in liquidating these entities and the procedures that will be required to do so.[10] The FDIC's rulemaking under Title II should build on the results of this related process. Doing so is possible only if the FDIC defers the adoption of a substantial portion of the Title II rules until the results of the living-will process are substantially complete.

In addition, The Clearing House re-emphasizes the critical link between the Title II liquidation authority and the designation of SIFIs under Title I. As we suggested in our November 5, 2010, letter to the Financial Stability Oversight Council,[11] the designation of SIFIs under Title I must be sufficiently broad to ensure that all institutions that could reasonably be expected to be subject to the Title II liquidation authority are also subject to the enhanced regulations applicable to SIFIs. This approach is essential to reduce the likelihood that the FDIC need ever invoke its Title II authority by making sure that all covered financial companies will be subject to these enhanced regulations, including living-will requirements that facilitate orderly liquidation, and related regulatory oversight.

As The Clearing House continues to consider the issues raised by Title II, we have identified the following areas where regulatory action would be beneficial.

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[10] *See* Sheila Bair, Testimony to the Senate Banking, Housing and Urban Affairs Comm. (Sep. 30, 2010) ("The information obtained from examinations (along with the information obtained through the resolution plan review process) is crucial for planning an effective liquidation.")

[11] *Available at* www.regulations.gov under document ID FSOC-2010-0001-0051.1.

- *Setoff*: As we noted in our prior comment letter, Section 210(a)(12)(F) permits the FDIC to transfer assets of (i.e., claims held by) a covered financial company in a manner that destroys rights of setoff. Although the Act also grants to the obligor on that asset a claim senior to those described in Section 210(b)(1)(E), in an amount equal to the value of such setoff rights, this change effectuates a material change in the setoff rights of creditors, significantly affecting some of them. Consider, for example, the financial risk suffered by a creditor who had been relying on its setoff right. Its claim against the failed financial institution, even if senior to other claims, will nonetheless be subordinated to a large number of claims—including traditional administrative expenses, obligations under financing arrangements assumed by the FDIC, claims of the United States Government and others—and thus may not result in full payment of the amount due.

  Moreover, creditors of a covered financial company, or even a covered financial company itself, may be significantly disadvantaged by this provision even if no liquidation proceeding is ever commenced against the firm. Any possible vitiation of setoff rights may disallow the recognition of the right of setoff for both accounting and regulatory-capital purposes. Significantly increased capital requirements for covered financial companies and their creditors may result. Under the insolvency regimes that would otherwise apply to covered financial companies, these setoff arrangements are an effective means of hedging or reducing significant credit risks. As a result, this added capital would have little prudential benefit except in the extraordinary circumstance in which the Title II liquidation authority is invoked.

  Thus the mere possibility that a company may be subject to a Title II liquidation would tie up significant amounts of costly capital and liquidity to address a risk that would never arise but for the commencement of the Title II proceeding itself. This may be particularly true for covered financial companies themselves, as their intercompany financing arrangements—arrangements that are vital functions of a holding company—may become substantially more costly if the holding company and the relevant subsidiary must begin to account, and hold capital, for offsetting obligations on a gross, rather than net, basis. Accordingly, and as we noted in our prior letter, the treatment of setoff rights is a considerable concern for creditors dealing in significant offsetting transactions with covered financial companies and may directly affect the accounting and capital requirements of those creditors and of the covered financial company.

  In any event, the Minimum Recovery requirement would require that the FDIC ensure that a creditor with setoff rights receive at least what the creditor would receive under the Bankruptcy Code, taking into account the setoff rights that are protected under that statute. In that light, we believe that the FDIC should adopt regulations to clarify that the receiver must exercise its right to transfer

assets of a covered financial company in a manner that would ensure that beneficiaries of rights of setoff are provided at least the same recovery that they would have received under otherwise applicable insolvency law. By preserving liquidity and, in particular, intercompany funding, this policy is necessary to implement the Minimum Recovery requirement effectively.

- *Procedural and Substantive Treatment of Secured Creditors*: As we noted in our prior letter, secured creditors face a number of difficulties in understanding how they will be treated under a Title II liquidation, whether or not it involves a bridge. A comprehensive regulation governing the treatment of secured creditors would provide welcome certainty. Such a rule could clarify (1) the range of options available to the FDIC, as receiver, including transferring an asset to a bridge subject to an existing lien, exercising a debtor's right of redemption, and providing "adequate protection" in lieu of the lien in some circumstances, (2) how "adequate protection" will be determined and provided, (3) how a creditor may obtain relief from a stay on foreclosure, particularly when the debtor has no equity in the collateral,[12] (4) how the "fair market value" of collateral may be determined, (5) whether and how creditors will be permitted to engage in credit bidding, and (6) how the FDIC will carry out its duty to preserve and protect the collateral while it determines how to handle the secured assets. We urge the FDIC to adopt regulations addressing these issues as a single, coordinated rule. Furthermore, we urge the FDIC to clarify how the operation of these provisions will be bounded by the Minimum Recovery provision.

