December 13, 2010

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Federal Deposit Insurance Corporation
550 17th Street, N.W.
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cc: Michael Krimminger
Office of the Chairman

R. Penfield Starke
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Via email to: comments@FDIC.gov

Re: Orderly Liquidation: Section 210(a)(11) (Avoidable Transfers) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act") Relating to Preferences

Ladies and Gentlemen:

The American Securitization Forum ("ASF")[1] is submitting this letter with respect to the request for responses to the following questions posed by the Federal Deposit Insurance Corporation (the "FDIC") under its "Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act," dated October 19, 2010 (the "Notice of Proposed Rulemaking"):

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

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

[1] The American Securitization Forum is a broad-based professional forum through which participants in the U.S. securitization market advocate their common interests on important legal, regulatory and market practice issues. ASF members include over 330 firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in securitization transactions. ASF also provides information, education and training on a range of securitization market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com.

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

The ASF has become aware of an emerging interpretive issue under Section 210(a)(11) of the Act relating to the power of the FDIC to avoid preferential transfers. The issue primarily affects the U.S. consumer finance and commercial credit industries. The issue essentially relates to the interpretation of several inconsistent provisions of the Act, although the legislative intent of these provisions appears to be manifestly clear. To eliminate the ambiguity in a manner consistent with the legislative intent, we are suggesting that the preference provisions of Section 210(a)(11) of the Act would benefit from additional rulemaking by the FDIC, or by the issuance of further guidance in the form of a "policy statement" or other release on which the affected industries, and their counterparties, may rely. Specifically, the ASF believes that Title II (Orderly Liquidation Authority, or "OLA") of the Act could reasonably be interpreted to give the FDIC, as receiver for a "covered financial company" under OLA (a "Covered Financial Company"), broader powers to avoid, as preferential transfers, certain previously perfected security interests that a trustee (a "Bankruptcy Trustee") under Title 11 of the United States Code (the "Bankruptcy Code") would have upon a Chapter 7 liquidation of the same Covered Financial Company.

Intent to Harmonize Dodd-Frank with the Bankruptcy Code

In enacting OLA, Congress intended to create a new statutory regime for the orderly liquidation of Covered Financial Companies. However, several sources, including the Act itself, suggest that Congress also intended for the resulting statutory regime to operate in such a way as to minimize the likelihood of different results to creditors of such potential Covered Financial Companies from those results arising under the Bankruptcy Code. This is especially so with respect to powers to avoid fraudulent transfers and preferences.

Sections 210(a)(7)(B) and (d)(2)(B) of the Act, provide that, in the context of OLA liquidation, "a creditor shall, in no event, receive less than the amount that creditor is entitled to receive" if the FDIC "had not been appointed receiver with respect to [a] covered financial company; and the covered financial company had been liquidated under chapter 7 of the Bankruptcy Code." Furthermore, Section 209 of the Act mandates that the FDIC "seek to harmonize applicable rules and regulations promulgated under [OLA] with the insolvency laws that would otherwise apply to a covered financial company." In the Notice of Proposed Rulemaking, the FDIC states that "[t]he liquidation rules of [OLA] are designed to create parity in the treatment of creditors with the Bankruptcy Code" and that "the provisions that empower the FDIC to avoid and recover fraudulent transfers, preferential transfers and unauthorized transfers of property by the covered financial company are drawn from Bankruptcy Code provisions."

The underlying policy rationale behind this desire for harmonization is that Congress wanted to avoid requiring parties extending credit to potential Covered Financial Companies to be forced to plan transactions based on two different insolvency regimes given that they would not know, at the time of extending credit, which regime would ultimately apply.

If a creditor faces the possibility of two different insolvency regimes, it will have to structure transactions to comply with both. Doing so will raise transaction costs and ultimately raise the costs and lower the availability of credit. Raising the costs and reducing the availability of credit are especially problematic if the rules under OLA producing a different outcome than under bankruptcy law cannot be justified on the grounds that they provide important benefits in controlling systemic risk.

In the case of preferences in particular, we believe it is extremely important to harmonize the OLA rules with those of bankruptcy law. There is no reason for differing rules, because the effect of the differing rules will be to increase transaction costs and increase the costs and lower the availability of credit without any corresponding benefit in controlling systemic risk.

Inconsistency in Section 210(a)(11) of Dodd-Frank

The ASF has identified an inconsistency in the drafting of the preference provisions of Section 210(a)(11) of the Act, which, if read in a certain way, would create a disparity between the treatment of creditors of potential Covered Financial Companies under the Bankruptcy Code and under OLA. Specifically, defining when a "transfer" is "made" by reference to when the rights of a "bona fide purchaser" are superior to the rights of a holder of a previously perfected security interest is a concept which, under the Bankruptcy Code is applied only in the context of fraudulent transfers and of preferential transfers of real property other than fixtures. Under OLA this concept is applied in the context of not only fraudulent transfers (Section 210(a)(11)(A) of the Act) and preferential transfers of real property other than fixtures but also to preferential transfers of personal property and fixtures (Section 210(a)(11)(B) of the Act). The result is that the FDIC as receiver for a Covered Financial Company under OLA may have broader powers than does a Bankruptcy Trustee under the Bankruptcy Code to avoid, as preferential transfers, certain previously perfected security interests in personal property and fixtures, even though the transfers are inherently non-preferential.

We are requesting that the FDIC issue guidance resolving the ambiguity, and providing that, (1) consistent with the Bankruptcy Code, the "bona fide purchaser" standard for defining when a transfer is "made" will be applied under OLA only with respect to fraudulent transfers and to preferential transfers of real property other than fixtures; (2) the standard found in Section 547(e)(1)(B) of the Bankruptcy Code be applied to determine the timing of transfers of personal property and fixtures and (3) the 30-day grace period to perfect a transfer, found in Section 547(e)(2) of the Bankruptcy Code be applied to preferences under Section 210(11)(B) of the Act. Although, as described in more detail below, the statute's drafting inconsistency is a narrow and technical one, the ASF believes that the resulting ambiguity is of considerable practical importance to the consumer and commercial credit industries, as many standard practices in these industries have been established and have evolved, in response to, and in reliance on, the well established Bankruptcy Code provisions.

Section 210(a)(11) of Dodd-Frank contrasted with Sections 547 and 548 of the Bankruptcy Code

The provisions that empower the FDIC to avoid certain types of fraudulent and preferential transfers, which appear in Section 210(a)(11) of the Act, are based on Sections 547 and 548 of the Bankruptcy Code. However, Section 210(a)(11) of the Act is not parallel to Section 547 of the Bankruptcy Code in one significant respect – Section 201(a)(11) defines the time a transfer is made for purposes of determining if there is a preferential transfer differently than such concept is defined under the Bankruptcy Code.

Fraudulent Transfers and Preferences Generally

Section 548 of the Bankruptcy Code relates to fraudulent transfers (*i.e.*, transfers made with "intent to hinder, delay or defraud" creditors, or transfers in exchange for which "less than a reasonably equivalent value" was received) and gives the Bankruptcy Trustee the power to avoid as a fraudulent transfer, any "transfer . . . of an interest [of the company in bankruptcy] in property . . . made . . . within 2 years before the date of the [bankruptcy] filing."

Section 547 of the Bankruptcy Code relates to preferential transfers and gives the Bankruptcy Trustee the power, generally, to avoid as a preferential transfer "any transfer of an interest of [the company in bankruptcy] in property":

- "to or for the benefit of a creditor";
- "made on or within 90 days [or the longer one year transfer period for insiders] before the date of the [bankruptcy] filing";
- made "for or on account of an antecedent debt owed by the [the company] before such transfer was made"; and
- if such transfer "enables such creditor to receive more than such creditor would receive [under a chapter 7 liquidation had such transfer] not been made."

Time of Transfer under Section 548 of the Bankruptcy Code

With respect to fraudulent transfers, under the Bankruptcy Code, a transfer occurs at the time a "bona fide purchaser"[2] cannot acquire an interest in the property transferred that is superior to that of the transferee.

Section 548(d)(1) of the Bankruptcy Code states:

> "a transfer is made when such transfer is so perfected that a bona fide purchaser from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the [bankruptcy] case, such transfer is made immediately before the date of the [bankruptcy] filing. . ."

[2] "Bona fide purchaser" is not defined in the Bankruptcy Code, OLA, or in the Uniform Commercial Code. Section 9-330(b) of the Uniform Commercial Code does, however, provide a commonly-accepted working definition when it refers to a purchaser who "gives a new value...in good faith and in the ordinary course of the purchaser's business, and without knowledge that the purchase violates the rights of [another] party." For purposes of the Bankruptcy Code, the Bankruptcy Trustee under Section 548 has the avoidance powers of a "hypothetical" bona fide purchaser.

The application of the "bona fide purchaser" construct in the context of fraudulent transfers pre-dates the adoption of the Uniform Commercial Code, the resulting reliance on financing statements, and the modern legal theory of preference. Its origin was to prevent the statute of limitations from running out on so-called "secret liens" before they were discovered.

Time of Transfer under Section 547 of the Bankruptcy Code of Real Property other than Fixtures

Section 547 of the Bankruptcy Code applies the same transfer test to preferential transfers of real property other than fixtures as does the fraudulent transfer provisions of Section 548. Section 547(e)(1)(A) states:

> "a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee"

Time of Transfer under Section 547 of the Bankruptcy Code of Personal Property and Fixtures

By contrast with fraudulent transfers and preferential transfers of real property other than fixtures, in the case of preferential transfers of personal property and fixtures under the Bankruptcy Code, a transfer occurs at the time a "hypothetical lien creditor"[3] cannot acquire an interest in the property transferred that is superior to that of the transferee.

This provision appears in Section 547(e)(1)(B), which provides that:

> "a transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien [the "hypothetical lien creditor"] that is superior to the interest of the transferee."

Pursuant to Section 547(e)(2), a transfer, whether of real property, fixtures or personal property, is made considered "made"–

> (A) "at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 30 days after, such time;
>
> (B) at the time such transfer is perfected, if such transfer is perfected after such 30 days; or

[3] The term "hypothetical lien creditor" does not in fact appear in the Bankruptcy Code, but is a commonly-used reference to the formulation in Section 544(a)(1) of the Bankruptcy Code whereby the Bankruptcy Trustee has "the rights and powers of, or may avoid any transfer of property of the debtor...that is voidable by...a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor or a simple contract could have obtained a judicial lien, whether or not such creditor exits." There is no parallel provision in OLA to this "strong arm" clause of the Bankruptcy Code.

> (C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of –
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> (i) the commencement of the case; or
> (ii) 30 days after such transfer takes effect between the transferor and the transferee."

Time of Transfer under Section 210(a)(11) of Dodd-Frank

Under OLA, the time of transfer with respect to both fraudulent transfers and preferential transfers, *including transfers of personal property and fixtures,* appears to occur at the time a "bona fide purchaser" cannot acquire an interest in the property transferred that is superior to that of the transferee. If the transferee's interest is not so superior, the transfer is deemed made on the day prior to the commencement of the receivership. The result of the latter rule is that the transfer becomes one made on account of an antecedent debt, and within the preference period.

More specifically, Section 210(a)(11) of the Act, which relates to both fraudulent transfers and preferential transfers (with both types of transfers defined in the same manner as they are defined under the Bankruptcy Code), gives the FDIC as receiver for a Covered Financial Company the power to avoid such transfers under the same circumstances as under the Bankruptcy Code. However, Section 210(a)(11)(H)(II) of the Act states that, for purposes of when both types of transfers are made, *including preferential transfers of personal property and fixtures*:

> "a transfer is made when such transfer is so perfected that a bona fide purchaser from the covered financial company against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the date on which the [FDIC] is appointed as receiver for the covered financial company, such transfer is made immediately before the date of such appointment."

The above provision, however, is in conflict with the rule set forth in Section 210(a)(11)(b)(v) of the Act, which appears in the clause headed "Preferential Transfers", and provides that one of the elements of a preferential transfer is that such transfer:

> "(v).....enables the creditor to receive more than the creditor would receive if –
>
> (I) the covered financial company had been liquidated under Chapter 7 of the Bankruptcy Code;
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> (II) the transfer had not been made; and
>
> (III) the creditor received payment of such debt to the extent provided by the provisions of Chapter 7 of the Bankruptcy Code."

This provision indicates that, with respect to preferential transfers of personal property and fixtures, the result under OLA should be identical to the result under the Bankruptcy Code.

Further, and as noted previously, Sections 210(a)(7)(B) and (d)(2)(B) of the Act, provide that, in the context of OLA liquidation, "a creditor shall, in no event, receive less than the amount that creditor is entitled to receive" if the FDIC "had not been appointed receiver with respect to [a] covered financial company; and the covered financial company had been liquidated under chapter 7 of the Bankruptcy Code."

In addition to the foregoing, we also note in this context Section 210(b)(5) of the Act, "Secured Claims Unaffected", which provides that:

> "[t]his section [Section 210] shall not affect secured claims or securities entitlements in respect of assets or property held by the covered financial company, except to the extent that the security is insufficient to satisfy the claim, and then only with regard to the difference between the claim and the amount realized from the security".

Consequences of the Inconsistency for Consumer and Commercial Credit Industries

The ambiguity described above could potentially impact all lending secured by personal property, securitizations of personal property and even sales involving non-possessory interests in personal property where perfection of transfers of such property by possession or other means could trump perfection by filing a financing statement under the Uniform Commercial Code (the "UCC")[4] or other similar filings or actions under other applicable law. The issue arises most prominently with respect to consumer and commercial credit transactions in which the subject property is characterized under the UCC either as "chattel paper" or as an "instrument." Specifically, the ambiguity could affect sales[5] of chattel paper or instruments, as well as transactions in which chattel paper or instruments serve as collateral securing a party's obligations if, in either case, the transfer has been properly perfected by filing a financing statement, as permitted under the UCC, and not through possession (which is not required for such proper perfection if perfection has been obtained by filing).

Section 9-102(a)(11) of the UCC defines "chattel paper" to include "a record or records that evidence both a monetary obligation, and a security interest in specific goods … or a lease of specific goods." Section 9-102(a)(47) of the UCC defines an "instrument" as "a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary endorsement or assignment." Under the UCC, a security interest in chattel paper or instruments may be properly perfected by filing a financing statement, among other means.

[4] See *e.g.,* UCC Section 9-330.

[5] Under Section 1-201(37) of the UCC, the term "security interest" includes "any interest of.....a buyer...of chattel paper."

Under the UCC, while the filing of a financing statement would properly perfect a security interest in chattel paper or instruments, such that a "hypothetical lien creditor" could not acquire a security interest in the chattel paper or instrument that is superior to that of the secured party, the filing of a financing statement alone would not prevent a "bona fide purchaser" from acquiring a security interest in the chattel paper or instrument that is superior to that of the secured party.[6] Therefore, while the Bankruptcy Trustee under the Bankruptcy Code *would not* be able to avoid as a preferential transfer a security interest in chattel paper or instruments granted and perfected by means of filing a financing statement at closing or within 30 days of closing; however, the FDIC under OLA *would* potentially be able to avoid as a preferential transfer that very same security interest. The following examples illustrate the statutory mechanics that lead to this disparity in the results.

Example 1 (under the Bankruptcy Code)

Financial Company ABC closes a new financing facility secured by auto loans consisting of chattel paper on January 1, 2011. The transfer of the security interest to the lender is properly perfected by filing a UCC financing statement before January 31. If Financial Company ABC later files for bankruptcy, the Bankruptcy Trustee cannot avoid the transfer of the security interest as a preference, even if the bankruptcy occurs within 90 days of closing because, under Section 547 of the Bankruptcy Code, a security interest which is properly perfected within 30 days of the closing, will be deemed to have been made on the closing date; therefore, the transfer of such a security interest is not made on account of an antecedent debt.

Example 2 (under the Bankruptcy Code)

Financial Company ABC closes a new financing facility secured by auto loans consisting of chattel paper on January 1, 2011. The transfer of the security interest to the lender is not properly perfected at closing because the required UCC financing statement is filed in the wrong filing office. The filing mistake is corrected in October 2011 (more than 30 days after closing) by the filing of the UCC financing statement in the proper filing office and Financial Company ABC files for bankruptcy in December 2011. The Bankruptcy Trustee may avoid the transfer of the security interest as a preference because, under Section 547 of the Bankruptcy Code, the transfer of such security interest will be deemed to have been "made" when it was properly perfected in October; therefore, the transfer of such security interest was "made" on account of antecedent debt and within the preference period.

Example 3 (under OLA)

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[6] This is a consequence, for chattel paper, of the rule found in Section 9-330(b) of the UCC: "A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed other than merely as proceeds of inventory subject to a security interest if the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under Section 9-105 in good faith, in the ordinary course of the purchaser's business, and without knowledge that the purchase violates the rights of the secured party." A good faith purchaser of an instrument who takes possession of it is likewise given priority under Section 9-330(d) of the UCC and, in the case of a negotiable instrument, a holder in due course of the negotiable instrument obtains priority under Section 9-331 of the UCC. None of these purchasers, who rely upon possession of the chattel paper or instrument, have an obligation to conduct UCC searches to discover any filed financing statements in order to obtain priority.

Financial Company XYZ closes a new financing facility secured by auto loans consisting of chattel paper on January 1, 2011. The transfer of the security interest to the lender is properly perfected by filing a UCC financing statement before January 31 (and hence is not subject to avoidance as a preference under the Bankruptcy Code). In October 2011, Financial Company XYZ is determined under OLA to be a Covered Financial Company, and the FDIC is appointed as its receiver. Under Section 210(a)(11) of the Act, the FDIC may have the power to avoid the transfer of the security interest as a preference because under Section 9-330(b) of the UCC the perfection of the security interest in the auto loans by the filing of a UCC financing statement would not prevent a "bona fide purchaser" from acquiring a security interest in those auto loans that is superior to that of the secured party. As a result, the transfer of such security interest will potentially be deemed to have been "made" immediately before to the appointment of the FDIC as receiver for Financial Company XYZ and thus, made on account of antecedent debt and within the preference period.

