January 18, 2011

By electronic submission to www.fdic.gov

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

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

FR Docket No. 2010-26049

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to respond to the questions posed by the FDIC on October 19, 2010,[2] in connection with Title II of the Dodd-Frank Act.[3]

As we noted in our comment letter to the FDIC dated November 18, 2010 (the "**SIFMA 30-Day Comment Letter**"), SIFMA believes that the new orderly liquidation authority

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[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

[2] Federal Deposit Insurance Corporation, Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 *Fed. Reg.* 64173 (Oct. 19, 2010).

[3] Pub. L. No. 111-203, § 201 et seq., 124 Stat. 1376 (2010).

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in Title II of the Dodd-Frank Act is one of the most important new tools in the U.S. regulatory toolbox. As we elaborated in the SIFMA 30-Day Comment Letter, we believe that in order for this new authority to work properly, the FDIC will need to issue rules and regulations that convince the market that Title II will be exercised in a consistent, transparent and predictable manner that strikes the right balance among preserving or restoring financial stability, maximizing the value of the enterprise, minimizing shareholder and creditor losses, preserving equal treatment among similarly situated creditors and maximizing market discipline. Creditors need to have confidence that they could be better off if Title II is invoked, but that they will never be worse off in order for Title II to have a stabilizing impact on the market during a financial panic.[4]

The interest of our members in clear rules and regulations under Title II is twofold: First, as creditors that have exposure to financial institutions that could be subject to resolution under Title II, our members need to be able to assess their counterparty risk, and clear rules and regulations assist in those evaluations. Second, as financial institutions that may themselves be subject to resolution under Title II, our members may adjust their operations based on the expectation of how a financial company would be resolved under Title II. In addition, the Orderly Liquidation Authority is relevant to other requirements under the Dodd-Frank Act, including rapid recovery and resolution planning. For these reasons, clear rules and regulations are important to our members and to the efficient functioning of the market overall.

As we noted in the SIFMA 30-Day Comment Letter, the discussion in Part I of that letter—which explains why the Too Big To Fail ("**TBTF**") dilemma arose during the financial panic of 2008 and how Title II could be used to provide a viable alternative way to address the dilemma in a future crisis—is relevant to the broader list of questions posed by the FDIC and to which we are responding in this letter. Additionally, Annex A to this letter provides answers to the specific questions posed in the NPR subject to a 90-day comment period.

I. Resolution of a Systemically Important Financial Institution

Among the challenges faced by the FDIC is anticipating and clarifying to the market how it would resolve a systemically important financial institution ("**SIFI**") that might be subject to Title II. There is no precedent for the orderly liquidation of such an institution in the bank resolution model or elsewhere. A SIFI is likely to have numerous separately regulated subsidiaries, which may include banks, broker-dealers, insurance company subsidiaries, and other entities. Adding to the complexity are the cross-border elements likely to be present with such an institution.

[4] *See* Letter from SIFMA to the FDIC, Regarding Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Nov. 18, 2010, *available at* http://www.sifma.org/issues/item.aspx?id=22345.

In order for Title II to provide a superior alternative to a bankruptcy, the FDIC will need to issue regulations and provide guidance that clarify how it and other regulators would resolve a SIFI in practice. Such regulations and guidance will need to include details about how such regulators would go about resolving the overall group, not just the individual pieces. Among the issues the FDIC will need to clarify is how the resolution of a bank holding company under Title II would be coordinated with the likely resolution by the FDIC of any bank subsidiary, including how intercompany claims and conflicts of interest would be resolved. In addition, Title II divides the responsibility for resolving a covered broker-dealer between the FDIC and the Securities Investor Protection Corporation ("**SIPC**"). The Securities and Exchange Commission ("**SEC**") and FDIC, in consultation with SIPC, must jointly issue regulations to provide clarity to the marketplace on how the FDIC and SIPC would work together in the event a broker-dealer is liquidated under Title II.

There are likely to be other regulated entities for which the rules under Title II and coordination with other regulators will be necessary, including clearinghouses and futures commission merchants. In an FDIC roundtable on Orderly Liquidation Authority, Gary Gensler, Chairman of the Commodity Futures Trading Commission ("**CFTC**") suggested there was a conflict between Title II and the CFTC's power to resolve a systemically important clearinghouse.[5] Chairman Gensler said that the CFTC and the FDIC, and possibly the SEC, were in discussions over a memorandum of understanding to coordinate their roles in resolving systemically important clearinghouses that might fail during a crisis. Any coordination should be transparent to the markets and include the Financial Stability Oversight Council ("**FSOC**"), the Board of Governors of the Federal Reserve System, and the Secretary of the Treasury.

The FDIC should also clarify in its regulations the criteria for deciding when management could be retained or when it must be replaced, how the FDIC would operate a bridge financial company and how a bridge financial company would be funded. Comprehensive regulations around the operation of bridge financial companies will enhance confidence in the liquidation process under Title II and allow the FDIC as receiver to access the necessary financing for the effective operation of the bridge financial company.

