Denyette DePierro
Senior Counsel
Office of Regulatory Policy
202-663-5333
ddepierr@aba.com

Thursday, November 18, 2010

By electronic delivery to:

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th St, NW
Washington, DC 20429

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

FR Doc. 2010-26049

Dear Mr. Feldman;

The American Bankers Association[1] (ABA) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) Notice of Proposed Rulemaking (NPR) to "implement certain provisions of its authority to resolve covered financial companies under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act ["Dodd-Frank Act"]."[2] This NPR relies on a bifurcated comment period with comments due Thursday, November 18, 2010, on certain technical issues and comments on a broader set of questions due Tuesday, January 18, 2011.

In this first letter, ABA's comments will focus on select aspects on the questions posed in the NPR. Part I of this letter responds to the proposal generally; ABA's responses to the specific questions posed for the November 18 comment letter are addressed in Part II. The January 2011 letter will provide additional information on these and other issues as appropriate following further consideration by the ABA membership.

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[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its 2 million employees. The majority of ABA's members are banks with less than $165 million in assets. Learn more at www.aba.com.

[2] FDIC's Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. *See* 75 Fed. Reg. 64173 (October 19, 2010). Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203 (July 21, 2010).

PART I: Implementation of FDIC's Orderly Liquidation Authority (OLA)

ABA supports the development of a mechanism for the orderly resolution of systemically important non-bank financial companies. The necessity of such a system was demonstrated in the recent financial crisis, which was exacerbated by the failure to resolve troubled non-banks in a predictable, uniform, and non-disruptive manner. During the crisis, government action treated some financial institutions as if they were too big or too complex to fail and in other cases failed to convince markets that it would *not* intercede. The too-big-to-fail concept has profound moral hazard implications and serious competitive consequences for the industry as a whole. A major ABA priority in the recent legislative effort has been to end too-big-to-fail, including the market perception of its existence. No firm should be considered too big to fail, and an effective and clearly recognized process for the resolution of any failing financial firm is an essential part of achieving that goal. This includes the construction of a comprehensive resolution mechanism for non-bank financial companies.

The structure and protocols for systemic risk resolution will shape the structure and fairness of the financial system. A suitable systemic risk resolution process should—

1. Create a workable liquidation regime that will stand up through a significant financial crisis;
2. Protect the taxpayer;
3. End too-big-to fail;
4. Be fair to financial firms of all sizes and business models, in terms of competitiveness and cost; and
5. Not impair the ability of financial markets to function effectively.[3]

We appreciate the FDIC's efforts to achieve these objectives. Unfortunately, the lack of detail and clarity found in the current orderly liquidation authority (OLA) framework is disconcerting to potential creditors who are carefully observing the development of OLA regulations. Care should be taken throughout the rulewriting process to demonstrate that the final framework will result in an efficient liquidation process with predictable outcomes. Anything less will impair the ability of financial markets to function effectively and will likely fall short of convincing the markets that too-big-to-fail has been eliminated as a policy option.

[3] Testimony of Edward L. Yingling on behalf of the American Bankers Association before the Committee on Financial Services, United States House of Representatives, October 20, 2009.

A Minimum of Sixty-Days Is Necessary for Comments

The ABA appreciates the implementation burden placed on the FDIC by the prescribed deadlines of the Dodd-Frank Act. However, unlike many of the other rules and regulations created under the Dodd-Frank Act, the OLA has no delivery deadline. Title II requires OLA implementing rules to be promulgated, but Congress wisely did not impose a deadline for a final rule governing the regulatory framework[4] or the management of Treasury funds.[5] The nation's financial system would be well served if the FDIC used the flexibility granted by Congress to adopt a measured and deliberate approach to the development and implementation of its Title II authority. The issues presented in the Dodd-Frank Act are complex and require careful analysis. Only after thoughtful discussion made possible by a comment period long enough to provide adequate deliberation can the industry offer a comprehensive response to the complex and regime-changing proposals presented in this and future proposals.