- *Coordination with Foreign Proceedings and Regulators*. The FDIC should clarify how the FDIC, as receiver, will interact with foreign and domestic regulators with authority over assets and subsidiaries transferred to the bridge. The Act does not solve this fundamental issue, which the Lehman Brothers bankruptcy highlighted: how to resolve separate subsidiaries incorporated and regulated outside the United States. Most complex financial institutions operate through subsidiaries in some jurisdictions or for some of their businesses, often in response to specific regulatory mandates. In contrast to the situation where businesses are conducted through branches or offices of a covered financial company or a covered subsidiary, the FDIC will not succeed directly to the rights and powers of a subsidiary entity that is not formed in the United States, even under the Act itself.[13] It is also possible that foreign regulators will refuse to acknowledge the FDIC's succession to the rights and powers of the covered

[12] As we noted in our prior letter, we believe that the FDIC should adopt a policy statement under the Act corresponding to its existing FDIA-related *Statement of Policy Regarding 12 U.S.C. 1825(b)(2) and 28 U.S.C. 2410(c)*, 57 Fed. Reg. 29491 (July 2, 1992).

[13] *See* Section 210(a)(1)(E), which permits the FDIC to appoint itself as receiver for any covered subsidiary "that is organized under Federal law or the laws of any State."

financial company itself, including by refusing to consent to, or even acknowledge, transfers to a bridge or other entity of assets or licenses that are essential for the proposed resolution. The rights of host-country supervisors to exercise this discretion are well recognized in pending global discussions on cross-border resolution policy, where negotiations to construct memoranda of understanding to clarify these rights are under consideration.[14] Without such a protocol, the FDIC's approach could fail to provide the necessary certainty and stabilization and, as a result, actually prove adverse to its receivership and liquidation interests.

Given these limitations, it will be critical for the FDIC to establish how it intends to address these issues, for example, by providing expressly in its regulations for cooperation with other regulators in cross-border proceedings. Furthermore, the FDIC must continue to negotiate protocols, memoranda of understanding and other arrangements with regulators in other jurisdictions. Without them, the purpose of Title II cannot be achieved.

- *Removal of Management and Directors*: Section 206 calls for the removal of "management responsible for the failed condition of the covered financial company" and "members of the board of directors . . . responsible for the failed condition of the covered financial company," respectively. The FDIC should adopt rules that describe the criteria that it will use to determine which members of management and the board are held responsible for the failure. Of particular importance, the FDIC should indicate that it will move promptly to make these determinations so that there can be certainty in the marketplace. We believe that the FDIC should balance considerations of culpability and stabilization, recognizing that wholesale removals in the midst of a crisis may be counterproductive. The FDIC would retain the authority to impose penalties on members of management and the board, even if they are not immediately removed.

- *Broker-Dealers*: As we noted in our prior letter, Section 205(h) calls for rulemaking to implement the provisions relating to the liquidation of broker-

[14] *See, e.g.,* FSF Principles for Cross-border Cooperation on Crisis Management (Apr. 2, 2009) (avail. at http://www.financialstabilityboard.org/publications/r_0904c.pdf); Cooperation Agreement on Cross-border Financial Stability, Crisis Management and Resolution Between Relevant Ministries, Central Banks and Financial Supervisory Authorities of Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden (Aug. 17, 2010) (avail. at http://www.riksbank.se/upload/Dokument_riksbank/Kat_AFS/2010/8a37263c.pdf) (proposing allocation of resolution costs among "Home" countries, where the parent institution is chartered, and "Host" countries, where its operations may be located on the basis of whether the Host-country operations are organized in a branch or subsidiary of the institution); Group of Twenty (G20), Declaration on Strengthening the Financial System – London Summit, at 2 (Apr. 2, 2009) (avail. at http://www.londonsummit.gov.uk/resources/en/PDF/annex-strengthening-fin-sysm) (memorializing agreement between members of the G20 to "strengthen international cooperation" among financial regulators by, inter alia, "implement[ing] FSF principles for cross-border crisis management immediately").

dealers. Section 205 provides a general framework for liquidating such entities, in general terms leaving the liquidation of the failed broker-dealer in the hands of the Securities Investor Protection Corporation ("**SIPC**") but giving the FDIC the power to transfer viable assets to a bridge broker-dealer and deal with the bridge broker-dealer under its general bridge authority.

Section 205 provides only a general framework and leaves open a number of issues that rulemaking could resolve. For example, Section 205 gives both the FDIC and SIPC ongoing authority to deal with the failed broker-dealer itself: SIPC, with respect to most matters, and the FDIC, with respect to the repudiation of contracts and the ongoing right to transfer assets to a bridge. To maintain investor confidence in systemically significant broker-dealers, the FDIC should clarify the manner in which it would coordinate with SIPC in undertaking these efforts, how it will provide notice to potentially affected creditors, and how it will exercise these powers without affecting customer interests.

Other areas requiring clarity include the procedures for handling customer accounts, including the criteria for determining whether to transfer accounts to a bridge or to retain them in the failed broker-dealer; how customers will be notified (and how that process will differ from the existing procedures under the Securities Investor Protection Act ("**SIPA**")); how their claims will be calculated and satisfied for purposes of Section 205(g); and how the FDIC will exercise its authority in order to satisfy the Section 205(d) mandate that customer claims not be adversely affected by the application of Title II, as opposed to SIPA or the Bankruptcy Code.