Upon the avoidance of such transfer, the claim otherwise secured by a properly perfected security interest would become an unsecured claim in the FDIC receivership. As a result, the creditor would receive less than it would have received in a Chapter 7 Bankruptcy Code liquidation of the same company.

The consequences to the consumer and commercial credit industries – and their creditor counterparties – are further, and indeed greatly, exacerbated by the absence of a "transition rule" for OLA. Many credit facilities, securitizations and sales date prior to the enactment of the Act, and were structured in reliance on the certainty of the provisions of the Bankruptcy Code. The documentation, policies and procedures of both the financial companies and their creditors, and the overall architecture of these transactions and programs, depended on the proper and effective perfection achieved by the filing of a UCC financing statement. Although in some instances these existing transactions and programs could now be re-engineered to comply with the "bona fide purchaser" construct applicable to fraudulent transfers and preferential transfers of real property other than fixtures, that is only a partial solution, and one which will be time consuming, difficult and expensive to implement. The delays needed for such implementation would also be expected to adversely affect the liquidity of the affected financed company during the delay, as it will be difficult, if not impossible during the period of delay to enter into new financing facilities, or portfolio sales, which rely on the existing practices.

With respect to programs currently in place, the re-engineering is in any event only a "partial solution." This is due to the look-back provisions of the preference rules. These rules, which provide that a solution, once implemented, is itself a transfer of property of the debtor to or for the account of a creditor on account of an antecedent debt. As a result, the implementation of the solution would not eliminate the creditor's preference risk until the preference period, commencing on the implementation of the solution has past. The general preference look-back period is 90 days, but for transfers among affiliated companies, the look-back period is a year. Since many consumer and commercial finance companies structure their financing, securitization and secondary-market activities through transfers to subsidiaries, the look-back period arguably could be a year. Accordingly, creditor counterparties will severely discount the efficacy of any proposed solution.

Further, the ASF has been advised that while some types of consumer and commercial credit transactions are documented by "chattel paper" and "instruments", others are not (such others being characterized under the UCC as, for example, "accounts" or "general intangibles"). Sometimes these are different products of the same finance company (for example, certain types of inventory financings), while in other instances they may be the identical product, simply documented in a different way (this is the case in the student loan industry). Under OLA, in some cases a properly perfected security interest could be attacked as a preferential transfer which another very similar transaction could not be. Thus, the effects and the uncertainty to financial companies' creditor counterparties are further magnified.

Conclusion

The overall result of the drafting inconsistencies in Section 210(a)(11) of the Act is to increase the costs and reduce the availability of credit without any corresponding important benefit in controlling systemic risk – the very result that Congress intended to avoid.

Given the immediate and significant impact this issue is having on the consumer and commercial credit industries, the importance of this issue to the continued smooth flow of credit to consumers and to business, the likely timetable for any Congressional action in the form of a Dodd-Frank "technical corrections act", and the difficulties, both practical and legal, of implementing solutions, we respectfully request the FDIC to issue, as promptly as practicable, guidance to the effect that the FDIC will apply:

- the "bona fide purchaser" construct for purposes of OLA's avoidance rules only to fraudulent transfers under Section 210(a)(11)(A) of the Act and to preferential transfers of real property other than fixtures, and not to preferential transfers of personal property and fixtures under Section 210(a)(11)(B) of the Act;

- to preferential transfers of personal property and fixtures, the "hypothetical lien creditor" construct, the same as under Section 547(e)(1)(B) of the Bankruptcy Code; and

- the 30-day grace period to perfect a transfer found in Section 547(e)(2) of the Bankruptcy Code to preferences under Section 210(11)(B) of the Act.

We believe that, in light of the drafting inconsistencies in Section 210 of the Act and the manifest legislative intent to achieve harmony between OLA and the Bankruptcy Code, the issuance of such policy guidance would be comfortably within the scope of the FDIC's rulemaking authority under well-settled principles of federal administrative law.

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The ASF appreciates in advance your consideration of this matter. Please do not hesitate to contact me at tdeutsch@americansecuritization.com or at 212.412.7107, or our outside counsels, Chris DiAngelo at chris.diangelo@kattenlaw.com or at 212.940.6452 and Reed Auerbach at reed.auerbach@bingham.com or at 212.705.7400, with any follow-up questions or concerns that you may have.

Sincerely,

Tom Deutsch

Tom Deutsch
Executive Director
American Securitization Forum