November 18, 2010

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

Re: Initial 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 comment letter in response to an invitation to comment on the Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (such act, the "**Act**" or "**Dodd-Frank**") published by the Federal Deposit Insurance Corporation (the "**FDIC**") in the *Federal Register* on October 19, 2010 (the "**NPR**").[2]

The NPR represents a first, and significant, step in the monumental task of creating, from whole cloth, a liquidation regime that will permit the orderly liquidation of some of the most complex business organizations in the world. We appreciate the effort reflected in the NPR, including its extensive preamble and list of questions, to provide predictability to parties dealing with companies that may be subject to the Dodd-Frank liquidation provisions ("**covered financial companies**") and to clarify some of the complex provisions of the statute.

[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). Rule numbers refer to the correspondingly numbered rules proposed in the NPR unless the context otherwise requires.

The Clearing House Association L.L.C. : 450 West 33rd Street : New York, NY 10001
Phone 212.613.0100 : Fax 212.613.0184 : www.theclearinghouse.org

The NPR contains two sets of questions, one for which responses are required within 30 days of the NPR's publication, and the second for which a 90-day response period is provided. In this letter we respond to the questions in the first list and provide initial responses to the broader questions in the second. We will submit further comments to the broader questions by separate letter. This letter also includes some additional comments that we hope will be useful to the FDIC's staff in further developing the regulatory framework implementing the Dodd-Frank liquidation authority.

For your reference we include the text of the questions below before each of our responses. We base all of our comments on the key concerns that, to the maximum possible extent, (1) creditors be treated the same under both the Dodd-Frank liquidation authority and pre-existing insolvency law, primarily the Bankruptcy Code,[3] (2) regulations 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 does become subject to the Dodd-Frank liquidation authority.

Executive Summary

First and foremost, we urge the FDIC to refrain from adopting proposed Rule 380.2, which is neither necessary nor time-critical and raises complex and substantial issues that must be fully worked through. While the adoption of rules addressing the issues proposed may be necessary and appropriate, there is no justification for adopting them without due consideration of these issues and their impact on financial companies and creditors dealing with them. Indeed, a precipitous rule could undermine fragile financial markets in general, exacerbating systemic risk and slowing recovery if credit markets freeze up in anticipation of a complex rule that is only imperfectly understood by market participants and, perhaps, global regulators. As the FDIC is aware, the Financial Stability Board and other international bodies are working diligently on a new resolution regime designed to achieve the same goals as the FDIC's orderly liquidation authority. It is vital that U.S. rules implementing the Dodd-Frank authority be carefully coordinated with the evolving global resolution framework to avoid trapped liquidity pools and similar results that would not only put U.S. banking organizations at a competitive disadvantage, but also increase the very market risk that they are intended to reduce.

Consider proposed Rule 380.2(a) and (b). We believe that the FDIC's proposal has already given fair warning to the markets as to the manner in which the FDIC presently intends to exercise its authority under the Act and that the markets have responded. Nonetheless, financial companies must be able to develop funding mechanisms that meet market requirements as they develop over time. A precipitous rule that does not reflect market complexity will not only skew the market for financing for financial companies, but will also likely become more problematic as markets evolve, increasing the difficulty of obtaining

[3] Title 11 of the United States Code.

financing as the markets evolve from the present situation to which the proposed rule responds. Our members, who are both financial companies and major creditors of financial companies, are continuing to study the impact of proposed Rule 380.2(a) and (b), and its ultimate effect on them in both of these capacities is unclear. The rule should not be adopted until these competing policy concerns have been fully evaluated and weighed and workable solutions appropriately reflected in the rule.

Similarly, we believe that Rule 380.2(c), dealing with the valuation of collateral, may have significant damaging effects on financial companies and their creditors. While the FDIC's goals may be beneficial to market stability and the pursuit of orderly liquidations, the rule could well have precisely the opposite effect. We also believe that the proposed rule is not consistent with the statutory mandate that creditors receive at least what they would have received in a liquidation under the Bankruptcy Code. Rather than adopting the rule in its proposed form, addressing only one small element within the complex range of issues relating to the treatment of collateral in insolvency, the FDIC should address this topic within a broader rule addressing the treatment of collateral in a more comprehensive manner.