As described in more detail in response to the questions in Annex A to this letter, the FDIC should also issue regulations detailing how it will value assets, liabilities, claims and collateral; it should provide a clear method for a creditor to challenge an FDIC valuation of an asset, liability, claim or collateral, and a remedy in the event of deficiency in payment to the creditor; and it should develop new techniques for resolving a large, complex non-bank financial

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[5] Hon. Gary Gensler, Chairman, CFTC, *The Federal Deposit Insurance Corporation Holds a Forum for Discussion of Views on the Implementation of the New Resolution Authority* (Aug. 31, 2010) (CQ Transcriptions database) (video recording *available at* http://www.vodium.com/MediapodLibrary/index.asp?library=pn100472_fdic_RoundTable).

institution so as to preserve the going concern value rather than only the liquidation value of the institution for the benefit of creditors and other claimants.

The FDIC should also clarify the role that a financial company's resolution and recovery plan ("**living will**") will play in the orderly liquidation of such a company under Title II. Although Title I provides that such plans will not be binding on the FDIC, the various goals of Title II are likely to be furthered if the FDIC clarifies the extent to which it will nevertheless follow the procedures laid out in such plans.

Finally, Section 216 of Title II requires the Federal Reserve, in consultation with the Administrative Office of the United States Courts, to conduct a study of the improvements that could be made to the Bankruptcy Code to enhance the ability to resolve financial companies in bankruptcy in a manner that minimizes the adverse impact on financial markets and without creating moral hazard. The study is to consider amendments to the Bankruptcy Code, the Federal Deposit Insurance Act and other insolvency laws to address the way in which qualified financial contracts are treated, and the benefits of creating a new chapter of the Bankruptcy Code to deal with financial companies. To facilitate this study, the FDIC should participate in the process of identifying, whether in its regulations or other publications, the gaps in the Bankruptcy Code that are likely to cause the standards in Section 203(b) to be satisfied.[6]

II. Coordination with Other Domestic and Foreign Authorities

In addition to coordination that is required with respect to the resolution of regulated entities, Title II requires the FDIC, in numerous contexts, to consult with other agencies and the Treasury prior to promulgating regulations. For example, Section 203(d) of the Orderly Liquidation Authority requires the FDIC, "as soon as practicable," to establish policies and procedures acceptable to the Treasury Secretary governing the use of funds to carry out Title II.[7] This statutory duty applies to virtually any action the FDIC proposes to take or fails to take in carrying out any provision of Title II. The FDIC should work with Treasury, the FSOC, the Federal Reserve, the SEC, the Federal Insurance Office ("**FIO**"), SIPC, state insurance commissioners and the other regulators and resolving agencies to implement Title II in a responsible manner.

The FDIC should also coordinate with its international counterparts. Without international coordination, it is hard to imagine how the resolution of a cross-border SIFI would

[6] Section 203(b) of the Dodd-Frank Act requires the Secretary to make certain findings in order to invoke Title II, including that "the failure of the financial company and its resolution under otherwise applicable Federal and State law would have serious adverse effects on financial stability in the United States." Dodd-Frank Act, § 203(b)(2).

[7] *Id.* § 203(d).

be resolved under Title II in a way that is stabilizing during a financial panic. As the FDIC has acknowledged, Title II will not be effective if there is ineffective coordination with foreign regulators.[8] SIFMA respectfully submits, however, that the necessary coordination involves substantially more than "recognition [of the FDIC] in the foreign legal and regulatory systems where the FDIC would control the company's assets and operations."[9]

We also urge the FDIC to adopt a rule that it will not exercise its powers in a way that discriminates against non-U.S. creditors. Nothing in Title II suggests that U.S. and non-U.S. creditors should be treated differently. A non-discrimination rule would enhance cross-border cooperation both in the event a U.S. SIFI with significant non-U.S. creditors is resolved under Title II, and in the event a non-U.S. SIFI with significant U.S. creditors is resolved under a foreign regulatory regime. In the case of the former, a non-discrimination rule would discourage foreign regulators from ring fencing the assets of the U.S. institution in those foreign jurisdictions, and in the case of the latter, a non-discrimination rule would encourage foreign regulators to adopt similar provisions to protect U.S. creditors.

Comprehensive guidance is needed as to how the FDIC would participate in foreign proceedings, as well as how foreign regulators would participate in proceedings in the United States. The FDIC should clarify in its regulations or other public pronouncements what sort of agreements, memoranda of understanding and protocols it has established, and what sort of simulations it will engage in with foreign regulators, courts and other resolving agencies to ensure that a cross-border resolution of a systemically important financial institution can be achieved in a manner that balances the financial stability, value maximization and market discipline goals of Title II. The FDIC should, in coordination with the Treasury, Federal Reserve, SEC and FIO, organize simulations of the resolution of a hypothetical cross-border SIFI with foreign authorities, and publish the results of those simulations, including issues that were identified and need to be resolved before an actual cross-border resolution is required.