- *FCMs; Clearing*: As we noted in our prior letter, Title II requires that the FDIC address futures commission merchant ("**FCM**") customer claims in accordance with the applicable provisions of Title VII of the Bankruptcy Code. The CFTC is currently working with the various clearing houses to implement the clearing of derivatives mandated by Title VII of Dodd-Frank. Making clear that Title II will not override or interfere with the arrangements developed by the CFTC under the Bankruptcy Code and in its Part 190 rules will be essential to permit the implementation of Title VII of Dodd-Frank. To the extent that the FDIC believes that the mandates of Title II would conflict with the Bankruptcy Code, the FDIC should coordinate with the CFTC to ensure that those conflicts are taken into account in the CFTC's regulations. Furthermore, existing and future efforts to reduce systemic risk rely on setoff and netting of obligations, both within and outside of clearing systems, and the FDIC should adopt rules that would make clear that it will not exercise its assignment right in a manner that would undermine these existing and developing systemic protections in the context of complicated cleared arrangements where a single dealer clears through one or more clearing houses for a number of different parties. Failure to provide this certainty in advance will make it difficult, if not impossible, for systemically

significant clearing systems and similar financial utilities to admit or retain as members those entities that pose a meaningful risk of being covered financial companies. This would reduce the effectiveness of these entities and make it more difficult to accomplish the reduction in systemic risk that Title VII was intended to provide.

- *Coordination with Resolution of IDI Subsidiaries*: The rules must clarify how the FDIC will coordinate the liquidation of a covered financial company that is an IDI holding company and the liquidation of its IDI subsidiaries. The markets must understand how the FDIC will resolve claims of a failed IDI subsidiary against its failed holding company and affiliates (and vice versa), how claims by creditors involving both elements of a holding-company structure will be resolved, and similar matters. At a minimum, the FDIC should adopt procedures relating to conflicts of interest between the two receiverships, and for handling claims that involve both the IDI and its non-bank affiliates.

- *Custodial Assets Held by Nonbanks*: The FDIC should adopt regulations providing certainty and clarity as to the manner in which trust and custodial assets held by non-banking entities, as well as collateral posted to those entities, would be treated under Title II. In fact, it would also be beneficial to codify existing interpretations under the FDIA to provide certainty when dealing with IDI custodians and pledgees. While the existing law and guidance is relatively clear under the FDIA, the critical importance of providing certainty to custodial and trust customers and to pledgors regarding the status of their assets in an IDI failure argues in favor of providing a clear, coherent statement of the manner in which these assets would be treated.

  Many customers—both individual and institutional—were surprised by the treatment of their assets in the Lehman Brothers default, learning too late the risks they had taken in using Lehman Brothers entities as custodian for their assets. Similarly, counterparties who had pledged assets to the Lehman Brothers entities were surprised to learn of some of the risks they had unknowingly taken. To some degree, this reflected a lack of market discipline; however, the complexity of the regulations governing these rights clearly contributed to this market confusion. While Section 210(m) begins to address these issues by providing for bankruptcy-equivalent treatment in certain cases, the FDIC should set forth clearly how it intends to address these issues when dealing with non-IDI custodians, custodial or trust assets, and assets pledged to a covered financial company.

- *Interest Rates*: Section 210(a)(7)(D) permits the FDIC to prescribe rules to establish an interest rate for post-insolvency interest to creditors holding proven claims against the receivership estate of a covered financial company and to make such payments after the principal amounts of all claims have been

satisfied. The FDIC should adopt such rules now to permit appropriate disclosure to prospective purchasers of financial-institution obligations and thereby to facilitate those institutions' access to the credit markets.

2. Section 209 of the Dodd-Frank Act requires the FDIC, "[t]o the extent possible," "to harmonize applicable rules and regulations promulgated under this section with the insolvency laws that would otherwise apply to a covered financial company." What are the key areas of Title II that may require additional rules or regulations in order to harmonize them with otherwise applicable insolvency laws? In your answer, please specify the source of insolvency laws to which you are making reference.

- *FDIA Securitizations and Nonbank Financial Institutions*: The Clearing House notes the December 29, 2010, letter sent by Michael Krimminger of the FDIC to the Securities Industry and Financial Markets Association and American Securitization Forum regarding the application of Section 210(a)(11) to certain transfers. We believe that this letter will prove to be of substantial assistance in facilitating participation by non-IDIs in the securitization market, and urge the FDIC to adopt regulations, as discussed in the letter, to conform the application of Section 210(a)(11) to the provisions of the Bankruptcy Code. Because this issue is a significant impediment to the completion of securitization transactions by non-bank sponsors, we urge the FDIC to act quickly to adopt these regulations to facilitate the restoration of the securitization markets.

  However, even if the issues raised by Section 210(a)(11) are resolved, non-bank financial institutions will still face difficulties in the securitization markets due to other powers granted to the FDIC in Title II. In view of the FDIC's ability to repudiate contracts, the issues relating to rights of setoff described above, and related provisions, it is proving difficult, if not impossible, for counsel to provide opinions on the way in which such transactions would be treated if the sponsor or other related entity were to be liquidated under Title II. This absence of legal certainty is hindering the recovery of the securitization markets, which is particularly unnecessary in light of the Minimum Recovery mandate of the Act and the requirement to harmonize the Act with otherwise applicable insolvency law whenever possible. The FDIC should adopt regulations permitting these entities to continue to complete securitizations in reliance on the Bankruptcy Code treatment that would ordinarily apply to them.

  The Clearing House continues to believe that the FDIC's recent rulemaking on the treatment of securitization transactions under Section 11(e) of the FDIA raises significant issues for IDIs in the securitization markets. We believe that extending these issues to non-banks would be even less justified. It is unnecessary to subject the non-bank securitization market to a broad regulatory regime under Title II when regulatory authority over this market has been specifically allocated under Title IX. Title IX provides the overall framework

under which this market is to operate in the future, and the rulemaking implementing Title IX is the proper place for the prudential regulation of this market to take place. Furthermore, considering that the Title II liquidation authority is specifically intended to be applied only in the most exceptional circumstances, it does not make sense to distort the securitization market with differing treatment in insolvency. Moreover, the justification of protecting the Deposit Insurance Fund ("**DIF**"), which the FDIC relied on in implementing Section 11(e) of the FDIA, is inapposite here.[15] For all these reasons, and given the great importance of the securitization market in restoring liquidity to the credit markets, we urge the FDIC (1) to restore legal certainty by adopting rules to ensure that securitization transactions sponsored by non-banking entities that are, or are affiliated with, covered financial companies may continue to be conducted on the basis of the Bankruptcy Code analysis that has applied to these transactions to date and (2) to leave the substantive regulation of securitizations to the rulemaking process called for by Title IX, and not condition any insolvency-related aspects of the treatment of these transactions on compliance with other substantive criteria (as was the case in the FDIA-related rulemaking).

- *Conduit Safe Harbor*: There are a number of areas in which the bankruptcy courts have established, by case law, certainty for creditors in dealing with failing companies. One example relates to the determination of when a transferee of an avoidable transfer will be treated as a mere "conduit" and therefore not subject to a clawback. These provisions are of great significance to creditors dealing with companies in distress. Adopting similar provisions by regulation would provide significant comfort to parties who are merely "conduits" for transfers under the Bankruptcy Code, as currently applied.

- *Implications for Subsidiaries*: Similarly, the bankruptcy courts, exercising their equitable powers, have developed a number of doctrines, such as "substantive consolidation," "equitable subordination" and similar matters. The FDIC, as receiver under the Act, does not share these equitable powers. At the same time, the FDIC has adopted, under the FDIA, positions that may jeopardize legitimate market transactions, such as the application of the *D'Oench Duhme* doctrine or its statutory codification to subsidiaries of IDIs.[16] We believe that the FDIC should clarify the manner in which it would act with respect to subsidiaries of a covered financial company for which it has not been appointed as receiver,

[15] The contours of the safe harbor provided by the FDIC with respect to securitization by IDIs were drawn by reference to "the FDIC's responsibilities to protect insured depositors and resolve failed insured banks and thrifts and its responsibilities to the DIF." Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection With a Securitization or Participation After September 30, 2010, 75 Fed. Reg. 60,287 at 60,289 (Sep. 30, 2010) (to be codified at 12 C.F.R. pt. 360).

[16] *See* footnote 8 above.

such as by confirming that it would not seek to apply the provisions of Title II indirectly to those subsidiaries but instead would either explicitly invoke Section 210(a)(1)(E) (including the related safeguards contained in that section) or use its existing powers under applicable law as a shareholder or creditor of those subsidiaries in order to manage and direct the affairs of such subsidiaries.

3. With the exception of the special provisions governing the liquidation of covered brokers and dealers (see section 205), are there different types of covered financial companies that require different rules and regulations in the application of the FDIC's powers and duties?

As we noted above and in our prior letter, the treatment of FCMs, major swap dealers, and similar entities under the Act's liquidation authority may have a significant impact on the creation or reduction of systemic risk. Failing to accommodate the specialized liquidation regimes being developed for these entities in a Dodd-Frank liquidation could substantially increase the risk to the market posed by their activities, particularly with respect to the involvement of FCMs in clearing organizations discussed above. We strongly urge the FDIC to coordinate with the CFTC and the SEC to develop a regulatory structure that ensures the safety and soundness of the market.

The provisions of the statute relating to the treatment of insurance companies are complex and somewhat unclear. Providing clarity as to how those entities would be liquidated if the FDIC is required to exercise its back-up authority under Section 203(e)(3) may be beneficial.

4. Section 210 specifies the powers and duties of the FDIC acting as receiver under Title II. Are regulations necessary to define how these specific powers should be applied in the liquidation of a covered company?