In addition, we urge the FDIC to amend its proposed rules such that:

- the FDIC not preclude itself from utilizing the powers that Congress granted it in the Act in a manner that could restrict its ability to overcome the restriction in a crisis;

- if the FDIC were to adopt a rule precluding so-called "excess" payments to any category of instruments, it do so in a manner that does not prevent or impair the success of consensual restructurings by companies subject to the statute;

- if the FDIC were to adopt a rule precluding such payments to any category of instruments, it base the application of the rule on the status of the instrument as regulatory capital, and avoid using any arbitrary bright lines based on maturities of debt that may have unintended market consequences;

- while we strongly oppose the use of any maturity-based classification, if the FDIC were to adopt a rule based on the term of an instrument, its ***remaining*** term be determinative;

- the rule regarding the treatment of contingent claims incorporate the statement from the preamble to the NPR clarifying that an obligation will no longer be deemed contingent if the contingency has occurred prior to the 270th day following the appointment of the FDIC as receiver, or later if the later date would not unduly burden the liquidation process; and

- the word "may" in Rule 380.4 be changed to "shall" to make clear that qualifying contingent claims will, in fact, be provable.

We discuss these and other comments in more detail below.

Responses to NPR Questions

1. Should ''long-term senior debt'' be defined in reference to a specific term, such as 270 or 360 days or some different term, or should it be defined through a functional definition?

We understand and appreciate the FDIC's desire to provide a clear signal to the market as to the absence of a Federal "safety net" for long-term creditors of major financial companies. As we note above, the proposed rulemaking may already be having the impact that the FDIC is seeking. We do, however, have several concerns regarding both the purpose and the drafting of proposed Rule 380.2(a) and (b).

We believe that the adoption of a rule causing any specific type of long-term debt to be subject to drastically different rules in a liquidation proceeding will inevitably lead to regulatory arbitrage. Whatever bright-line term the FDIC selects for its rule, the market will adjust by skewing maturities to terms shorter than the one specified. This adjustment may have the undesirable effect of shortening the average maturity of the funding that major financial companies are able to maintain, particularly as those companies find themselves in financial distress. Indeed, because any bright-line term would unavoidably distort the funding available to financial companies, singling out one particular category of funding may be inconsistent with the goals of the Dodd-Frank liquidation authority. This effect runs counter to the efforts that financial institutions are currently undertaking—both voluntarily and in response to regulatory mandates—to enhance their liquidity by broadening the range and types of funding mechanisms that they maintain and, in particular, by extending the maturity profile of their funding in order to enable them to survive a short-term liquidity crisis. Systemic risk will be reduced by encouraging institutions to rely more heavily on longer-term debt, but the proposed rule does not support this goal. Moreover, if short-term creditors believe that they are at greater risk in a Bankruptcy Code proceeding, and longer-term creditors believe that they are at greater risk in a Dodd-Frank liquidation proceeding, then *both* types of creditors may balk at funding institutions in distress, given the inability of creditors to know in advance which regime will actually apply.

If the FDIC believes that it is necessary to single out a particular category of instruments under the proposed rule, we believe that this treatment should apply to instruments that qualify as capital under the applicable regulatory regime, rather than to those with other particular terms or characteristics. Holders of qualifying capital are aware that their claims are intended to be satisfied only after those of other creditors. Therefore, a rule disadvantaging such holders would likely less adversely affect the market for such instruments than would the proposed rule and would reduce the potential skewing effect on the funding profiles of major financial companies.

In addition, the rule should not impose limits that the Act does not mandate. For example, depending on its interpretation, proposed Rule 380.2(a) and (b) may prevent consensual restructurings (whether before or after the commencement of a liquidation) that result in the conversion of long-term or subordinated debt into equity interests in a reorganized

company. A consensual restructuring, in which long-term creditors are paid in this way, might provide long-term creditors more value than they would receive in a Chapter 7 liquidation under the Bankruptcy Code—but it would do so only to the extent that the value exists and is available to be distributed, and only after satisfaction of all more highly ranking creditors, including the resolution fund and the U.S. government. The FDIC, as liquidator, is obligated to maximize value for shareholders, subject to satisfying its other obligations under Dodd-Frank, and there may be many times when such a restructuring would be the most practical, or even the only feasible, means of obtaining value for creditors. There is no reason—statutory or otherwise—to impose any impediment to consensual restructuring. We believe that the absolute bar set forth in Rule 380.2(a) and (b), if applied mechanically, could have this unintended result, and we therefore oppose its adoption. To avoid this result, we urge that the rule clarify the nature of the payments that it would prohibit, at a minimum making clear that the delivery of equity[4] of a bridge financial company to creditors of the covered financial company in satisfaction or resolution of their claims would not be a "payment" for the purpose of this rule.

While The Clearing House believes that the FDIC should not adopt any rule based purely on the term of an instrument, we note that the current proposal is vague as to the manner in which the term-based rule would apply. We thus recommend that the rule, if adopted, should be revised to clarify that the relevant term of an instrument is its ***remaining*** term. Moreover, regardless of the criteria used, the rule should make clear that payments to holders of the relevant instruments are barred only in their capacity as holders of such instruments, but not in their capacity as holders of any other type of claim. This clarification could be accomplished by inserting the words "in such capacity" after references to "holders" in the proposed rule.