We recommend that the FDIC and the Federal Reserve consider a pilot simulation with the Bank of England and the UK Financial Services Authority ("**FSA**") of the resolution of hypothetical cross-border SIFIs where one SIFI is domiciled in the United States and has substantial operations in the United Kingdom, and another SIFI is domiciled in the United Kingdom and has substantial operations in the United States. Such a pilot exercise would allow regulators in the United States and the United Kingdom to test their resolution procedures and amend those procedures before they are required to be implemented on an actual institution in an actual financial crisis. Moreover, publishing a model for how a hypothetical cross-border SIFI

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[8] 75 Fed. Reg. 64173, 64177 (Oct. 19, 2010).

[9] *Id.*

would be resolved would provide a practical framework for the market and an effective model for cooperation with other jurisdictions.

III. Ongoing Improvements and Advisory Council

Finally, as the FDIC implements regulations it should treat its mandatory rulemaking obligations under Section 209 as part of an ongoing process of improvements to increase legal certainty and reduce the gaps between Title II and the Bankruptcy Code, rather than as a one-time event. The FDIC should incorporate input from other financial regulators and experts from the private sector in such an ongoing process. The FDIC should consider the establishment of an Advisory Council to incorporate such input from other financial regulators and experts from the private sector. Such an Advisory Council could recommend improvements and refinements to Title II that would increase legal certainty, and assist the FDIC in avoiding unintended consequences with its rulemaking.

Please see Annex A for our responses to the specific questions posed in the NPR subject to a 90-day comment period.

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SIFMA thanks the FDIC for the opportunity to respond to the FDIC's questions. If you have any questions, please do not hesitate to call me at 202-962-7400, or SIFMA's counsel, Randall D. Guynn, Davis Polk & Wardwell LLP, at 212-450-4239.

Sincerely,

Kenneth E. Bentsen, Jr.
Executive Vice President, Public Policy and Advocacy
Securities Industry and Financial Markets Association

Annex A

Solicitation for Comments on the Orderly Liquidation Authority

Questions on the FDIC NPR with 90-day Comment Period (by January 18, 2011)

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

Covered Companies. The FDIC should clarify in its regulations that there is a strong presumption against invoking the Orderly Liquidation Authority, except in the most extreme cases during a financial panic. This is consistent with public statements made by FDIC Chairman Sheila Bair, and others. By specifically reflecting this intent in its regulations, the FDIC will provide assurance to the market that these public statements are consistent with how the FDIC will exercise its authority under Title II.

Bankruptcy Code Study. Section 216 requires the Federal Reserve, in consultation with the Administrative Office of the United States Courts, to conduct a study of the improvements that could be made to the Bankruptcy Code to enhance the ability to resolve financial companies in bankruptcy in a manner that minimizes the adverse impact on financial markets and without creating moral hazard. The study is to consider amendments to the Bankruptcy Code, the Federal Deposit Insurance Act and other insolvency laws to address the way in which qualified financial contracts are treated, and the benefits of creating a new chapter of the Bankruptcy Code to deal with financial companies. To facilitate this study, the FDIC should participate in the process of identifying, whether in its regulations or other publications, the gaps in the Bankruptcy Code that are likely to cause the standards in Section 203(b) to be satisfied.

Preserving Going-Concern Value Rather Than Liquidation Value. The FDIC should identify in its regulations new techniques that it will consider using and how they would work in practice for resolving cross-border SIFIs. These would be alternatives to the FDIC's current purchase and assumption model, which is unlikely to be a credible option for resolving cross-border SIFIs during a financial panic in a manner that satisfies the financial stability, value maximization and market discipline goals of Title II.

The new techniques should be designed to recapitalize a covered financial company, maximize its value for the benefit of the company's creditors and other claimants as a group and, if possible consistent with its duty to promote financial stability, in a manner that preserves the going-concern value of the company rather than its lower liquidation value, subject to the shareholders and creditors absorbing any losses necessary to recapitalize the insolvent company at an appropriate level. These alternative techniques for resolving a covered financial company could include means of recapitalizing a failing institution by converting preferred stock, subordinated debt or senior debt to common equity according to the absolute priority of claims.

In addition, the FDIC should clarify in its regulations that the realization of any equity value from the assets of the covered financial company, including through the disposition of the assets transferred to a bridge financial company, would be for the benefit of the left-behind creditors whose liabilities were not transferred to the bridge financial company. Rulemaking in this area would provide the market with assurance that a large, complex financial institution subject to Title II would not necessarily be disposed of at the lowest liquidation value and that the left-behind creditors will benefit from any disposition and participate in the recapitalization.

