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VIA ELECTRONIC MAIL (Comments@FDIC.gov)

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington D.C. 20429

Re: Proposed Orderly Liquidation Rulemaking

Ladies and Gentlemen:

The American Insurance Association ("AIA") appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's ("FDIC") notice of proposed rulemaking regarding implementation of certain provisions of the FDIC's authority to resolve covered financial companies under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[1] AIA represents approximately 300 major U.S. insurance companies that provide all lines of property-casualty insurance to U.S. consumers and businesses, writing more than $117 billion annually in premiums. Our members have a significant interest in the FDIC's proposed rule as it could impact property-casualty insurance companies. AIA recognizes that the FDIC's proposal is the first of several proposed rulemakings called for by Title II of the Dodd-Frank Act. We look forward to working with the FDIC on future proposals and in the implementation of Title II.

It Is Unlikely That A Property-Casualty Insurer Will Be Subject To Title II

Title II of the Dodd-Frank Act establishes a procedure for the appointment of the FDIC as receiver of a failing financial company that poses significant risk to the financial stability of the United States. Under this procedure, certain designated Federal agencies would recommend to the Secretary of the Treasury (the "Secretary") that the Secretary, after consultation with the President, make a determination that grounds exist to appoint the FDIC as receiver of the

[1] 75 *Fed. Reg.* 64173 (October 19, 2010).

company. The Federal Reserve Board and the Director of the Federal Insurance Office will make the recommendation if the company or its largest subsidiary is an insurance company.[2] The process is similar to that which is applied to systemic risk determinations under section 13 of the Federal Deposit Insurance Act.[3]

Recommendations to the Secretary are to include an evaluation of whether the covered financial company is in default or in danger of default, a description of the effect that the company's default would have on the financial stability of the United States, and an evaluation of why a case under the Bankruptcy Code would not be appropriate.[4] In determining whether the FDIC should be appointed as receiver, the Secretary must make specific findings in support, including that: the company is in default or in danger of default; the failure of the company and its resolution under otherwise applicable Federal or State law would have serious adverse effects on financial stability in the United States; no viable private sector alternative is available; any effect on the claims or interests of creditors, counterparties, and shareholders is appropriate; and any action under the liquidation authority will avoid or mitigate such adverse effects taking into consideration the effectiveness of the action in mitigating the potential adverse effects on the financial system, cost to the general fund of the Treasury, and the potential to increase excessive risk-taking.[5] If the Secretary makes the recommended determination and the board of directors (or similar governing body) of the company acquiesces or consents to the appointment, then the FDIC's appointment as receiver is effective immediately. Judicial review is available in the event the company's board objects to the appointment.[6]

AIA believes that the low risk profile of property-casualty insurers engaged in traditional insurance activities would effectively prevent such insurers from posing a systemic threat to U.S. financial stability.[7] As a result, AIA is of the view that the chances are quite remote that a property-casualty insurer would ever be designated a covered financial company under section 203(b).

Nonetheless, in order to deal with the uniqueness of the insurance industry, the Dodd-Frank Act has separate provisions that address the treatment of insurance companies under Title II's orderly liquidation process. If a covered financial company is an insurance company, or if an insurance company is a subsidiary or an affiliate of a covered financial company, liquidation of the insurance company is to be conducted in accordance with applicable state law.[8] The FDIC may step in to file an action in state court to place the company into liquidation <u>only</u> in the event that the appropriate state authority fails to initiate the required judicial action within 60 days of the determination. If the state authority files with the state court to place the company into liquidation, a receiver for the company will be appointed and its liquidation will proceed in

[2] Dodd-Frank Act, § 203(a)(1)(C). *See also* Dodd-Frank Act, § 502(a)(3) (adding 31 U.S.C. § 313(c)(1)(C)).
[3] 12 U.S.C. § 1823(c)(4).
[4] Dodd-Frank Act, § 203(a)(2).
[5] Dodd-Frank Act, § 203(b).
[6] Dodd-Frank Act, § 202(a)(1)(A)(i).
[7] *See Comments of the American Insurance Association in Response to Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (and related attachments)*, Docket ID No. FSOC-2010-0001-0029, 0029.1, 0029.2 & 0029.3 (Nov. 5, 2010), for a more detailed explanation of this position.
[8] Dodd-Frank Act § 203(e).

accordance with state law. There is nothing in section 203(e) or in the available legislative history of the Dodd-Frank Act that suggests that in the event the FDIC makes the required filing in state court, the court must appoint the FDIC as receiver. Absent such an appointment, the FDIC has no jurisdiction over the liquidation of the company in receivership. Accordingly, AIA believes that the FDIC is incorrect when it states that section 203(e) provides that the liquidation (or rehabilitation) of an insurance company shall be conducted either by the appropriate state agency or by the FDIC.[9] That statement should be clarified to note that the FDIC only has the authority to file if the state authority has failed to act and the state court chooses to appoint the FDIC, rather than another person, as receiver. Moreover, it should be clarified that the liquidation process in all instances occurs under state law.