Furthermore, we believe that the FDIC would unnecessarily limit the future use of the powers that the Act grants it if the proposed rule limits the FDIC's exercise of its powers in a manner that it cannot override absent a vote of its board of directors. Preserving liquidity in the markets is the very purpose of the Dodd-Frank liquidation authority, and exercising its authority under 12 U.S.C. 5390(b)(4), (d)(4), or (h)(5)(E) is one of the key tools available to the FDIC to achieve this goal. It is impossible to predict the nature of the next crisis, and it then could be essential to address long-term creditors by making the types of payments that the rule would preclude. All of the other conditions and restraints contained in the Act, and those that the FDIC will adopt in its final orderly liquidation framework, will ensure that these payments will not constitute a bailout of creditors, but these very payments could be essential to contain risk in the U.S. financial market. If the FDIC requires a means to recover payments made to creditors in a Dodd-Frank liquidation, it has both the payment powers that it seeks to restrict and the assessment mechanism in Section 210(o)(1)(D)(i) of the Act at its disposal. In any given crisis, the FDIC may determine that its statutory duties will be best met by utilizing its authority to make payments and to impose assessments in the manner best suited to that situation. We thus recommend that, if the FDIC were to adopt a rule affecting the treatment of categories of

[4] For this purpose "equity" would include common or preferred shares, options, warrants, or similar rights to receive equity.

creditors, it do so without constraining its ability to change course in the face of a crisis demanding a different approach.

For all of these reasons, The Clearing House urges the FDIC not to adopt the rule as proposed or, at a minimum, to defer its adoption until its consequences have been fully discussed.[5]

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[5] If the FDIC were to proceed with Rule 380.2 in some form, the language below would reflect the comments set forth in the text above:

> ~~(a) For the purposes of this section, the term ''long-term senior debt'' means senior debt issued by the covered financial company to bondholders or other creditors that has a term of more than 360 days. It does not include partially funded, revolving or other open lines of credit that are necessary to continuing operations essential to the receivership or any bridge financial company, nor to any contracts to extend credit enforced by the receiver under 12 U.S.C. 5390(c)(13)(D).~~
>
> (~~b~~a) **Except as otherwise provided in this Section 380.2, in** ~~In~~ applying any provision of the Act permitting the Corporation to exercise its discretion, upon appropriate determination, to make payments or credit amounts~~,~~ pursuant to 12 U.S.C. 5390(b)(4), (d)(4), or (h)(5)(E) to or for some creditors but not **to** others similarly situated at the same level of payment priority, the Corporation shall not exercise such authority in a manner that would result in the following **persons, in the capacities specified below,** recovering more than the amount established and due under 12 U.S.C. 5390(b)(1), or other priorities of payment specified by law:
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> (1) Holders of ~~long-term senior~~ debt ~~who have a claim entitled to priority of payment at the level set out under 12 U.S.C. 5390(b)(1)(E)~~ **that, prior to the appointment of the Corporation as receiver pursuant to 12 U.S.C. 5382, constituted tier 1 capital or tier 2 capital under the regulations of the primary federal regulator (if any) of the covered financial company**;
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> (2) ~~Holders of subordinated debt who have a claim entitled to priority of payment at the level set out under 12 U.S.C. 5390(b)(1)(F);~~
>
> ~~(3)~~ Shareholders, members, general partners, limited partners, or other persons who have a claim entitled to priority of payment at the level set out under 12 U.S.C. 5390(b)(1)(H); or
>
> (4) Other holders of claims entitled to priority of payment at the level set out under 12 U.S.C. 5390(b)(1)(E)**;**
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> unless**, in each case,** the Corporation, through a vote of the members of the Board of Directors then serving and in its sole discretion, specifically determines that additional payments or credit amounts to such holders**, in such capacities,** are necessary and meet all of the requirements under 12 U.S.C. 5390(b)(4), (d)(4), or (h)(5)(E), as applicable. The authority of the Board to make the foregoing determination cannot be delegated.
>
> ~~(c) Proven claims secured by a legally valid and enforceable or perfected security interest or security entitlement in any property or other assets of the covered financial company shall be paid or satisfied in full to the extent of such collateral, but any portion of such claim which exceeds an amount equal to the fair market value of such property or other assets shall be treated as an unsecured claim and paid in accordance with the priorities established in 12 U.S.C. 5390(b) and otherwise applicable provisions. Proven claims secured by such security interests or security entitlements in securities that are direct obligations of, or that are fully guaranteed by, the United States or any agency of the United States shall be valued for such purposes at par value.~~
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> **(b) If the Corporation, as receiver, enforces any contract to extend credit under 12 U.S.C. 5390(c)(13)(D), any valid and enforceable obligation to repay such debt shall be paid by the Corporation, as receiver, as an administrative expense of the receivership. In addition, the provisions of Section 380.2(a) shall not apply, nor shall the Corporation be restricted in applying any provision of the Act permitting the Corporation to exercise its discretion, upon appropriate determination, to make payments or credit amounts, pursuant to**

2. Is the description of ''partially funded, revolving or other open lines of credit'' adequately descriptive? Is there a more effective definition that could be used? If so, what is that definition and how is it more effective?