Customer Property. The FDIC should issue rules to provide clarity and certainty in connection with the treatment under Title II of collateral posted to, and property held in a custodial capacity by, unregulated covered financial companies. In the wake of Lehman's failure, there is heightened concern among participants in all segments of the market over the protection of posted collateral and other customer assets. While Section 210(m) provides some guidance with respect to the application of otherwise applicable customer property distribution rules in the case of covered financial companies that are stockbrokers or commodity brokers, clear and predictable rules are needed to provide certainty with respect to the procedures for, and ultimate right to obtain, the return of collateral posted to, and assets held in a custodial capacity by, all covered financial companies, whether regulated or unregulated. Section 210(a)(5) provides for the establishment of procedures for expedited relief outside of the claims process with respect to certain types of claims. We urge the FDIC to adopt additional rules that provide clarity regarding the return of posted collateral and other property held in a custodial capacity by unregulated covered financial companies consistent with the requirements of the statute.

This should include a discussion of the extent to which the outcome is dependent on segregation of such assets by the covered financial company and how such segregation can be achieved, particularly in the modern securities holding system, where interests are held through multiple tiers of securities intermediaries and often through omnibus accounts where one customer's securities are pooled with other customer securities. We note that similar rulemaking expressly clarifying any segregation requirements under the Federal Deposit Insurance Act for customer securities held at banks would be appropriate.

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? Please specify the source of insolvency laws to which you are making reference.

This question is the most difficult one to answer adequately at this time. We have identified a number of the key inconsistencies between Title II and the Bankruptcy Code, but we have not identified any of the inconsistencies that surely exist

between Title II and the Securities Investor Protection Act or other insolvency laws that would otherwise apply, and the list we have provided is by no means exhaustive. The full range of material inconsistencies between the two laws is only likely to be discovered over time as market participants enter into transactions, seek legal opinions and discover inconsistencies or uncertainties. That is why we have urged the FDIC to treat its mandatory rulemaking obligations under Section 209 as part of an ongoing process, rather than a one-time event. The FDIC will need to establish a process for promptly addressing and resolving inconsistencies as they are identified over time.

The following is a non-exclusive list of some of the more important inconsistencies that should be addressed in the FDIC's initial rulemaking:

Securitizations. See our response to question 6 below.

Defenses to an Avoidance Action. Section 210(a)(11)(F)(i) provides that a transferee or obligee from which the FDIC seeks to recover a transfer or avoid an obligation has the same defenses that are available to a transferee or obligee from which a trustee seeks to recover a transfer or avoid an obligation under Sections 547, 548 and 549 of the Bankruptcy Code. Under the plain meaning of the statute, a transferee or obligee can assert the same defenses to an action under Section 210(a)(11)(A), (B), (C) or (D) that a transferee or obligee can assert to an action under Sections 547, 548 and 549 of the Bankruptcy Code. However, the term "defenses" is not defined anywhere, and so it is not clear the scope of what is being imported by Section 210(a)(11)(F)(i). Also, the scope of Section 210(a)(11)(F)(i) is made ambiguous by Section 210(a)(11)(F)(ii), which provides that the FDIC's authority to recover a transfer or avoid an obligation is subject to the limitations in Section 546(b) and (c), Section 547(c), and Section 548(c) of the Bankruptcy Code. The inclusion in Section 210(a)(11)(F)(ii) of these specific subsections of Sections 546, 547 and 548 leads to confusion as to whether or not certain other subsections of such sections (which may be thought of as "defenses") fall within the scope of the defenses imported by 210(a)(11)(F)(i).

The FDIC should provide more specificity in its regulations as to what transfers are potentially avoidable and clarify that a transferee or obligee will have available all the defenses to an action under Section 210(a)(11)(A), (B), (C) and (D) that are available to an action under Sections 547, 548 and 549 of the Bankruptcy Code. Creditors should be comfortable that they have the same protections from avoidance under Title II as they would have under the Bankruptcy Code, and that such protections will be applied as broadly as they are applied under the Bankruptcy Code.

Setoff. See our response to question 7 below.

Unenforceability of Certain Agreements. Section 210(p) allows the FDIC to render unenforceable certain provisions in any existing or future standstill,

confidentiality or other agreements. The FDIC should clarify that this only applies to an agreement between the covered financial company and a third party that would interfere with the FDIC's ability to resolve or liquidate a covered financial company under Title II. It should not apply to an agreement or covenant between third parties, even if it would limit the freedom of one of the third parties to purchase an asset from a covered financial company or the FDIC as receiver of such company. This is an important clarification without which Section 210(p) could cause enormous uncertainty in the market if it is thought that the FDIC could apply the provision more broadly to invalidate the enforceability of agreements in the marketplace.

