MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

November 18, 2010

Via Electronic Filing:

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

Re: MFA Comments on Orderly Liquidation Authority Proposal

Dear Mr. Feldman:

Managed Funds Association ("MFA")[1] appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (the "FDIC") notice of proposed rulemaking (the "Proposed Rule") on the implementation of certain orderly liquidation authority provisions in Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). MFA supports an orderly liquidation authority that unwinds failing firms that pose a threat to the stability of the U.S. financial system.

Because Title II of the Dodd-Frank Act establishes a new liquidation framework that replaces well-established and widely-understood existing rules and practices under bankruptcy law, investors now face a significant amount of uncertainty, potential confusion and fear with respect to the implementation and consequences of this new framework. We believe that it is critical for the proper functioning of our capital markets and the reduction of systemic risk that regulators create clear, objective, pragmatic and equitable rules regarding the implementation of the resolution framework and reduce the current uncertainty and potential confusion investors and counterparties face.[2] Though the Proposed Rule provides helpful clarity regarding the treatment of creditors as

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1 MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

2 We note the relative ease in which the futures and options contracts held by Lehman Brothers on behalf of its customers were safely transferred out of the company within a single week of the bankruptcy filing, and believe regulators should consider aspects of the customer protections afforded futures customers under the futures insolvency regime. *See* Will Acworth, The Lessons of Lehman, Reassessing Customer Protections, Futures Industry Magazine, January/February 2009, *available at:* http://www.futuresindustry.org/fi-magazine-home.asp?a=1297.

compared to the statutory text, we believe that the proposed framework still needs to go further to provide greater certainty, a greater level of transparency and a more equitable approach regarding the treatment of creditors.

MFA supports efforts to develop procedures to govern the liquidation of systemically important financial institutions. However, these procedures should be in alignment with existing bankruptcy law to limit the unintended consequences of a resolution. Congress recognized the importance of maintaining consistent procedures when it stated that the FDIC should "seek to harmonize applicable rules and regulations promulgated under this section with the insolvency laws that would otherwise apply to a covered financial company."[3] We believe that this approach is critical to providing greater certainty to market participants and will maximize the effectiveness of the liquidation framework. Deviating from well-known, widely-understood and established rules and practices will substantially increase uncertainty and ultimately could increase systemic risk by inhibiting investors from staying invested in, providing capital to, or otherwise doing business with, financially weak or weakening firms – at the very time such firms need capital most. Procedures consistent with existing law and practices will facilitate the goal of ensuring an orderly wind-down. Therefore, unless otherwise specifically directed by the Dodd-Frank Act, we encourage the FDIC to implement rules under Title II of the Act in a manner consistent with existing rules and practices established under the Bankruptcy Code.

The MFA represents many firms that play an important role in our financial markets by purchasing the debt and securities of, and providing "rescue" capital to, distressed companies, including distressed financial institutions. They are particularly critical players who provide a floor to the marketplace in situations where other investors, including original (*i.e.*, par) bondholders in financial institutions are either unable or unwilling to remain holders of distressed debt or securities. Such distressed-focused investors must be able to make an informed decision analyzing the potential outcomes from a standpoint of fundamental valuation and distribution of that value, in order of priority, to the applicable creditors. Significant uncertainty, lack of transparency and/or arbitrary decision-making in connection with such distribution will have a chilling effect on the willingness of firms to invest capital in these situations – which will only serve to exacerbate adverse consequences for the marketplace.

Set out below are our comments on several key aspects of the Proposed Rule, which we believe are consistent with the approach contemplated by section 209 of the Dodd-Frank Act, including: (1) the categories of creditors eligible to receive additional payments beyond what they would otherwise receive under the defined priority of payments; and (2) valuation of assets of a failing financial firm. MFA intends to submit further comments on issues beyond the scope of the initial set of questions that the FDIC has requested comment on by November 18 including: (a) the ability of the FDIC to claw back payments made to creditors; (b) the treatment of qualified financial contracts ("QFCs") accepted by the FDIC; (c) increased transparency with respect to the FDIC's

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[3] Section 209 of the Dodd-Frank Act.

process and decision-making under the resolution framework; (d) review of non-emergency FDIC decisions; and (e) explicit guidance that all creditors and equity holders will be able to freely trade the debt or claims they hold after FDIC seizure and receivership.

Treatment of Similarly Situated Creditors

We acknowledge the provisions in the Proposed Rule that provide greater clarity to investors by narrowing the circumstances in which a creditor may be entitled to receive additional payments. If the rules allowing extra payments are too broad, we believe that creditors, including investors that hold outstanding debt of these institutions will face enormous incentive to divest their holdings at the first sign of distress. This withdrawal of liquidity will harm firms at the very time that they most need capital and could force companies into the liquidation process. This outcome is detrimental not to just the financially weak companies themselves but to the broader financial markets. Moreover, the potential for preferential treatment of certain debt holders (*e.g.,* holders of short-term debt) could lead to market distortions, as creditors would have an incentive to provide debt that could receive such preferential treatment. The follow-on effects on the market could be profound, with vulnerable firms failing more rapidly and contagion spreading to other financial firms of questionable health; in effect producing the opposite of the intended goals of reduced and contained risk.