Because, as we advocate above, the proposed rule should not distinguish between long-term and short-term debt, clarifying the treatment of open lines of credit is unnecessary. Nevertheless, if FDIC were to proceed with such a classification, we offer the following suggestions. To clarify that "long-term debt" does not include revolving or similar facilities that exceed the term limit established in proposed Rule 380.2(a), the FDIC should insert the words "regardless of term" after the words "open lines of credit." However, again, rather than referring to the specific terms of the debt that is to be carved out of the definition, the FDIC should, to maintain flexibility for the FDIC and protection for creditors of major financial companies, carve out of the definition of "long-term senior debt" *any* financing agreement or arrangement that the FDIC seeks to enforce after its appointment as receiver, including contingent-capital instruments and similar arrangements. This proposal (as well as our recommendation that the FDIC refer to the remaining maturity of long-term debt) could be achieved by revising the definition of long-term senior debt as follows:

> For the purposes of this section, the term ''long-term senior debt'' means **any** ~~senior~~ **unsecured, unsubordinated** debt ~~issued by~~ **that** the covered financial company **has issued** to bondholders or other creditors **and** that has a **remaining** term of more than 360 days**, other than**~~. It does not include partially funded, revolving or other open lines of credit that are necessary to continuing operations essential to the receivership or any bridge financial company, nor to~~ any contracts to extend credit enforced by the receiver under 12 U.S.C. 5390(c)(13)(D).

3. Should there be further limits to additional payments or credit amounts that can be provided to shorter-term general creditors? Are there further limits that should be applied to ensure that any such payments maximize value, minimize losses, or are to initiate and continue operations essential to the implementation of the receivership or any bridge financial company? If so, what limits should be applied consistent with other applicable provisions of law?

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12 U.S.C. 5390(b)(4), (d)(4), or (h)(5)(E) to or for some creditors but not others similarly situated at the same level of payment priority, in a manner that would result in the party extending such credit recovering more than the amount established and due under 12 U.S.C. 5390(b)(1), or other priorities of payment specified by law.

(c) For the avoidance of doubt, the payments and credited amounts prohibited by Rule 380.2(a) shall not include any value, whether present, future, or contingent, that any creditor may realize as a result of accepting any interest in or instrument of any bridge financial company or other entity formed for the purpose of, or in connection with, the restructuring, reorganization or resolution of any covered financial company, or any warrant, option or right to receive any such interest or instrument, in satisfaction or resolution of the claim of that creditor.

As we note above, we believe that the FDIC should retain the flexibility to act in response to circumstances as they arise, and we therefore recommend that the FDIC adopt no further regulatory limits to additional payments or credit amounts.

4. Under the proposed rule, the FDIC's Board of Directors must determine to make additional payments or credit amounts available to shorter-term general creditors only if such payments or credits meet the standards specified in 12 U.S.C. 5390(b)(4), (d)(4), and (h)(5)(E). Should additional requirements be imposed on this decision-making process for the Board? Should a super-majority be required?

In view of the need for predictability in the marketplace and for ensuring equitable application of any restrictions, we believe that, should the FDIC elect to adopt any additional requirements, they should be based on the satisfaction of objective standards, such as the use of proceeds, credit quality, or normal course of business of the debtor or bridge institution, rather than procedural requirements governing the FDIC board's exercise of its discretion.

5. Under the Dodd-Frank Act, secured creditors will be paid in full up to the extent of the pledged collateral, and the proposed rule specifies that direct obligations of, or those fully guaranteed by, the United States or any agency of the United States shall be valued for such purposes at par value. How should other collateral be valued in determining whether a creditor is fully secured or partially secured?

At the outset, we believe that it is critical that the final rule make clear the circumstances in which the proposed valuation mechanism will be used. The placement of this collateral-valuation rule within proposed Rule 380.2 suggests that it applies only to determine what portion of the claim be treated as unsecured. If that requirement were made completely clear so that it could not be misinterpreted in the heat of a crisis, then the rule could provide useful certainty to creditors.

We understand, however, that the FDIC intends that this valuation mechanism would be applied for a broader range of purposes under the Dodd-Frank liquidation authority. If this provision were to be applied more broadly, the potential for mischief is significant. To the extent that this provision is intended merely to restate the provisions of law—i.e., to state that a secured creditor is entitled either to retain its security interest in assets that the FDIC transfers to a third party or a bridge or to satisfaction of the secured portion of the claim out of the proceeds of the collateral—the rule should track the statutory language more specifically.

In its current form, the proposed rule, by stating that claims "shall be paid" to the extent of the value of collateral and specifying the value to ascribe to collateral, appears to create an obligation on the part of the receiver to, in fact, pay to each creditor holding collateral the value of that collateral as defined in the rule—whether or not the funds available to the receivership estate are sufficient to make those payments. At the same time, the rule does not make clear what the rights of the secured creditor with respect to the collateral would be after giving effect to that payment. This leads to a number of questions:

- Would the FDIC, in fact, be obliged to pay the value of the collateral (as so defined) to the creditor? Would it be obliged to pay that amount only in exchange for the release of the collateral? The proposed text of the rule would appear to create such an obligation on the part of the FDIC, as receiver, but does not make clear that such payment would permit the FDIC to "redeem" the collateral.

- If a creditor believes that the value that the creditor would receive for the collateral in the open market is greater than the value prescribed by the rule, must the creditor sell the collateral to the FDIC at the prescribed value? Or may the creditor sell the collateral into the open market? The rule does not directly address these questions but, by not specifying any obligation on the part of the creditor, appears to allow such a creditor to choose to sell the collateral into the market rather than accept payment from the FDIC.

- If the FDIC sells the collateral to a bridge or a third party (subject to the pre-existing lien), and the proceeds of the collateral that the transferee actually receives differ from the prescribed valuation, how does the proposed rule resolve that difference? The rule would appear to require the FDIC, as receiver, to make up the difference.

- If the creditor can reject the FDIC's valuation and instead sell the collateral in the market, which valuation determines the creditor's residual unsecured claim: the valuation designated by regulation or the valuation actually obtained upon sale? Although unclear, the rule suggests that the residual claim would be based on the valuation mandated by the regulation.

- How would the valuation determined under the proposed rule interact with the non-defaulting parties' rights to liquidate and apply collateral under contracts and other provisions of the Act? If a creditor believes that it can realize an amount greater than or equal to the valuation determined under the proposed regulation, will the FDIC lift the stay on the exercise of remedies provided by Section 210(c)(13)(C) of the Act? The rule does not provide guidance as to the manner in which the FDIC will exercise its authority under this section, so the answers to these questions are unclear. Creditors thus cannot predict the treatment of their collateral rights, order their arrangements with the pledging institution before a default, or evaluate their risk as the institution begins to fail and after a proceeding has begun.

- In some cases (for example, with respect to "qualified financial contracts" or "QFCs,"[6] in some circumstances), a counterparty may have the right to liquidate and apply collateral shortly after the appointment of the FDIC as receiver. That

[6] *See* Dodd-Frank Section 210(c)(8)(D)(i) for the definition of "qualified financial contracts."

liquidation may result in an actual valuation that differs substantially from the value determined under the proposed rule. Which valuation would determine the creditor's residual claim? As we note above, the rule is unclear but suggests that the residual claim would be based on the valuation mandated by the regulation.

- For contracts that are not QFCs, the Act may limit the creditor's right to liquidate collateral by virtue of both the 90-day stay on the exercise of remedies specified in Section 210(c)(13)(C) and the restriction on foreclosure without FDIC consent set forth in Section 210(q)(1)(B) of the Act. These limitations make it difficult to evaluate how the valuation rule would affect a non-QFC creditor. For example, if the collateral is valued as of the filing date but the creditor only gets its value at a later date, the creditor may be either advantaged or disadvantaged, depending on whether the collateral increased or decreased in value and whether the creditor's residual claim or clawback assessments are at issue.

- When would a creditor's collateral be valued: upon appointment of the FDIC as receiver, when the collateral is liquidated, or at some other time? Under the Bankruptcy Code, the timing of valuation depends on the purpose for which the valuation is made. The use of a different time could have a substantial impact on a creditor's rights against the estate.

Depending on the answers to these, and similar, questions, the proposed regulation could potentially impose significant injustices on both the secured creditors who are directly affected and other creditors of the covered financial company. For example, if (i) a creditor is not entitled to require the FDIC to "redeem" the collateral at the specified price but is instead required to liquidate and apply the collateral, (ii) the FDIC does not consent to lift the stay on the exercise of remedies, and (iii) the receiver does not perform under the secured contract, the potential variation between the actual proceeds obtained by the creditor and the valuation imposed by the proposed rule may be substantial. The result for the relevant creditor could be a significant loss or a potential windfall, depending on the circumstances. Importantly, it may interfere with the ability of creditors to hedge or protect themselves in the markets. Again, this will increase the reluctance of creditors to deal with institutions that are potentially subject to the Dodd-Frank liquidation authority, even on a secured basis, further enhancing the risk that a financial institution will default and increasing, not decreasing, systemic risk.

We understand that the FDIC's inclusion of this proposed provision arises out of its concern that counterparties may rush to liquidate collateral when a reasonable delay would result in obtaining a better valuation. We believe that existing state law (primarily the Uniform Commercial Code) already balances the right of a debtor to a commercially reasonable liquidation with the right of a creditor to protect itself from a debtor's default. The FDIC may avail itself of those provisions of law without adopting a regulation that has the potential to substantially muddy the already complex waters governing creditors' and debtors' rights.

Wrongly applied, the proposed regulation could substantially disadvantage creditors who find themselves dealing with liquidation under the Act rather than under the Bankruptcy Code.

The commentary in the NPR suggests that the FDIC is adopting a par-value-based valuation to encourage reliance on Treasury and agency securities, as opposed to other types of collateral. However, given the constraints on the application of the Dodd-Frank liquidation authority, we assume that the only time at which the proposed valuation would be applied would be a time in which markets are in significant turmoil. Typically, in these markets, Treasury and agency securities experience a "flight to quality," resulting in valuations that may actually exceed par. If the valuation used to determine eligibility for excess payments is artificially low, it may unduly favor creditors secured by Treasury and agency securities. On the other hand, using such an artificially low valuation for any other purpose, such as requiring a creditor to permit redemption of the collateral at the rule-based valuation, could severely disadvantage creditors secured by Treasury or agency securities.[7] The second sentence of Rule 380.2(c)[8] should therefore be deleted. In any event, if the FDIC wants to promote the use of this type of collateral, it can do so in other ways, such as by adopting a safe harbor or presumption that the FDIC would not challenge a creditor's disposition of such collateral on the basis that it is not commercially reasonable. The FDIC also could insert a statement in the preamble to the rule that the FDIC would reserve its rights to challenge a disposition of other collateral under applicable state law relating to commercially unreasonable dispositions of collateral.

At a minimum, we believe that, before this rule is adopted, this issue needs to be more fully considered and discussed and should thus not be included in any initial rulemaking. Indeed, no rule should be adopted until clear answers to all the questions above have been established. The text of the proposed rule has the potential to subject creditors of systemically significant financial institutions to conditions that are unlike those applicable to any other type of debtor. Furthermore, if the FDIC intends to create a regulatory overlay on existing law, the FDIC should address the treatment of secured creditors more comprehensively, providing needed clarity more generally to parties dealing with covered financial companies. If adopted, the rule must address (i) the timing of the valuation of collateral in all situations described above, (ii) the process for that valuation, (iii) the rights of creditors to exercise their own judgment about the valuation of collateral and the potential actions that a creditor may take to maximize its recovery, such as making credit bids, taking the collateral, and holding it or liquidating it independently, and (iv) the ability of the creditor to dispute FDIC valuations in court. The rule should also be consistent with the Act's mandate that creditors receive at least

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[7] The proposed rule also appears to contain a drafting error, by referring to the "value" of the claim secured by Treasuries, rather than the value of the collateral securing that claim. If read literally, this sentence would value the claim secured by the Treasuries collateral at par, a result that does not appear to be intended; for example, a $100 claim secured by $1 in Treasuries would be valued at $100, rather than $1.

[8] The sentence to be deleted reads as follows: "Proven claims secured by such security interests or security entitlements in securities that are direct obligations of, or that are fully guaranteed by, the United States or any agency of the United States shall be valued for such purposes at par value."

what they would in a liquidation under the Bankruptcy Code. In addition, the rule should address the manner in which the FDIC intends to apply Section 210(q)(1)(B), which, in addition to the automatic stay and other limitations on the exercise of foreclosure remedies, requires the FDIC's affirmative consent before a creditor may exercise its rights with respect to collateral. Under the mirror provision of the Federal Deposit Insurance Act,[9] the FDIC issued a policy statement granting advance consent to the exercise of remedies.[10] The FDIC should include a similar advance consent in the proposed rules.

Regardless of the purpose for which the valuation is used, we believe that it would be helpful for the proposed rule to specify, with respect to securities that accrue interest, that the valuation will include both par and accrued interest. Further detail may be required to address the valuation of specific instruments, such as Treasury strips or slugs (i.e., discounted securities).