The FDIC's intent in issuing the proposed OLA rule "is to provide greater clarity and certainty about how key components of this authority will be implemented and to ensure that the liquidation process under Title II reflects the Dodd-Frank Act's mandate of transparency in the liquidation of failing systemic financial companies."[6] ABA appreciates the FDIC's efforts to provide clarity and certainty through an open rulewriting process and increased transparency. However, it is difficult for industry to comment on the pieces of the proposal when not yet understanding the plan in the aggregate.

During the development of the Dodd-Frank Act, ABA advocated for a strong liquidation regime that clearly addresses issues that will impact management, the board of directors, and equity investors. In the absence of a clear understanding of credit risk, banks will price for the worst case – a circumstance that would increase the price of funding to any financial company or bank holding company that could potentially fall within the jurisdiction of FDIC non-bank liquidation. Only with regulatory clarity will markets and potential stakeholders know their risk and be able to price risk accordingly. The objective of a detailed OLA regulatory framework should be a controlled resolution of a complex financial company with minimal disruptions to the market or national economy.

[4] Sec. 203(d)
[5] Sec. 209
[6] *See* Fed. Reg. 64173

Development of a New Resolution Regime Requires Frequent Review and Revision

Congress intended to create a new liquidation regime that is more efficient and effective for complex financial companies than existing liquidation tools. To encourage the continual improvement of OLA through review and revision, section 202 of the Dodd-Frank Act gives joint authority to the Administrative Office of the United States Courts and the Comptroller General of the United States (GAO) to deliver a series[7] of studies. The studies will "monitor the activities of the Court… regarding bankruptcy and the orderly liquidation process for financial companies under the Bankruptcy Code."[8] Among the issues to be studied are the effectiveness of chapter 7 and chapter 11 bankruptcy in managing the orderly liquidation or reorganization of financial companies, maximizing the "efficiency and effectiveness of the Court[,]"[9] and making recommendations to make the orderly liquidation process more efficient for financial companies.[10]

The Dodd-Frank Act emphasis on review and revision serves as a good example for OLA implementation. The creation of the OLA regime should not be limited to a fixed time, but a continual process with reoccurring opportunities for review, revision, and improvement. The periodic §202 OLA studies can serve as a catalyst for regular dialogue across the industry to review the OLA structure, rules, and implementation. With time, familiarity with the OLA process will bring its own clarity, and the industry will be in a better position to comment and recommend changes.[11]

The FDIC Deposit Insurance Fund Should not Be Used to Finance Non-Bank Liquidations

A primary concern for the ABA is the continued partition of the FDIC Deposit Insurance Fund (DIF) from FDIC non-bank liquidations. The DIF is entirely funded by premiums and special assessments paid by FDIC insured depository institutions, together with any earnings on those premiums held in reserve by the FDIC. In addition to previous assessments, the new risk-based assessment established under the Dodd-Frank Act will continue to augment the DIF to levels that no longer are subject to a statutory cap.[12] The hazards presented by an unlimited DIF will be addressed by an ABA comment letter to be filed by Friday, November 28, 2010 in response to the FDIC's proposed DIF Restoration Plan.[13]

[7] Pub. L. No. 111-203, §203(e)(2) codified at 12 U.S.C. 5383(e)(2). The studies are to be released "[n]ot later than 1 year after the date of enactment of [the Dodd-Frank Act], in each successive year after the third year, and every fifth year after the date of enactment…"
[8] Pub. L. No. 111-203, §203(e) codified at 12 U.S.C. 5383(e). *Study of Bankruptcy and Orderly Liquidation Process for Financial Companies.*
[9] Pub. L. No. 111-203, §203(e)(1)(B)(ii) codified at 12 U.S.C. 5383(e)(1)(B)(ii).
[10] Pub. L. No. 111-203, §203(e)(1)(B) codified at 12 U.S.C. 5383(e)(1)(B).
[11] Any proposed changes to OLA stemming from a §202 study should be subject to notice and comment.
[12] The Dodd-Frank Act requires a designated reserve ratio of not less than 1.35 percent for any year. Pub. L. No. 111-203, §334(a), 124 Stat. 1376, 2709 codified at 12 U.S.C. § 1817(b)(3)(B). The Dodd-Frank Act also requires "such steps as may be necessary" to increase the level of the DIF to 1.35 percent of estimated insured deposits by September 30, 2020. Pub. L. No. 111-203, §334(d), 124 Stat. 1376, 2709 codified at 12 U.S.C. §1817(d).
[13] 75 Fed. Reg. 66272, Oct. 27, 2010.