<u>Losses Should Be Borne By Creditors Rather Than Through Industry Assessments</u>

In order to create parity in the treatment of creditors with the Bankruptcy Code and other normally applicable insolvency laws, section 209 of the Dodd-Frank Act directs the FDIC, to the extent possible, to harmonize its rules and regulations with the insolvency laws that would otherwise apply to a covered financial company. Accordingly, the FDIC's proposed rule emphasizes the basic principle that losses should be borne by creditors and shareholders, and never by taxpayers. In order to ensure that taxpayers bear none of the costs in the event the costs of a liquidation exceed available resources, the Dodd-Frank Act requires assessments be imposed on the financial sector.[10]

However, AIA does not believe that the FDIC's proposal goes far enough. AIA believes that it is inappropriate for unsecured creditors or shareholders to receive a return on their claims and to then pass the cost of such returns to the financial industry through the assessment process. Accordingly, AIA recommends that the FDIC clarify in its rule that it will use its assessment authority only in rare and unusual situations, and only if the claims of all unsecured creditors and shareholders remain unsatisfied. Section 210(o) of the Dodd-Frank Act underscores this principle by establishing an assessment procedure that requires the FDIC to impose assessments as soon as possible on any person that received additional payments from the FDIC in an amount that exceeds the amount the person would have received for its claim from the proceeds of the company's liquidation.[11]

<u>Advances To Unsecured Creditors Should Be Made Only In Rare Circumstances</u>

The Dodd-Frank Act directs the FDIC to liquidate a covered financial company in a manner that maximizes the value of the company's assets, minimizes losses, mitigates risk, and minimizes moral hazard.[12] In order to underscore the principle that all unsecured creditors should expect to absorb losses along with other creditors, the FDIC proposes that its authority to make additional payments to certain creditors will not be used to make additional payments, beyond those appropriate under the defined priority of payments, to shareholders, subordinated debt holders, and long-term unsecured debt holders. Accordingly, the proposed rule provides narrow circumstances under which creditors could receive any additional payments or credit amounts.

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[9] *See* 75 *Fed. Reg.* at 64179.
[10] Dodd-Frank Act, § 214.
[11] Dodd-Frank Act § 210(o)(1)(D).
[12] Dodd-Frank Act, §§ 204(a) and 210(a)(9)(E).

Such payments could be provided to a creditor only if the FDIC Board determines that the payments or credits are necessary to the essential operations of the receivership (or bridge financial company), to maximize the value of the assets or returns from sale, or to minimize losses, and meet the requirements of sections 210(b)(4), (d)(4), or (h)(5)(E) of the Dodd-Frank Act. AIA supports this position because it helps minimize the possibility that assessments will be imposed on the financial industry. However, in exercising such authority, AIA urges the FDIC to go further and establish procedures to ensure that such creditors bear the bulk of the cost of the resolution. Moreover, such creditors should not receive any more than they would have received if the covered financial company had been liquidated in a Chapter 7 bankruptcy proceeding.

The proposed rule further provides that the FDIC will not exercise its discretion to make additional payments to holders of unsecured debt with a term of more than one year (over 360 days after issuance), subordinated debt holders and shareholders, as well as members, partners, and other equity holders. AIA does not envision any circumstances under which this class of claimants would meet the standard that the Dodd-Frank Act establishes for additional payments. Accordingly, AIA supports proposed rule § 380.2 because it provides flexibility that enables the FDIC to preserve the "going concern" value of the covered financial institution without providing the unwarranted prospect of additional payments to these classes of claimants. However, to ensure that this authority is used sparingly, AIA believes that the FDIC should indicate that it will make advances to unsecured creditors, including those claimants who hold unsecured debt maturing in 360 days or less, only in rare circumstances and only when absolutely required.

U.S. Government And Agency Securities Should Be Valued At Fair Market Value

The proposed rule also provides that proven claims secured by a valid and enforceable perfected security interest in assets of a covered financial company will be paid in full to the extent of the collateral.[13] In order to ensure that creditors are not over-compensated, the FDIC indicates that it will exercise caution in valuing collateral. Accordingly, it would appear reasonable for the FDIC to value an asset securing a claim by applying a reasonable haircut to the asset's fair market value. AIA believes that no asset should be valued higher than fair market value. However, the FDIC proposes to value obligations of the U.S., or fully guaranteed by the U.S. or an agency thereof at par value. AIA believes that valuing U.S. government and agency securities at par could result in excess payments to claimants. In this regard, AIA notes that even the U.S. Treasury applies haircuts of varying percentages to U.S government and agency securities that are pledged as security under the Treasury Tax and Loan Program.[14] Given the volatility of financial markets, AIA believes it would be prudent for the FDIC to apply a similar approach to valuation of U.S. government and agency securities to ensure that claimants are not over-compensated. AIA recognizes that the FDIC's power to "clawback" additional payments to creditors if the proceeds from the sale of the covered financial company's assets are insufficient to repay FDIC borrowings from the U.S. Treasury provides a degree of protection against overvaluation of collateral. However, AIA is concerned that attempts to clawback excess payments may result in protracted proceedings or may not be successful due to the financial

[13] Proposed Rule § 380.2.
[14] *See* http://www.treasurydirect.gov/instit/statreg/collateral/collateral_taxandloantablel.pdf.

condition of claimants or may result in protracted proceedings. Applying a reasonable haircut to all assets of a covered financial company, including U.S. government and agency securities, would be a simpler and more prudent approach.

Clarify Distribution Of Proceeds Of Liquidation Of Subsidiaries Of Insurance Companies

The FDIC proposes that where the FDIC acts as a receiver for a direct or indirect subsidiary of an insurance company that is not a depository institution or an insurance company, it will distribute the value realized from the liquidation or resolution of the subsidiary among the claimants in accordance with the priorities set forth in the Dodd-Frank Act.[15] The FDIC indicates that to clarify that the value realized will be available to policyholders of the parent insurance company to the extent required by state law, the proposed rule expressly recognizes the requirement that the company's receiver remit all proceeds due to the parent insurance company in accordance with the order of priority set forth in section 210(b)(1). AIA believes that the FDIC's clarification should be made explicit in the final rule by expressly indicating in the rule that, as provided for by state law, the covered financial company's parent insurance company and its policyholders may come within section 210(b)(1) of the Dodd-Frank Act.

Liens On Insurance Company Assets

Section 203(e) of the Dodd-Frank Act provides that in the event a covered financial institution is an insurance company, the liquidation will be conducted as set forth in state law. However, the liquidation of a subsidiary or affiliate of an insurance company that itself is not an insurance company is subject to the provisions of Title II. Section 204(d)(4) of the Dodd-Frank Act provides that the FDIC may, as receiver for a covered financial institution and at its discretion, make funds available to a receivership. Such funds may be used for taking a lien on any assets of the covered financial institution or any covered subsidiary in order to secure repayment of the funds so advanced. In recognition of the role of the state as primary supervisor of insurance companies, and in order to avoid interfering with the state authority's exercise of its resolution authority, the FDIC proposes that it will not take a lien on the assets of a covered financial company that is an insurance company or on the assets of a covered subsidiary or covered affiliate of the insurance company unless the FDIC determines, in its "sole discretion," that the taking of the lien is necessary for the orderly liquidation of the entity, and will not unduly interfere with the liquidation of the insurance company or recovery by policyholders.[16] However, the provision further provides that it does not affect the FDIC's ability to take a lien on the assets of the covered entity in connection with the sale of such entity or any of its assets in order to secure financing being provided by the FDIC in connection with the sale.[17]

AIA believes that the FDIC's proposed rule does not provide a meaningful limitation on the FDIC's authority to take liens on assets of a covered insurance company or its subsidiaries and affiliates consistent with Title II of the Dodd-Frank Act. The "unduly impede or delay" standard set forth in the proposed rule is a very low bar that is easily hurdled. AIA is concerned that the FDIC's broad discretion to provide funding and take liens on any assets of a covered insurance company or covered subsidiary or affiliate could conflict with the resolution plans of the

[15]Proposed Rule § 380.5.
[16] Proposed Rule § 380.6(a).
[17] Proposed Rule § 380.6(b).

relevant state authority and be inconsistent with what the state authority believes is in the best interests of policyholders. Accordingly, AIA urges the FDIC to amend the proposed rule to require consultation with and agreement to the proposed funding by the appropriate state authority before exercising its authority to take a lien on the assets of a covered insurance company or its covered subsidiary or affiliate. Such an approach is consistent with the Dodd-Frank Act's recognition that the resolution of insurance company receiverships should be addressed primarily by the state authority under state law. In addition, in the event the FDIC takes a lien in connection with an advance it is making, AIA believes that the FDIC should take a lien only on the assets of the entity to which the FDIC made the advance, thereby ensuring that the assets of a covered subsidiary or affiliate are not impaired.

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AIA appreciates this opportunity to provide its views on the FDIC's proposed rule and would be pleased to discuss our comments further with you.

Respectfully submitted,

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