Similar to the Bankruptcy Code framework, the Dodd-Frank Act requires claims to be paid in accordance with a statutory priority of creditors.[4] Under the Dodd-Frank Act, the FDIC generally must treat all similarly-situated claimants in a similar manner.[5] Notwithstanding this requirement, the Dodd-Frank Act also authorizes the FDIC to pay additional amounts to creditors if the FDIC determines such payments meet certain statutory and policy objectives.[6] The FDIC proposes in Section 380.2 of the Proposed Rule to explicitly prevent holders of "long-term senior debt" (as defined in the Proposed Rule) and other claimants of lower priority from receiving additional payments under 12 U.S.C. 5390(b)(4)(A), while potentially permitting holders of short-term to receive extra payments.

None of the priorities in the Bankruptcy Code depend on the time the debtor's obligation was incurred, except for considerations as to whether the obligation was incurred pre- or post-petition, or certain narrow exceptions where priority payments may occur. Under the Bankruptcy Code, similarly situated creditors must be treated similarly, unless the holder of a particular claim or interest agrees to less favorable treatment. Although the Bankruptcy Court has the power to treat similarly situated creditors

4 12 U.S.C. 5390(b)(1).

5 12 U.S.C. 5390(b)(4).

6 12 U.S.C. 5390(b)(4)(A).

dissimilarly, these exceptions are narrow and specific. For example, critical vendors may be paid in full for pre-petition claims if they are deemed necessary to the debtor's survival; parties to assumed executory contracts may be paid cure amounts relating to pre-petition claims; and certain trade creditors may be paid for goods sold and delivered to a debtor within 20 days before the bankruptcy filing.

We generally support the FDIC's approach of narrowing the categories of creditors who may be eligible to receive extra payments. Consistent with the approach taken under the Bankruptcy Code, however, we believe that the final rule should further narrow the categories to include only two categories of creditors: those that provide critical services to the failing institution (or bridge financial institution) such as utility, payment services providers and other essential vendors; and those parties to financial contracts that the FDIC requires to continue to perform under the contract (but only to the extent of their compelled performance). We further encourage the FDIC to eliminate the proposed distinction between creditors based on the length of the term of the financing provided to the failing institution. We believe this approach achieves the dual objectives of ensuring that critical services and funding continue to be provided to allow for an orderly liquidation, while minimizing the uncertainty that would result from a broad authority to treat similarly situated creditors differently.

Valuation

Appropriate valuation of assets is a critical component of any liquidation or dissolution process. Section 210(a)(3)(D)(ii)(I) of the Dodd-Frank Act[7] treats any portion of a secured claim which exceeds the fair market value of the underlying collateral as an unsecured claim, paid in the same manner as other general unsecured creditors.[8] The Dodd-Frank statutory framework does not define the term "fair market value" for the purpose of determining the amount of secured claim that will be treated as an unsecured claim. The Proposed Rule contemplates adopting a rule establishing a fixed valuation for U.S. government securities, and asks whether valuations should be fixed for other forms of collateral.

We believe that fixed parameters of fair market value set in advance of a resolution will lead to skewed valuations. As such, we believe that assigning fixed valuations for certain types of assets in advance, as the Proposed Rule contemplates for Treasury and other U.S. government securities, is likely to lead to valuations inconsistent with the statutory standard of fair market value. We further believe that assigning valuations in advance could lead to distortions in market activity.

We encourage the FDIC to develop valuation policies that will allow it to determine fair market value for all assets at the time it is acting as receiver. Developing

7 12 U.S.C. 5390(a)(3)(D)(ii).

8 We note that secured claims are treated separately from the Dodd-Frank Act's priority of claims under 12 U.S.C. 5390(b)(5).

written valuation policies will also provide market participants with greater certainty as to the fairness of the valuation process. We further encourage the FDIC to submit those policies for public comment to ensure appropriate transparency into the process and to allow market participants to provide their expertise to the FDIC with respect to valuation policies, particularly with respect to hard-to-value assets.

Conclusion

MFA appreciates the opportunity to comment on the Proposed Rule. We recognize the importance of developing an effective liquidation framework and we are committed to working with the FDIC as it develops rules to implement that framework. We look forward to continuing discussions with the FDIC as it continues its rule making on this important topic.

If you have any questions regarding any of these comments, or if we can provide further information with respect to these or other regulatory issues, please do not hesitate to contact Stuart J. Kaswell or me at (202) 367-1140.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO