April 4, 2011

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

Dear Sir:

Re: Proposed Rules on Orderly Liquidation Authority (Comments on RIN 3064-AD73)

This letter presents comments of The Heritage Foundation ("Foundation") on the Federal Deposit Insurance Corporation (FDIC) notice of proposed rulemaking on "Orderly Liquidation Authority" (76 Fed. Reg. 16324, March 23, 2011). The notice includes proposed sections 380.1 and 380.7 of title 12 of the Code of Federal Regulations, which purport to implement the remuneration-recovery provisions in section 210(s) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203, July 21, 2010)("Dodd-Frank Act")(12 U.S.C. 5390(s)). The Foundation recommends against FDIC adoption of proposed sections 380.1(b)(1) and 380.7(a), (b)(1), and (b)(2) of title 12, because they exceed the statutory authority of the FDIC and injure America's economic interests. The Foundation proposes instead revisions that both follow the law and serve America's economic interests.

The Foundation is a District of Columbia nonprofit corporation that is recognized as exempt under section 501(c)(3) of the Internal Revenue Code, with the mission "to formulate and promote conservative public policies based on the principles of free enterprise, limited government, individual freedom, traditional American values, and a strong national defense." The Foundation submits these comments as permitted by law (5 U.S.C. 553(c), 2 U.S.C. 1602(8)(B)(x), and 26 U.S.C. 4911(d)(2)(E)).

Section 210(s) of the Dodd-Frank Act provides:

> (s) RECOUPMENT OF COMPENSATION FROM SENIOR EXECUTIVES AND DIRECTORS.--
>
> (1) IN GENERAL.--The Corporation, as receiver of a covered financial company, may recover from any current or former senior executive or director substantially responsible for the failed condition of the covered financial company any compensation received during the 2–year period preceding the date on which the Corporation was appointed as the receiver of the covered financial company, except that, in the case of fraud, no time limit shall apply.

(2) COST CONSIDERATIONS.--In seeking to recover any such compensation, the Corporation shall weigh the financial and deterrent benefits of such recovery against the cost of executing the recovery.

(3) RULEMAKING.--The Corporation shall promulgate regulations to implement the requirements of this subsection, including defining the term "compensation" to mean any financial remuneration, including salary, bonuses, incentives, benefits, severance, deferred compensation, or golden parachute benefits, and any profits realized from the sale of the securities of the covered financial company.

Proposed sections 380.1(b)(1) and 380.7 of title 12 of the Code of Federal Regulations stray from the authority granted by the statute.

I. Proposed Definition of "Compensation" in 12 CFR 380.1(b)(1) is Contrary to Statute

Section 210(s)(1) of the Dodd-Frank Act allows, in certain circumstances, the FDIC as a receiver of a covered financial company to take back "compensation" from a former senior executive or director of the company. In section 210(s)(3) Congress gave explicit instructions on how the FDIC must define the term "compensation" in its regulations implementing section 210(s):

> The Corporation shall promulgate regulations to implement the requirements of this subsection, including defining the term "compensation" to mean any financial remuneration, including salary, bonuses, incentives, benefits, severance, deferred compensation, or golden parachute benefits, and any profits realized from the sale of the securities of the covered financial company.

Contrary to the command of section 210(s)(3), the FDIC has defined "compensation" as follows in proposed section 380.1(b)(1) of title 12 of the Code of Federal Regulations:

> (b) The following words shall be defined as follows:
>
> (1) *Compensation*. The word compensation means any direct or indirect financial remuneration received from the covered financial company, including, but not limited to, salary; bonuses; incentives; benefits; severance pay; deferred compensation; golden parachute benefits; benefits derived from an employment contract, or other compensation or benefit arrangement; perquisites; stock option plans; post-employment benefits; profits realized from a sale of securities in the covered financial company; or any cash or non-cash payments or benefits granted to or for the benefit of the senior executive or director.

Even taking into account the definition of the term "including" in section 3(t) of the Federal Deposit Insurance Act (12 U.S.C. 1813(t))[1] as incorporated by section 2(a)(18) of the Dodd-

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[1] Section 3(t) of the Federal Deposit Insurance Act provides:

> As used in this Act-- . . .
>
> (t) INCLUDES, INCLUDING.--
>
> (1) IN GENERAL.--The terms "includes" and "including" shall not be construed more restrictively than the ordinary usage of such terms so as to exclude any other thing not referred to or described.

Frank Act (12 U.S.C. 5301),[2] it is clear on the face of section 210(s)(3) that Congress set the outer limits of the meaning the FDIC could assign in its regulations to the term "compensation." Under section 210(s)(3), the FDIC can only put an item into its definition of the term "compensation" if it falls within the outer limits of: "any financial remuneration . . . and any profits realized from the sale of securities of the covered financial company." The FDIC has acted contrary to that statutory command by adding to its proposed regulatory definition of "compensation" four items that often are neither financial remuneration nor profits from the sale of securities: "benefits derived from an employment contract, or other compensation or benefit arrangement;" "perquisites;" "post-employment benefits;" "non-cash . . . benefits granted."

It is impossible to find a statutory basis for the FDIC to add to the term "compensation" items that do not fall within the statutory limit of "any financial remuneration . . . and any profits realized from the sale of securities of the covered financial company," unless the FDIC construes the words in section 210(s)(3) after "[t]he Corporation shall promulgate regulations to implement the requirements of this subsection" as if they have no effect and are mere surplusage. Such a construction is impermissible. TRW Inc. v. Andrews, 534 U.S. 19, 31 (2001)("It is 'a cardinal principle of statutory construction' that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.' Duncan v. Walker, 533 U.S. 167, 174 (2001)(internal quotation marks omitted) . . . We are 'reluctant to treat statutory terms as surplusage in any setting,' ibid. . . ."). Congress "has spoken to the precise question" of the meaning of the term "compensation" for the FDIC regulations and since "the intent of Congress is clear, that is the end of the matter; for the . . . agency . . . must give effect to the unambiguously expressed intent of Congress." Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984).