As the OLA mechanism is being designed and once it is fully established, participants in the financial system need assurances that the DIF will not be used to fund FDIC non-bank liquidation activities. Otherwise, over time there will be a strong temptation to rely on the DIF to pay for non-bank liquidations much as other federal trust fund resources have been diverted to unintended uses. In the case of the DIF, such a misallocation of DIF resources could undermine public confidence that there will always be adequate resources within the DIF to honor all insured deposits, as there has always been throughout the history of the FDIC, including the most recent experiences. ABA and its member banks strongly opposed the DIF being used for any reason other than the protection of insured depositors.

PART II: ABA Responses to the FDIC Request for Comment

Treatment of Long-Term Senior Debt.

At this time, the FDIC should not adopt the proposed rules defining and controlling the treatment of short-term and long-term debt. The banking industry needs additional time to evaluate potential unintended market consequences of a maturity-based or term-based rule as proposed. In addition to the initial comments below, ABA's January 18, 2011, letter will provide a further response on this matter.

The OLA treatment of debt, whether long- or short-term, should not be determined by the debt term. There are classes of long-term debt, such as long-term hedges and other risk mitigation tools that are essential to critical business functions and should not receive less favorable treatment than short-term debt merely due to the length of term. To treat a multi-year hedge as disfavored long-term debt fails to recognize the importance of hedging to a stable business model and may cause the cost of long-term hedges to increase and undermine bank efforts to manage risk efficiently.

The preferential treatment of short-term debt also threatens to place the banking industry out of step with the Basel III[14] and heightened prudential supervision standards under the Dodd-Frank Act,[15] which focus on longer-term debt. In response to these new standards, large financial institutions already are reducing their exposures to short term funding. The reliance on term encourages creditors simply to manipulate debt terms and creates a perception of regulatory preference for short-term debt. This is contrary to sound banking practices, which ask banks to select long- and short-term debt, not based on regulatory preference or treatment in liquidation, but to balance risk.

[14] The Basel III standards, developed by the Basel Committee on Banking Supervision, require banks to hold minimum common equity equal to 4.5 percent of risk-weighted assets, Tier 1 capital equal to 6 percent, and total capital equal to 8 percent. The standards also require banks to hold a "conservation buffer" equal to 2.5 percent in each category. Basel III standards are scheduled to be phased in for U.S. banks by January 1, 2013.

[15] Title I of the Dodd-Frank Act gives the Board of Governors of the Federal Reserve broad powers to establish prudential standards and disclosure requirements for large bank holding companies and significant nonbanks. The new prudential supervisory framework must be more stringent that the rules applied generally and must address several areas of oversight, including capital, liquidity, concentration limits, and risk management, among others.

Streamlined and Efficient Process for Approving Additional Payments

The proposal allows some additional payments to shorter-term general creditors if the payments meet certain requirements, and additional payments are approved by a recorded majority vote of the FDIC Board of Directors (the Board).[16] While in line with the FDIC's efforts to bring transparency to the liquidation process, subjecting additional payments to Board approval threatens to restrict the FDIC's authority to manage a liquidation or bridge company efficiently. The process as proposed is time-consuming, cumbersome, and it introduces an unfortunate and unpredictable element of subjectivity into the resolution process, frustrating efforts to eliminate the public perception of the perseverance of too-big-to-fail. Moreover, it would impede unnecessarily the management of a liquidation or operation of a bridge company, without creating substantial transparency or certainty.

ABA recommends a two-part process that would assure efficient operation of liquidations while preserving the oversight and transparency of Board approval. The authority to make payment decisions for essential business functions should be within the exclusive purview of the FDIC staff directing the daily operation of the liquidation or bridge company in keeping with policies set by the Board and oversight provided by appropriate accountability programs (including inspector general reviews). A recorded majority vote by the Board should be reserved for the unusual circumstance where further review or greater transparency is appropriate.

Treatment of Collateral

The proposal's lack of clarity in the treatment of collateral is troublesome and undermines creditor confidence in the nascent OLA regime. Collateral valuation and transfer of collateral is a routine and well-known process in bankruptcy. The proposal should clearly address the valuation and treatment of collateral, including the procedures governing the timing of valuation, and the appeal of valuation disputes, among others. However, neither the statute nor the proposal offers a clear framework to evaluate the treatment of collateral and secured creditor claims in FDIC liquidation. Thus, without detail as to the treatment of collateral and ample time to consider the impact on banks and funding, it is difficult for the ABA to evaluate the proposal or make recommendations for its improvement. What must be borne in mind is that an approach to collateral that may be appropriate for a resolution regime involving government-insured deposits may not be appropriate outside of that context.

[16] *See* Fed. Reg. 64181, §380.2(4)

Changes to Proposed Sections 380.3 through 380.6

§380.3 – Treatment of personal service agreements

Under §213(d) of the Dodd-Frank Act, the FDIC will be collaborating with the Board of Governors of the Federal Reserve to produce joint regulations controlling the definition of "senior executives" and the implementation of the rule to remove management from bank holding companies and financial companies upon liquidation. Although the bulk of our comments will be reserved for this later proposal, the importance of this issue to bank holding companies should not be overlooked and is closely tied to understanding the aggregate affect of this proposal on the banks, both as creditors and subsidiaries of bank holding companies.

1. Certainty Is Needed in the Scope and Application of Proposed Removal of Bank Holding Company Executives.

Under the proposed liquidation rules, "the FDIC must remove any management and members of the board of directors of the company who are responsible for the failing condition of the covered financial company." The removal of management is of particular concern to bank holding companies where it is common for senior executives to be intertwined with the senior management of subsidiaries and affiliates. Although the removal of management may be essential to fulfilling the statute's focus on accountability, the process, procedures, and timing for identifying and removing management needs to be clarified in regulation to allow subsidiaries – both bank and non-bank – to prepare business continuity plans, succession strategies, and operational redundancy.

The proposal is unclear as to the treatment of bank holding company executives who hold joint positions at the bank holding company and a subsidiary. Will senior executives be removed as a matter of course from all concurrent positions they hold within all affiliated entities? The ability of a viable subsidiary to operate as a going concern and survive the liquidation of a parent is significantly greater if the subsidiary's management structure is intact. At a minimum, subsidiaries need to understand the implications of bank holding company liquidation in order to prepare an emergency plan if faced with unexpected and widespread terminations among senior executives.

2. §380.3(a)(2) Definition of "Senior Executive" – Regulation O Conforming Amendment.

The definition of the term "senior executive," mirrors the definition used in Regulation O.[17] However, under Regulation O, a *resolution* of the board of directors can exclude an executive officer from the definition of senior executive. In the text as proposed, a person is an executive director, "unless the person is excluded, by *liquidation* of the board of directors…" In order to conform to the Regulation O definition, the term "resolution" should be substituted for the term "liquidation," or the term "liquidation" needs to be better defined in this context.

<u>Other issues</u>

Ambiguity of OLA Jurisdiction

The threshold governing the application of OLA to non-bank financial companies operates with a strong presumption favoring the bankruptcy court[18] as the appropriate venue for most non-bank liquidations. By assumption, an FDIC-assisted liquidation is reserved only for those few companies meeting the threshold criteria established in the statute. The statute asks the FDIC and the Board of Governors of the Federal Reserve, working with Treasury and the President, to consider—[19]

1. Whether the financial company is in default or danger of default;
2. The effect on financial stability in the United States;
3. The effect on economic conditions or financial stability for low income, minority, or underserved communities;
4. The nature and extent of action required under Title II authority;
5. The likelihood of private sector alternatives to prevent default;
6. Whether bankruptcy is an appropriate venue;
7. The effect on creditors, counterparties, shareholders, and other market participants; and
8. Whether the company is a financial company as defined under §201.