6. During periods of market disruption, the liquidation value of collateral may decline precipitously. Since creditors are normally held to a duty of commercially reasonable disposition of collateral [Uniform Commercial Code], should the FDIC adopt a rule governing valuation of collateral other than United States or agency collateral? Would a valuation based on rolling average prices, weighted by the volume of sales during the month preceding the appointment of the receiver, provide more certainty to valuation of other collateral? Would that help reduce the incentives to quickly liquidate collateral in a crisis?

In general, avoiding arbitrary distinctions among collateral of different types is important because such rules may distort the market for those assets at a time of crisis—potentially driving down valuations on disfavored assets and further driving up valuations for favored assets. Furthermore, rules that artificially disfavor types or categories of collateral exacerbate systemic risk because they increase the risk that major financial companies will fail, as short-term creditors find themselves forced to take action pre-failure to protect themselves if and when a Dodd-Frank liquidation proceeding begins. For example, if a creditor's ability to claim for any unsecured residual in the receivership is to be reduced as a result of an artificially low valuation, this may increase the pressure on creditors to maximize their collateral recoveries by liquidating promptly, rather than to take a longer-term view.

7. Are changes necessary to the provisions of proposed Sections 380.3 through 380.6? What other specific issues addressed in these sections should be addressed in the proposed rule or in future proposed rules?

With respect to the subject matter of the proposed rules themselves, we believe that the FDIC should incorporate into Rule 380.4 the view stated in the preamble to the NPR that "an obligation in the form of a guarantee or letter of credit is no longer contingent if the principal obligor (i.e., the party whose obligation is backed by the guarantee or letter of credit)

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[9] 12 U.S.C. § 1825(b)(2).

[10] See *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).

becomes insolvent or is the subject of insolvency proceedings." As the FDIC is aware, the concept of "contingency" has been a significant barrier to claimants under the provisions of the Federal Deposit Insurance Act and was a significant source of concern to creditors contemplating the adoption of Dodd-Frank. Several provisions were thus included in the Act to ensure that contingent creditors would be treated as they would under the Bankruptcy Code. Providing as much clarity as possible as to the manner in which the FDIC will apply these provisions would substantially reduce market uncertainty in routine dealings with major financial companies and ensure that the statutorily mandated "floor" on creditor recoveries under Dodd-Frank is satisfied.

In addition, we believe that Rule 380.4 should state that a "claim based on a contingent obligation of the financial company shall be provable against the receiver." Furthermore, the timing at which contingency is determined should conform to the timing under the Bankruptcy Code, which provides that the occurrence of the contingency will be recognized at any time, including well after the commencement of the bankruptcy case, for purposes of determining the claim amount, so long as doing so would not "unduly delay the administration" of the bankruptcy case.[11] Because the late occurrence of a contingency may affect the amount of the claim, the statutory mandate that creditors receive no less than they would in a liquidation under the Bankruptcy Code mandates that the FDIC, in a Dodd-Frank liquidation, adopt the same rule.

To achieve these goals, we propose that Rule 380.4 be revised to read as follows:

§ 380.4 Provability of claims based on contingent obligations.

(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**s** that become~~s~~ due and payable upon the occurrence of a specified future event (other than the mere passage of time), which:

(1) ~~I~~**i**s not under the control of either the covered financial company or the party to whom the obligation is owed; and

(2) ~~H~~**h**as not occurred ~~as of the date of the appointment of the receiver~~ **prior to final distributions on claims generally**.[12]

(b) A claim based on a contingent obligation of the covered financial company ~~may~~ **shall** be provable against the receiver notwithstanding the obligation not having become due and payable as of the date of the appointment of the receiver.

[11] See Section 502(c)(1) of the Bankruptcy Code.

[12] This proposed language would effectively create a safe harbor of at least 90 days for contingent claims to become fixed, given that the final distribution on claims generally cannot be made by the receiver before the end of the statutorily provided 90-day minimum claims period.

(c) If the receiver repudiates a guarantee, letter of credit, loan commitment, or similar credit obligation that is contingent ~~as of the date of the receiver's appointment~~, the actual direct compensatory damages for repudiation shall be no less than the estimated value of the claim as of the date the Corporation was appointed receiver of the covered financial company, as such value is measured based upon the likelihood that such contingent claim would become fixed and the probable magnitude thereof.

(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).[13]

We also believe that the FDIC should adopt regulations to implement the statement in the preamble to the NPR that the "rules of Title II governing the setoff of mutual debt provide equivalent protections to those under the Bankruptcy Code." While that statement is largely true, Dodd-Frank contains a provision[14] that grants the FDIC the power to assign claims that a failed financial company holds against creditors. Such an assignment could impair those creditors' setoff rights, which would otherwise have been enforceable in bankruptcy. This difference may have a substantial financial impact in the event of a failure of a financial company and, even before such failure, result in substantially different regulatory capital treatment of offsetting obligations. If the FDIC intends to enforce the provisions of the Act consistent with the description in the preamble, we believe that additional regulations should be issued to effectuate that intention.