Payment of Post-insolvency Interest. Under Section 210(a)(7)(D), creditors holding proven claims against the receivership may receive payments of post-insolvency interest, but such interest payments would only be made after the receiver has satisfied the principal amount of all creditor claims. Over-secured creditors would not receive post-repudiation interest (up to the value of their collateral) in the same manner that they would under Section 506(b) of the Bankruptcy Code, and there is no explicit provision for fees and expenses as there is under Section 506(b) of the Bankruptcy Code. This is a very fundamental expectation of secured creditors, and a significant difference between the Bankruptcy Code and the Orderly Liquidation Authority.

In light of the minimum recovery right in Section 210(a)(7)(B), which provides that a claimant will receive no less than the claimant would have received in a liquidation under Chapter 7 of the Bankruptcy Code notwithstanding any other conflicting provision, an over-secured creditor should receive post-repudiation interest, as well as fees and expenses, as the creditor would under the Bankruptcy Code. We suggest the FDIC promulgate regulations harmonizing the treatment of secured creditors under Title II with this treatment under the Bankruptcy Code so that over-secured creditors of a covered financial company will receive post-repudiation interest up to the value of their collateral. The FDIC should also promulgate regulations establishing the appropriate post-insolvency interest rate, as provided for in Section 210(a)(7)(D).

Protection of Secured Creditors. In many circumstances under the Bankruptcy Code, a secured creditor can bid its own claim in the event of a sale of the creditor's collateral by the trustee. This gives the secured creditor an important protection from the trustee selling the collateral at an amount that the secured creditor believes to be insufficient. No such equivalent express provision mandating that a secured creditor has the right to credit bid in a sale of its collateral exists in Title II. Adopting a regulation providing that in a sale of collateral, the secured creditor has the right to credit bid is consistent with the receiver's duty to maximize the value of the enterprise and each claimant's minimum recovery right, and provides an important protection to secured creditors.

3. With the exception of the special provisions governing the liquidation of covered brokers and dealers (see section 205), are there different types of covered financial companies that require different rules and regulations in the application of the FDIC's powers and duties?

Please see Section I of our comment letter in which we recommend that the FDIC coordinate with other regulators to assess how other regulated entities, including swap dealers, futures commission merchants, and clearinghouses, would be resolved under Title II. We believe that the FDIC should provide guidance as to how individual pieces of an institution would be resolved, how the FDIC would coordinate with the regulators for such regulated subsidiaries, and how the FDIC would resolve those pieces in the context of the overall group. We also suggest the FDIC clarify in its regulations how the resolution regime for futures commission merchants in 17 C.F.R. Part 190 would apply in the event of a resolution under Title II. It is important for the FDIC to promulgate clear rules in this area in order to promote confidence in regulated entities potentially subject to resolution under Title II.

4. Section 210 specifies the powers and duties of the FDIC acting as receiver under Title II. Are regulations necessary to define how these specific powers should be applied in the liquidation of a covered company?

We believe that in order for Title II to have a stabilizing effect on the markets in the event of a financial crisis, market participants need as much clarity and guidance as possible about how the FDIC will exercise its authority under Title II. In particular, market participants need clarity as to how the FDIC will value assets, liabilities, claims, collateral and other items, and provide a clear administrative procedure for the determinations.

Valuation of Assets and Liabilities and Minimum Recovery Rights. The FDIC has the authority to administer the process of deciding which creditors receive what, and in what order, from the liquidation of any left-behind assets, including any value received from the sale of any portion of the business. The FDIC should clearly outline how it will value assets for purposes of paying claims and determining minimum recovery rights.

The FDIC should specify that it will not rely on fire sale prices in making those calculations. The use of prices at the bottom of the market is inconsistent with the statutory obligation to maximize the value of the enterprise. It also is inconsistent with the financial stability purpose of the Orderly Liquidation Authority. If creditors believe that their claims will be valued at fire sale prices, they will cause a run on institutions in a financial panic, thus exacerbating financial instability.

In addition to a clear method for valuing claims, including minimum recovery rights, there should be a practical procedure and remedy for challenging the

FDIC's valuations and minimum recovery determinations. A *de novo* after-the-fact judicial review of claims determinations on a case-by-case basis is not adequate. Under Section 210(e), except where expressly provided in Title II, creditors are not authorized to seek judicial review of FDIC determinations, or to obtain injunctive relief. There is no statutory remedy or judicial recourse for a claimant that believes the FDIC is acting arbitrarily or capriciously or exceeding the scope of its authority. Though there is some judicial oversight over the claims determination process, this is a much more limited level of judicial review.

The FDIC should provide a clear and practical administrative or judicial remedy for claimants who believe that the FDIC has not satisfied its statutory duty to maximize the value of the company for the benefit of creditors and other claimants, that their claims or security interests were not appropriately valued or that they have received less than they would have received in a liquidation under Chapter 7 of the Bankruptcy Code. In considering the administrative or judicial remedy for challenging whether the FDIC has satisfied its duty to maximize the value of the company, an FDIC valuation or whether a claimant's minimum recovery right has been satisfied, the FDIC should consider a method which will satisfy the standards for fundamental fairness and maximize financial stability during a financial crisis. This could include a procedure for aggregating or joining claimants into a single proceeding. In addition, the FDIC should recommend and not oppose such a joinder of claims into a single proceeding. The process for challenging the FDIC's determinations should conclude prior to final distribution on claims.

None of this, however, should affect the FDIC's ability to transfer assets or liabilities to a bridge financial company during a financial crisis, or the timing of such transfer.

Clawback Provision. Under Section 210(o)(1), the FDIC is required to recoup from any creditors, including short-term creditors, any additional payments or amounts from the FDIC over what such creditor was entitled to receive in a liquidation under Chapter 7 of the Bankruptcy Code. The FDIC should detail in its regulations if and when it will exercise this clawback provision, how it will implement it and the circumstances under which it would not exercise it. It should consider how to implement this provision in a manner that eliminates or decreases the incentive of short-term unsecured creditors to run during a financial panic.

Assessment Fund. Under Section 210(o)(6), the FDIC is required to promulgate regulations regarding assessments to repay borrowings from Treasury for resolutions under the Orderly Liquidation Authority. The FDIC, in coordination with Treasury and the FSOC, should consider how to structure the assessments to minimize the impact on financial institutions at a time of severe financial distress. In addition, the FDIC should provide for a window to allow for the asset values of the covered financial

company to recover so that Treasury can be repaid from the proceeds of the sale of such assets, making assessments unnecessary.

5. Should the FDIC adopt regulations to define how claims against the covered financial company and the receiver are determined under section 210(a)(2)? What specific elements of this process require clarification?

As noted in the response to question 4, we believe that the FDIC should provide clarity and guidance as to how it will value claims against a covered financial company. Not only should the FDIC adopt regulations that specify how claims will be valued, but we also believe that the FDIC should specify an administrative or judicial method for bringing claims and for challenging a claims determination that supplements the *de novo* review by a federal court that is provided in Title II. We do not consider such judicial review to be sufficiently adequate or practical.

6. 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 fraudulent transfer provisions? What are the most important issues to address for the preferential transfers provisions? How should these issues be addressed?

As we noted in our letter to the FDIC dated December 21, 2010,[10] we believe the FDIC should promulgate regulations and issue guidance on how it will exercise its avoidance powers under Section 210(a)(11) to be consistent with the preferential transfer and fraudulent transfer provisions in Sections 547 and 548 of the Bankruptcy Code. Due to a difference in the statutory language of Title II and the Bankruptcy Code, security interests that are perfected by filing alone, rather than by control, may be treated differently under the Orderly Liquidation Authority than under the Bankruptcy Code in that the grant of those security interests may be avoided as preferential transfers in the event a financial company is resolved under the Orderly Liquidation Authority rather than the Bankruptcy Code.

Under the Bankruptcy Code, for preference purposes, a transfer takes effect when the transfer is made, if it is perfected within 30 days. Perfection can be by control (for real property) or by filing (for other property). So, if a creditor extends a loan and takes a security interest that it then perfects (by control or filing) within 30 days, the security interest would not later be avoided as a preferential transfer on account of antecedent debt, even if the debtor files for bankruptcy within the preference period. Title II does not expressly have the equivalent provision protecting a security interest that is perfected within 30 days. Therefore, secured lenders are concerned that perfection by filing within 30 days would not be sufficient to protect against preference risk with respect

[10] *See* Letter from SIFMA to the FDIC, Regarding Avoidance Powers Under the Orderly Liquidation Authority Title of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Dec. 21, 2010, *available at* http://www.sifma.org/issues/item.aspx?id=22785.

to debtors who are potentially subject to Title II. There is no reason to believe that this gap with the Bankruptcy Code was intended.

As Acting General Counsel Michael Krimminger noted in the General Counsel's opinion written in response to our letter,[11] the FDIC has agreed with this interpretation and indicated that it will apply the statute consistent with the Bankruptcy Code. Moreover, Mr. Krimminger stated that the FDIC staff will recommend to the FDIC Board that the FDIC adopt a regulation harmonizing the application of Section 210(a)(11) with the Bankruptcy Code in this regard. We urge the FDIC to take such actions and adopt the recommended regulation, and to do so in advance of broader rulemaking by the FDIC under Title II.

7. What are the key issues that should be addressed to clarify the application of the setoff provisions in section 210(a)(12)? How should these issues be addressed?

Section 210(a)(12)(F) permits the sale of assets free and clear of the creditors' setoff rights, but provides the setoff claimant with a priority claim in respect of such setoff rights that ranks ahead of all unsecured creditors and behind administrative expenses, claims owed to the U.S. Government and priority wage claims. This treatment of unexercised setoff rights under Title II is very different than the treatment under the Bankruptcy Code. Under the Bankruptcy Code, a creditor with setoff rights is treated like a secured creditor, and mutuality cannot be destroyed in the manner that it can be under Title II. Moreover, a setoff claim would not be subordinated in order of priority to other claims as it would be under Title II.

As a result of this gap between Title II and the Bankruptcy Code, there may be more of a delay under Title II than under the Bankruptcy Code in a setoff claimant being made whole. Also, if there is no distribution to unsecured creditors then, absent the minimum recovery right, the claimant's recovery could be at risk. In light of the minimum recovery right, however, the FDIC should clarify that a setoff claimant will be made whole and will receive what it would have received had the setoff been effected as of the date of the appointment of the FDIC as receiver of the covered financial company.

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[11] *See* Letter from Acting General Counsel, Michael Krimminger, FDIC, to SIFMA, Regarding Certain Transfers Under Section 210(a)(11) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 5301 *et seq.*, Dec. 29, 2010, *available at* https://www.sifma.org/Issues/item.aspx?id=22820.

8. Do the provisions governing the priority of payments of expenses and claims in section 210(b) and other sections require clarification? If so, what are the key issues to clarify in any regulation?

The FDIC should clarify how the minimum recovery right would be paid in light of the priority provisions in Section 210(b). The FDIC should specify that regardless of the priority provisions, it would pay the minimum recovery amounts due to creditors under Title II. This is consistent with the plain language in Sections 210(a)(7)(B) and (b)(4) and the statutory scheme implemented by Title II.

In addition, Section 202(d)(6) states that the FDIC and the Deposit Insurance Fund will not be liable for "unresolved claims" arising from the receivership after the termination of the receivership. Consistent with Section 202(d)(5), which grants the FDIC authority to issue regulations governing the termination of receiverships, the FDIC should promulgate regulations to clarify that it will not terminate a receivership until all unresolved claims are resolved and paid, and that "unresolved claims" would include any claims potentially subject to payment by the receivership. Without such a regulation, the FDIC could move to terminate the receivership without paying all pending or outstanding claims, and thereby limit its liability to creditors. This seems inconsistent with the Congressional intent of the statute and can easily be clarified by regulation.

9. Section 210(b)(4), (d)(4), and (h)(5)(E) address potential payments to creditors "similarly situated" that are addressed in this Proposed Rule. Are there additional issues on the application of this provision, or related provisions, that require clarification in a regulation?

As we noted in response to question 4, the FDIC should issue regulations that clarify how the minimum recovery right will be calculated. The FDIC has cited to this right to receive at least as much as a creditor would receive in a liquidation under Chapter 7 of the Bankruptcy Code as evidence that creditors will be no worse off under the Orderly Liquidation Authority than in bankruptcy. However, without clear regulations about how the FDIC will calculate this minimum recovery right, and that such calculations would be consistent with the calculation by a bankruptcy court, the minimum recovery right will not enhance market stability, and may undermine such stability in the event of a financial crisis. In addition, if creditors believe they would have enjoyed the going concern value of the company in a reorganization under the Bankruptcy Code, it will be cold comfort if all they receive under Title II is the lesser liquidation value of the company.

We also urge the FDIC to adopt a rule that it will not exercise its powers in a way that discriminates against non-U.S. creditors. Nothing in Title II suggests that U.S. and non-U.S. creditors should be treated differently. A non-discrimination rule would enhance cross-border cooperation both in the event a U.S. SIFI with significant non-U.S. creditors is resolved under Title II, and in the event a non-U.S. SIFI with significant U.S. creditors is resolved under a foreign regulatory regime. In the case of the former, a non-

discrimination rule would discourage foreign regulators from ring fencing the assets of the U.S. institution in those foreign jurisdictions, and in the case of the latter, a non-discrimination rule would encourage foreign regulators to adopt similar provisions to protect U.S. creditors.

10. Section 210(h) provides the FDIC with authority to charter a bridge financial company to facilitate the liquidation of a covered financial company. What issues surrounding the chartering, operation, and termination of a bridge company would benefit from a regulation? How should those issues be addressed?

Please see Section I of our comment letter which describes why the FDIC should issue regulations regarding the operation of bridge financial companies. The most important issue that needs to be clarified publicly is how these bridge financial companies will be funded until they are recapitalized, sold or otherwise returned to the private sector.

In addition, the FDIC should provide by regulation that it will only treat a bridge financial company as a covered financial company in default pursuant to Section 210(h)(4) for limited purposes, and specify certain purposes for which it will not be treated as a covered financial company in default.[12] Specifically, a bridge financial company should not be treated as a covered financial company in default for purposes of discriminating among similarly situated creditors under Title II or the FDIC proposed rules or for the purpose of valuing margin collateral under FDIC Proposed Rule 380.2(c). Without clear and specific regulations on this issue, it could be difficult for a bridge financial company to find creditors willing to extend financing to the company.