Yes, as we discuss in response to the questions above. In addition to the items that we address in those responses, we believe that the FDIC should adopt regulations clarifying the application of Sections 210(d)(2) and (3). Section 210(d)(2) provides that the maximum liability of the receiver to any claim holder is limited by that holder's estimated recovery in a hypothetical liquidation of the covered financial company under Chapter 7 of the Bankruptcy Code; Section 210(d)(3) contains a corresponding provision relating to creditors of a broker-dealer. Sections 210(a)(7)(B) and 210(b)(4)(B), which make the amount calculated under Section 210(d) a floor on recoveries, the obligation of the receiver to distribute all the funds of the estate in accordance with Section 210(a)(7), and the legislative history of the provision of the FDIA on which Section 210(d) was based all make clear that, rather than establishing a ceiling on what creditors may be paid by the receiver in respect of their claims, Section 210(d)(2) only limits the amount that a claimant may collect from the receiver as a

matter of right.[17] We urge the FDIC to adopt a regulation confirming this plain reading of the statute.

5. Should the FDIC adopt regulations to define how claims against the covered financial company and the receiver are determined under section 210(a)(2)? What specific elements of this process require clarification?

The FDIC's existing claims procedure is not well understood by the market. As much clarity as can be given in advance of the proof required, the procedures to be followed, the factors that will eliminate claims, and similar matters would help ease concerns in the market about the impact of the Act on creditors' rights. Additionally, the FDIC should consider rules clarifying the timeline for the general treatment of claims, criteria and procedures for expediting certain claims, criteria and procedures for claims proceedings when an appropriate group, class or type of creditors raises matters that should be dealt with collectively, procedures to appeal an adverse claim determination, and a mechanism for periodic informational updates regarding outstanding claims.

A key reason for enacting a special liquidation authority for large and complex financial institutions was to provide for prompt payment to creditors and thereby minimize the impact of the failure on systemic liquidity. To this end, the FDIC should also establish procedures for determining when it may pay a preliminary or advance dividend to creditors, as it is permitted to do under Section 210(a)(7)(C). The FDIC is protected in this process by the special "clawback" assessment provision in Section 210(o) and its authority thereunder to call on SIFIs to fund any shortfall. In addition, the FDIC is provided with a liquidity line by the Department of the Treasury to finance any payments.

In these circumstances, we believe that the FDIC should establish an expedited schedule (from which it could deviate if special circumstances required) for receiving claims, reaching determinations on the claims and making an initial pay-out based on recovery estimations. For purposes of maximizing transparency, the FDIC should include in these regulations a requirement that it provide information, as promptly as practicable, about the anticipated level of recoveries for creditors in the receivership at each level of priority. This knowledge would permit creditors to assess the value of pursuing a particular claim, which would reduce the burden on the market and may reduce the burden on the receiver as well.

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[17] H.R. Rep. No. 101-54, at 42 (1989) (explaining that 12 U.S.C. § 1821(i) provides "that claimants against a failed financial institution are only entitled to their pro rata share of the institution's estate" but "also permits the FDIC to make additional payments to . . . particular creditors or categories of creditors out of its own resources without becoming obligated to make similar payments to any other claimant or category of claimants"); *Lawson v. Fleet Bank of Maine*, 807 F. Supp. 136, 143 n.6 (D. Me. 1992) (explaining that, though § 1821(i) imposes a "limitation of liability," the "FDIC may in its discretion decide to make additional payments to certain claimants"); *Senior Unsecured Creditors' Comm. v. FDIC*, 749 F. Supp. 758, 773 (N.D. Tex. 1990) (explaining that "if § 1821(i)(2) is applicable to this case, plaintiffs are entitled only to the liquidation value of their claims, regardless [of] whether other creditors may have received payment in full").

Collectively, these provisions will provide assurance to creditors in dealing with covered financial companies in the ordinary course and help brake systemic consequences if the OLA must actually be utilized.

6. Should the FDIC adopt regulations governing the avoidable transfer provisions of section 210(a)(11)? What are the most important issues to address for the fraudulent transfer provisions? What are the most important issues to address for the preferential transfers provisions? How should these issues be addressed?

The single greatest concern of creditors will be to ensure consistency in the application of these provisions with the application of the corresponding provisions of the Bankruptcy Code. To the extent that rules are required to ensure that consistency, such as rules providing direction to this effect to officers directly engaged in conducting liquidations, those rules would be helpful.

In addition, we urge the FDIC to act quickly to resolve the securitization problem posed by the manner in which Section 210(a)(11) was framed, as we discuss above in our response to Question 2.

7. What are the key issues that should be addressed to clarify the application of the setoff provisions in section 210(a)(12)? How should these issues be addressed?

Please see our response to Question 1 above.

8. Do the provisions governing the priority of payments of expenses and claims in section 210(b) and other sections require clarification? If so, what are the key issues to clarify in any regulation?

The statute designates a number of different claims as "administrative expenses of the receiver," or gives such claims treatment that is either equivalent to such administrative expenses or higher or lower than administrative or other designated categories of creditors. It would be helpful, and avoid confusion, if rulemaking would establish clearly, and in a single place, the priority scheme that would apply, taking into account all such claims, including the claims under service contracts and employee benefit contracts addressed by the proposed rule.

In addition, to the extent that the FDIC intends to interpret the priority categories in a manner different from the corresponding provisions under the Bankruptcy Code, clarification of those differences would avoid market confusion.

9. Section 210(b)(4), (d)(4), and (h)(5)(E) address potential payments to creditors "similarly situated" that are addressed in this Proposed Rule. Are there additional issues on the application of this provision, or related provisions, that require clarification in a regulation?

(a) We urge the FDIC to reject any reading of Sections 210(b)(4), (d)(4) and (h)(5)(E) that would prohibit creditors of the covered financial company from sharing in its going-

concern value. Title II cannot be read as instructing the FDIC to squander that value, which the FDIC must instead deliver to the creditors of the covered financial company in satisfaction of their claims, subject to the priorities established in Section 210(b)(1). To that end, we encourage the FDIC to promulgate regulations that confirm that, in accordance with the plain meaning of Sections 210(b)(4), (d)(4) and (h)(5)(E), the receiver will distribute all the assets of the estate to pay claimants the full value of their claims to the full extent of the available proceeds, whether those proceeds are in the form of cash, shares of a related bridge, or any other type of property.[18]

Furthermore, to meet the statutory deadline and loss-minimization requirement imposed on receiverships under Title II, the FDIC may find it necessary or beneficial to enter into negotiated transactions or settlements with one or more classes of creditors, such as by delivering shares or other equity interests in a bridge to some or all creditors in satisfaction of their claims. To execute this type of transaction, the FDIC will have to resolve several questions, such as how and when equity interests would be valued and how they would be distributed to creditors. The FDIC should adopt regulations clarifying these matters.

(b) Proposed Rule 380.2 indicates circumstances in which the FDIC currently anticipates that it will exercise its authority under Sections 210(b)(4), (d)(4) and (h)(5)(E) to make payments to creditors in excess of those made to other similarly situated creditors ("**designated payments**"). However, determining what the creditors of each class would receive in the liquidation proceeding requires the completion of an analysis of the assets and liabilities of that estate, as well as a calculation of the Minimum Recovery of each creditor, neither of which can conceivably be completed until the receivership is well under way. As a result, the FDIC will necessarily be forced to pay creditors without certainty as to whether any particular payment would constitute a designated payment, especially early on in a proceeding. Congress provided redress to the FDIC by giving it the ability to recoup any designated payments through the assessment process at the completion of the receivership.

The impossibility of knowing, at the time that a payment is made, whether the payment is a designated payment makes it clear that the FDIC cannot, in reality, prohibit itself from making designated payments to any class or classes of creditors, unless it does not make any payments to those classes of creditors until the entire liquidation has been completed. As we note above, suspending payments completely would run counter to a fundamental purpose of the Act.

Furthermore, this difficulty drives home the interdependency of several elements of the FDIC's powers and responsibilities under the Act: those relating to making payments to creditors over the course of a liquidation proceeding; those relating to determining claims and calculating the Minimum Recovery level; and those relating to the post-liquidation-assessment mechanism, including the identification of designated payments that are not subject to the

[18] As we note in response to Question 10 below, we believe that the FDIC should provide clarity as to the manner in which the value realized by or from any bridge in relation to a receivership would be made available to the creditors of the related covered financial company.

"clawback" regime. Without understanding any one of these elements, a creditor cannot know whether a payment that it receives from the receiver for a covered financial company will be subject to clawback. As a result, any creditor or counterparty—even if the FDIC is willing to make a payment to that creditor—will be less likely to rely on any payment from, and thus continue to deal with, the receivership estate (assuming, of course, that the creditor or counterparty has the right to make this choice). We urge the FDIC to undertake a comprehensive process that coordinates its rulemaking concerning all three of these elements, rather than adopting any one of them without adopting the others.

(c) The Clearing House also requests guidance on how the FDIC will address a failure by a claimant to pay an assessment under Section 210(o)(1)(D)(i), whether by reason of its own insolvency or otherwise, including the extent, if any, to which similarly situated and other creditors that received additional payments may become subject to additional assessments.

10. Section 210(h) provides the FDIC with authority to charter a bridge financial company to facilitate the liquidation of a covered financial company. What issues surrounding the chartering, operation, and termination of a bridge company would benefit from a regulation? How should those issues be addressed?

The ability of the FDIC to establish bridges is the most fundamental difference between the powers of the FDIC under the Act and the powers of a trustee in bankruptcy under the Bankruptcy Code. It is likely that the use of bridges will play an essential role in any future resolutions under Title II. Creditors of covered financial companies must understand clearly how they will be treated in the establishment, operation and termination of a bridge. Any lack of clarity in those rights will cause creditors to demand additional protections against the uncertainty, thus burdening covered financial companies even when healthy. It will also lead creditors to take precipitous action as a covered financial company begins to experience distress, thus potentially increasing both the likelihood and the cost of the covered financial company's ultimate failure. It is essential that the FDIC issue comprehensive regulations that describe the "cradle to grave" life cycle of bridges, including how they may be organized, operated, financed, and ultimately wound down. Some of these essential bridge-related areas of rulemaking follow.

- *Payments to Creditors:* The issues concerning potential overpayments to creditors and possible subsequent assessments, which we discuss above in response to Question 9, apply to receiverships whether or not a bridge is utilized. However, the need to ensure the continued operation of the bridge, and the resulting likelihood that creditors will be paid to keep the business running, make these issues that much more critical in the bridge context than in a liquidation in which not only the failed covered financial company, but all its businesses, are liquidated.