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

The Act specifically calls for rulemaking in a number of areas. Each of these areas reflects an area of substantial complexity and would benefit from well-considered and comprehensive rulemaking. We urge the FDIC (jointly with other agencies, where appropriate) to address these topics as a matter of urgency. In particular, we would urge action regarding the following areas.

[13] It will also be necessary to adopt regulations clarifying the meaning of "adequate protection" in this context.

[14] Dodd-Frank Section 210(a)(12)(F).

- The treatment of futures commission merchants ("**FCMs**") that are subsidiaries of major financial companies. While liquidation authority was one major element of the Act, another was the clearing of customer derivatives. Swap dealers and clearing agencies are working to adopt the changes necessary to satisfy this fundamental statutory mandate, but they face a significant lack of clarity regarding the treatment of cleared derivatives in the failure of a swap dealer subject to the Dodd-Frank liquidation authority. Prompt clarification regarding the impact of a swap dealer's failure on its customers and the clearing houses, including the interaction of the Act with the rules that apply to FCMs under the Bankruptcy Code and the Commodity Futures Trading Commission's Party 190 Rules, will further the goals of the Act.

- We believe that the FDIC should adopt, by regulation, the analysis of the bankruptcy courts as to when a transferee of a voidable transfer should be treated as a mere conduit for that transfer and therefore not be liable for clawback under the avoidance provisions of the Act. We believe that this regulation would facilitate confidence in dealing with major financial companies and constitute a significant step toward conforming the rights of creditors under the Act with those under otherwise applicable insolvency law, as the statute mandates.

Conclusion

The Clearing House acknowledges the enormity of the task facing the FDIC under Title II. Creating an insolvency regime to address multi-tiered, complex financial institutions will require careful analysis and the weighing of important and competing policy goals. It also requires careful coordination with ongoing global efforts to craft a systemic resolution framework that prevents the conclusion that entities are "too big to fail" and the resulting risk to taxpayers and the financial system. We urge the FDIC to act promptly on its rulemaking procedures—but not so promptly as to prevent this critical analytical step. Accordingly, we urge the FDIC to withhold adopting Section 380.2 until, as part of the planned 90-day rulemaking process, its impact on, and implications for, financial institutions and their creditors have been thoroughly evaluated and the rule can be placed within a broader framework of regulations governing the conduct of liquidations under the Act. Furthermore, we urge the FDIC to continue its dialogue with representatives of all affected constituencies to identify and deal with the unique issues arising in the context of these liquidation proceedings, and we respectfully request the opportunity to meet with you to discuss any questions you may have regarding this letter. The ability of complex financial institutions to operate in a safe and sound manner, and the confidence of market participants dealing with these creditors, will be significantly affected by the FDIC's willingness to take the time needed to work these issues through to their proper conclusion. If the FDIC concludes that it cannot defer these far-reaching regulations even for this additional brief period, or such period as a full analysis of the issues would require, we urge the FDIC to consider the specific textual changes noted in this letter to mitigate, in part, the concerns raised in this letter.

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The Clearing House appreciates your consideration of the views expressed in this letter. Many of these matters are complex and involve a number of interrelated policy and practical issues. We would appreciate the opportunity to meet with you to discuss the proposed rules and our comments in this letter and subsequent ones. If you have any questions or need further information, please contact me at (212) 6139812 (email: Mark.Zingale@TheClearingHouse.org) or Eli Peterson, Vice President and Regulatory Counsel, at (202) 649-4602 (email: Eli.Peterson@TheClearingHouse.org).

Very truly yours,

Senior Vice President and
Associate General Counsel

cc: Mr. Michael K. Krimminger
Deputy to the Chairman for Policy
Federal Deposit Insurance Corporation

R. Penfield Starke, Esq.
Counsel, Legal Division
Federal Deposit Insurance Corporation

Karen Shaw Petrou
Managing Partner
Federal Financial Analytics, Inc.

H. Rodgin Cohen, Esq.
Partner
Sullivan & Cromwell LLP

Rebecca J. Simmons, Esq.
Partner
Sullivan & Cromwell LLP

The Clearing House Association Bank Regulatory Committee

The Clearing House Association Government and Public Affairs Committee

The Clearing House Association Working Groups on Basel Capital Proposals

Paul Saltzman
Executive Vice President and General Counsel
Head of *The Clearing House Association*

Joseph R. Alexander
Senior Vice President and Deputy General Counsel
The Clearing House Association