11. Regarding actual direct compensatory damages for the repudiation of a contingent obligation in the form of a guarantee, letter of credit, loan commitment, or similar credit obligation, should the Proposed Rule be amended to specifically provide a method for determining the estimated value of the claim? In addition to the statutory considerations in valuation, including the likelihood that the contingent claim would become fixed and its probable magnitude, what other factors are appropriate? If so, what methods for determining such estimated value would be appropriate? Should the regulation provide more detail on when a claim is contingent?

As we noted in our comment letter dated November 18, 2010, Proposed Rule 380.4(b) confirms that a claim based on a contingent obligation of a covered financial company "may" be provable against the receiver. Section 201(a)(4) provides that the term "claim" includes a "contingent" claim. There is no discretion under the statute about whether a contingent claim is provable against the receiver. If it is proved, the FDIC must

[12] Section 210(h)(4) states that "A bridge financial company shall be treated as a covered financial company in default at such times and for such purposes as the [FDIC], in its discretion, may determine." Dodd-Frank Act, § 210(h)(4).

accept it as a proven claim. As a result, the word "may" should be changed to "shall" to assure that contingent claims, once proved, will be accepted.

Proposed Rule 380.4(c) provides that the "actual direct compensatory damages for repudiation" of a contingent obligation shall be no less than "the estimated value" of the claim as of the date the FDIC is appointed as receiver, and shall be "measured based upon the likelihood that such contingent claim would become fixed and the probable magnitude thereof." This simply confirms the statute and is consistent with the standard used by bankruptcy courts and the FDIC's statutory duty under Section 209 to harmonize the rules and regulations implementing Title II with the Bankruptcy Code. The rule should be revised to clarify that if the contingent claim becomes fixed before final distributions are made to creditors generally, the fixed amount should be the relevant amount rather than any estimate. Again, this is consistent with the standard in bankruptcy and with the FDIC's duty under Section 209 to harmonize the rules and regulations implementing Title II with the Bankruptcy Code.

Finally, the release accompanying the proposed rules includes the following comment, but no corresponding rule implementing this concept:

> "In addition, the FDIC holds the view that an obligation in the form of a guarantee or letter of credit is no longer contingent if the principal obligator (*i.e.*, the party whose obligation is backed by the guarantee or letter of credit) becomes insolvent or is the subject of insolvency proceedings."[13]

Although we understand the FDIC intended for this passage to mean that the claim against the guarantor or letter of credit issuer becomes absolute, the FDIC should clarify this language. The FDIC should also amend this statement so that the guarantee or letter of credit would become absolute upon the occurrence of any event that would permit a draw down as a contractual matter, including a default by the primary obligor or a cross-default, and not simply the primary obligor's insolvency or being the subject of insolvency proceedings. Finally, the guidance should be transformed into a binding rule—a new subsection (d) to proposed Rule 380.4—rather than remain as a non-binding statement in the release accompanying the proposed rule. This issue is so important that it needs to be confirmed in the form of a binding rule.

12. Are the provisions of the Dodd-Frank Act relating to the classification of claims as administrative expenses of the receiver sufficiently clear, or is additional rulemaking necessary to clarify such classification?

Any additional clarity that the FDIC can provide with regard to the classification of claims as administrative expenses would be welcome. The definition of

[13] 75 Fed. Reg. at 64179.

"administrative expenses" which includes any obligations that the FDIC as receiver determines are "necessary and appropriate to facilitate the smooth and orderly liquidation of the covered financial company" is very broad.[14] This gives the FDIC wide discretion to determine what constitutes an administrative expense, and therefore given priority of payment over otherwise similarly situated creditors.

13. Should the Proposed Rule's definition of "long-term senior debt" be clarified or amended?

As noted in our comment letter dated November 18, 2010, we believe that making a sharp distinction between long-term and short-term creditors could have unintended and even unforeseen adverse consequences on the market. These might include creating incentives for investors to restructure their investments to fit within the short-term category or distortions in the cost of long-term credit upward and the cost of short-term credit downward.

We also believe it would be a mistake to impose any absolute prohibition on the FDIC's discretion to provide financial assistance to any class of creditors for the reasons set forth in our November 18 comment letter. At a minimum, the FDIC should limit any such absolute prohibition to the holders of regulatory capital instruments. Such instruments are, by definition, expected to absorb losses, and the holders of such instruments have almost no ability to run because of the perpetual or very long-dated nature of their instruments. Such a more limited prohibition also seems more consistent with the text of Title II, which provides that the only liabilities that may not be assumed by a bridge financial company are liabilities that count as regulatory capital.[15]

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[14] Dodd-Frank Act, § 201(a)(1).

[15] *Id.* § 210(h)(1)(B)(i).