- *Chartering and Corporate Governance*: Under Section 210(h)(2) the FDIC may grant a federal charter to a bridge, elect that it follow the corporate-governance practices and procedures applicable under the general corporate law of

Delaware or the state of organization of the covered financial company, produce the bridge's charter and bylaws, and otherwise specify which corporate-governance regime applies. We believe that a bridge can accomplish its objective of maximizing recovery only if there is certainty among counterparties as to the validity and enforceability of their transactions. We therefore urge the FDIC to clarify the powers of the bridge to maintain and enter into contractual relationships and to grant counterparties rights in its assets. This clarification should specify the evidence on which counterparties may rely to ensure that transactions by the bridge are authorized, what rights counterparties will have if the FDIC ultimately liquidates the bridge rather than sells it or its assets, and how counterparties' rights will be affected by a subsequent purchase of bridge assets or stock, assumption of its liabilities, or merger or consolidation.

- *Transfer of Assets and Liabilities*: The FDIC acting as receiver may transfer assets and liabilities of the covered financial company to a bridge. We urge the FDIC to specify which of its Title II powers will apply to transferred contracts, what obligations the bridge will have to cure pre-transfer breaches and what rights a counterparty would have should the bridge breach its contract and how those rights would be enforced. The FDIC should also clarify when the contractual rights of a party whose contract has been transferred to the bridge would be given priority as administrative expenses under the Act, particularly when pre-failure obligations have been transferred to the bridge and the bridge subsequently incurs new obligations under the same contract.

- *Financing*: The Act establishes several sources of liquidity for a bridge. Section 210(h)(2)(G)(iii) allows the bridge to issue equity, Section 210(h)(2)(G)(iv) permits the FDIC (not acting as receiver) to make available "funds for the operation of the bridge [entity] in lieu of capital," subject to repayment under Section 210(n)(9), and Section 210(h)(16) permits the bridge to "obtain unsecured credit and issue unsecured debt." Moreover, like any other asset, liquid assets and cash, potentially including cash borrowed under Section 210(b)(2), may be transferred to the bridge to provide working capital. The bridge may also obtain financing from the U.S. Treasury and incur other obligations with superpriority status. We urge the FDIC to articulate the manner in which it will exercise these authorities, including the manner in which each type of financing will affect other creditors of the bridge, how "adequate protection" will be provided to creditors whose priorities or interests are "trumped" by the rights of creditors providing new financing to the bridge, and how each type of financing would fare in a liquidation of the bridge.

- *Relationship Between the Bridge and the Receivership Estate*: We urge the FDIC to lay out in its rules the legal relationship between the bridge established in connection with a receivership and the receivership estate itself. For example, the FDIC should clarify the right of the receivership estate to the proceeds of the

bridge, whether in the form of residual value, proceeds of asset sales, proceeds of share sales, or the shares of the bridge itself. The FDIC should explain both how and when these proceeds will be made available to the creditors of the receivership estate. Furthermore, the FDIC should explain the rights of creditors whose contracts with the bridge are repudiated, as compared to the rights of creditors whose contracts are repudiated while in the receivership estate.

- *Termination*: Section 210(h) anticipates several alternative terminations of the bridge, including (i) sale of its equity, (ii) purchase or assumption of all or substantially all of its assets or liabilities, respectively, and (iii) merger or consolidation of the bridge with or into another entity. Section 210(h)(9) permits the FDIC to extend exit financing in connection with these transactional terminations. Section 210(h)(12) provides the bridge with a two-year lifespan, subject to three one-year extensions. We urge the FDIC to clarify how remaining creditors would be treated in each of these scenarios, how and when equity in the bridge will be made available to creditors in the receivership in satisfaction of their claims, and how the FDIC would choose between different methods of recapitalizing the entity and returning it to the private sector, such as a public stock offering or a sale of equity to a private buyer, and what procedures it would follow in each of these events. These clarifications should help maximize the value that the FDIC obtains upon the disposition of the bridge, a benefit that would reduce the cost of the resolution and redound to creditors as well as the financial system more broadly.[19]

The FDIC has considerable experience in establishing and operating bridge banks and has the ability to provide to the markets substantial guidance on these and other matters that relate to the organizing, operating, financing and winding down of bridges and the distribution of any proceeds. However, the scale and complexity of the bridge financial institutions that would be required in the context of a liquidation of a covered financial company is likely to be different by an order of magnitude from the scale of the largest bridge banks previously handled by the FDIC. Furthermore, specifying these matters in regulations would help reduce market confusion and thus uncertainty regarding the utilization of bridge financial institutions. We believe that considering and specifying in advance the procedures that would apply to these proceedings would not only substantially enhance the utility of these entities in preserving the value of those businesses that the FDIC determines are appropriately transferred to a bridge, but also thereby reduce the market impact of the failure of the covered financial company, maximize the recovery to the creditors of the covered financial company, and minimize the cost and complexity of the resolution process.