[17] 12 C.F.R. § 215.2(e)(1) "The chairman of the board, the president, every vice president, the cashier, the secretary, and the treasurer of a company or bank are considered executive officers, unless the officer is excluded, by <u>resolution</u> of the board of directors or by the bylaws of the bank or company, from participation (other than in the capacity of a director) in major policymaking functions of the bank or company, and the officer does not actually participate therein." [Emphasis added.]
[18] Pub. L. No. 111-203, §203(e) codified at 12 U.S.C. 5383(e) *Treatment of Insurance Companies and Insurance Company Subsidiaries.* The liquidation or rehabilitation of insurance companies and insurance company subsidiaries will be conducted according to applicable state law.
[19] Pub. L. No. 111-203, §203(a)(2)(A)-(H) codified at 12 U.S.C. 5383(a)(2)(A)-(H).

Although the assumption is that FDIC assisted liquidation was created for only the most systemically significant companies, nothing in the criteria requires a financial company to be systemically significant. Any bank holding company or financial company could qualify, even if the company was never identified as systemically significant prior to the time of resolution. From a creditor's perspective, this broad jurisdiction creates more credit risk for all financial companies, not only those predetermined as systemically significant. The OLA authority needs to be more limited, and in a manner clearly understood by the investor community. As recent experience has demonstrated, broad public misperception of a potential federal role in resolution of a failing financial firm can be a powerful source of market instability.

The industry also is concerned by the inequitable treatment of financial companies created by the ambiguous OLA jurisdiction. The assessment burden for the OLA fund falls on only two industry actors: financial companies regulated by the Federal Reserve and bank holding companies with $50 billion in consolidated assets.[20] These same companies also are subject to risk-based Title I assessments[21] and, if identified, the cost of heightened prudential supervision under Title I.[22] OLA's permeable and uncertain jurisdiction places these financial companies in the unfair position of funding the liquidation of financial companies that were not designated as SIFIs, never bore the costs of increased supervision, and did not pay assessments into the OLA fund. The burden of liquidating these undesignated, undefined, but OLA-eligible financial companies should not fall to the financial companies providing OLA funding. Overnight conversions of firms into OLA-eligible entities should be clearly banned under the rules and procedures.

A future proposal should specifically address the ambiguity of the OLA threshold criteria. Participants in the financial system in general, and the banking industry in particular, especially those banks that provide liquidity to financial companies and bank holding companies, need clarity and predictability, not only in the underlying OLA framework, but also in its designation of financial companies eligible for FDIC-assisted liquidation. The high threshold and approval process is intended to keep the application of OLA and the pool of eligible companies narrowly defined.

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[20] Pub. L. No. 111-203, §210(o)(1)(A) codified at 12 U.S.C. 5390(o)(1)(A).

[21] Title I assessments provide for the funding of FSOC and the Office of Financial Research. FSOC expenses are funded by the Office of Financial Research. Pub. L. No. 111-203, §118 codified at 12 U.S.C. 5328. C*ouncil Funding*. "During the 2-year period following the date of enactment of [the Dodd-Frank Act], the Board of Governors of the Federal Reserve shall provide to the Office [of Financial Research] an amount sufficient to cover the expenses of the Office." Pub. L. No. 111-203, §155(c) codified at 12 U.S.C. 5345(c) *Interim Funding*. "Beginning 2 years after the date of enactment of [the Dodd-Frank Act], the Secretary [of the Treasury] shall establish…an assessment schedule…applicable to bank holding companies with total consolidated assets of $50,000,000,000 or greater and nonbank financial companies supervised by the Board of Governors…to collect expenses equal to the total expenses of the Office [of Financial Research]." Pub. L. No. 111-203, §155(d) codified at 12 U.S.C. 5345(d) *Permanent Self-Funding*.

[22] Pub. L. No. 111-203, §115 codified at 12 U.S.C. 5325 *Enhanced Supervision and Prudential Standards for Nonbank Financial Companies Supervised by the Board of Governors and Certain Bank Holding Companies.* Large, interconnected bank holding companies and nonbank financial companies supervised by the Board of Governors of the Federal Reserve will be subject to the Dodd-Frank Act's heightened prudential regulation,

ABA appreciates the opportunity to comment on this proposed rulemaking. Please contact the undersigned at (202) 663-5333 or ddepierr@aba.com, if you have any questions. Thank you for considering our comments and recommendations.

Sincerely,

Denyette DePierro