[19] While the FDIC has had vast experience disposing of the assets–and sometimes the franchise value–of failed IDIs through largely-private receivership transactions, we believe that recent experience demonstrates that privatizing government-held formerly troubled companies through the public equity markets can be an effective and efficient means of recovering their value and returning their operations to the private sector.

11. Regarding actual direct compensatory damages for the repudiation of a contingent obligation in the form of a guarantee, letter of credit, loan commitment, or similar credit obligation, should the Proposed Rule be amended to specifically provide a method for determining the estimated value of the claim? In addition to the statutory considerations in valuation, including the likelihood that the contingent claim would become fixed and its probable magnitude, what other factors are appropriate? If so, what methods for determining such estimated value would be appropriate? Should the regulation provide more detail on when a claim is contingent?

To ensure consistent treatment of creditors who had anticipated that their claims would be addressed under the Bankruptcy Code, and consistent with the mandate to make rights equivalent to those that would apply under otherwise applicable insolvency law, we believe it would be beneficial to specify by rule that the FDIC will apply the same analysis as would be applied under the Bankruptcy Code, including the definitive case law under that statute, as it develops over time—essentially, an "auto-conform" provision similar to one in the FDIC's securitization rule.

In addition, it would be helpful for the rules to specify which aspects of prior law under the FDIA relating to contingent claims would apply, as there are certain respects in which the Federal Circuits have disagreed as to the "provability" of certain types of "contingent" claims, including when a claim is initially presumed to be contingent.

12. Are the provisions of the Dodd-Frank Act relating to the classification of claims as administrative expenses of the receiver sufficiently clear, or is additional rulemaking necessary to clarify such classification?

Please see our response to Question 8 above.

13. Should the Proposed Rule's definition of "long-term senior debt" be clarified or amended?

The Clearing House reaffirms the suggestions made in our prior comment letter relating to the NPR.

Conclusion

The Clearing House appreciates your consideration of the views expressed in this letter. We believe that understanding of the application of the new liquidation authority will develop over the coming years, as the full range of entities and transactions that must be addressed by the new regime is worked through by regulators, creditors and other parties.

A number of items that we discuss above can be dealt with expeditiously. Most importantly, the FDIC can and should address the operation of the Minimum Recovery provision, as described above. In addition, the FDIC may be able to adopt, relatively quickly, regulations (i) addressing the securitization issue connected to Section 210(a)(11), (ii) defining

the conditions, if any, under which the FDIC would interfere with setoff rights that a claimant would have but for Title II, (iii) addressing the rights of secured creditors, (iv) establishing an interest rate for post-receivership interest, (v) establishing claims procedures, (vi) specifying the manner in which trust and custodial assets held by non-banking entities, as well as collateral posted to those entities, would be treated under Title II, (vii) establishing safe harbors for parties acting as conduits in transfers of assets from the receivership, and (ix) confirming that the FDIC will apply those provisions of the Act that are analogous to the Bankruptcy Code in accordance with evolving jurisprudence. Certain other areas that may otherwise be amenable to early rulemaking may depend on coordination that will itself require significant time, such as (i) clarifying the interaction between the Bankruptcy Code's FCM provisions and Title II and (ii) implementing the resolution of broker-dealers under Section 205(h).

In contrast, the regulations detailing the procedures for the establishment, operation and termination of a bridge, together with the regulations addressing the manner in which the FDIC would exercise its authority to make upfront payments, the manner by which it would calculate the minimum recovery to which creditors are entitled, and the basis on which it will impose after-the-fact assessments, all call for a comprehensive and coordinated rulemaking. Addressing these issues separately, or in piecemeal fashion, will take needed flexibility away from the FDIC and could substantially alter the rights that market participants will rely on when transacting with potential covered financial companies. A piecemeal approach risks exposing potential covered financial companies, their investors, their clients, and ultimately U.S. taxpayers to costly market reactions and inefficient financing and capital arrangements. While we urge the FDIC to pursue these regulations as quickly as possible, the urgency does not outweigh the need to act in a comprehensive manner.

In addition, we recommend that, even after the initial regulations addressing these issues have been adopted, the FDIC plan for an ongoing process involving periodic consultations with other regulators and market participants, and the adoption of modifications to the rules as needed, to ensure that developments in the financial markets are accommodated and that the liquidation authority reflects the realities that exist when, if ever, this liquidation authority is invoked.

The Clearing House supports the FDIC in its implementation of Title II. To achieve an orderly resolution that does not disrupt the financial system, the FDIC must have powers to maintain liquidity and the key functions of failing institutions. At the same time, to avoid adding stress during times of market distress, the scope of these powers must be well defined and creditors must be assured of the Minimum Recovery and understand the alternatives for distributing any going-concern value of the failed institution. A clear and comprehensive implementation of Title II can achieve these goals, reducing the risk of future panics and bail-outs.

We welcome the opportunity to meet with you on an ongoing basis to discuss the proposed rules and our comments in our letters. If you have any questions or need further

information, please contact me at (212) 613-9812 (or Mark.Zingale@TheClearingHouse.org) or Eli Peterson at (202) 649-4602 (or Eli.Peterson@TheClearingHouse.org).

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