Note also that the FDIC proposed regulatory definition of the term "compensation" contains the word "compensation," thus rendering the definition circular and logically flawed.

For the foregoing reasons, the Foundation recommends that the FDIC revise proposed section 380.1(b)(1) defining "compensation" to read as follows:

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(2) RULE OF CONSTRUCTION.--Paragraph (1) shall not be construed as creating any inference that the term "includes" or "including" in any other provision of Federal law may be deemed to exclude any other thing not referred to or described.

[2] Section 2(a)(18) of the Dodd-Frank Act provides:

As used in this Act, the following definitions shall apply, except as the context otherwise requires or as otherwise specifically provided in this Act: . . .

(18) OTHER INCORPORATED DEFINITIONS.—

(A) FEDERAL DEPOSIT INSURANCE ACT.—The terms ''bank'', . . . ''foreign bank'', ''including'', . . . and ''subsidiary'' have the same meanings as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813) . . . .

(b) The following words shall be defined as follows:

(1) *Compensation*. The word compensation means--

(A) any direct or indirect financial remuneration received from the covered financial company, including, but not limited to, salary; bonuses; incentives; benefits; severance pay; deferred financial remuneration; golden parachute benefits; financial benefits derived from an employment contract or from a benefit arrangement; financial post-employment benefits; or cash payments or cash benefits; or

(B) any profits realized from the sale of the securities of the covered financial company.

The above revised definition removes from the FDIC's proposed definition the items that were beyond the limits set by section 210(s)(3) of the Dodd-Frank Act.

II. Presumption in Proposed 12 CFR 380.7 Concerning Substantial Responsibility of Senior Company Officials is Irrational and Bad for the Economy

Section 380.7 of title 12 of the Code of Federal Regulations as proposed by the FDIC implements section 210(s) of the Dodd-Frank Act on recovery of compensation. The first sentence of section 380.7(a) mirrors section 210(s)(1) of the Dodd-Frank Act, but the FDIC generated the remainder of the section. Section 380.7 states:

Sec. 380.7 Recoupment of compensation from senior executives and directors.

(a) *Substantially Responsible*. The Corporation, as receiver of a covered financial company, may recover from any current or former senior executive or director substantially responsible for the failed condition of the covered financial company any compensation received during the 2-year period preceding the date on which the Corporation was appointed as the receiver of the covered financial company, except that, in the case of fraud, no time limit shall apply. A senior executive or director shall be deemed to be substantially responsible for the failed condition of a covered financial company that is placed into receivership under the orderly liquidation authority of the Dodd-Frank Act if:

(1) He or she failed to conduct his or her responsibilities with the requisite degree of skill and care required by that position, and

(2) As a result, individually or collectively, caused a loss to the covered financial company that materially contributed to the failure of the covered financial company under the facts and circumstances.

(b) *Presumptions*. The following presumptions shall apply for purposes of assessing whether a senior executive or director is substantially responsible for the failed condition of a covered financial company:

(1) It shall be presumed that a senior executive or director is substantially responsible for the failed condition of a covered financial company that is placed into receivership under the orderly liquidation authority of the Dodd-Frank Act under any of the following circumstances:

(i) The senior executive or director served as the chairman of the board of directors, chief executive officer, president, chief financial officer, or in any other similar role regardless of his or her title if in this role he or she had responsibility for the strategic, policymaking, or company-wide operational decisions of the covered financial company prior to the date that it was placed into receivership under the orderly liquidation authority of the Dodd-Frank Act;

(ii) The senior executive or director is adjudged liable by a court or tribunal of competent jurisdiction for having breached his or her duty of loyalty to the covered financial company;

(iii) The senior executive was removed from the management of the covered financial company under 12 U.S.C. 5386(4); or

(iv) The director was removed from the board of directors of the covered financial company under 12 U.S.C. 5386(5).

(2) The presumption under paragraph (b)(1)(i) of this section may be rebutted by evidence that the senior executive or director performed his or her duties with the requisite degree of skill and care required by that position. The presumptions under paragraphs (b)(1)(ii),)(iii) and (iv) of this section may be rebutted by evidence that the senior executive or director did not cause a loss to the covered financial company that materially contributed to the failure of the covered financial company under the facts and circumstances.

(3) The presumptions do not apply to:

(i) A senior executive hired by the covered financial company during the two years prior to the Corporation's appointment as receiver to assist in preventing further deterioration of the financial condition of the covered financial company; or

(ii) A director who joined the board of directors of the covered financial company during the two years prior to the Corporation's appointment as receiver under an agreement or resolution to assist in preventing further deterioration of the financial condition of the covered financial company.

(4) Notwithstanding that the presumption does not apply under paragraphs (b)(3)(i) and (ii) of this section, the Corporation as receiver still may pursue recoupment of compensation from a senior executive or director in paragraphs (b)(3)(i) and (ii) of this section if they are substantially responsible for the failed condition of the covered financial company.

(c) *Actions by the Corporation as receiver for Losses to the Covered Financial Company.* Pursuing recoupment of compensation under this section shall not in any way limit or impair the ability of the Corporation as receiver to pursue any other claims or causes of action it may have against senior executives and directors of the covered financial company for losses they cause to the covered financial company in the same or separate actions.

Subsections (a) and (b) of section 380.7 are flawed.

A. Subsection 380.7(a) Should Explicitly Adopt the Business Judgment Rules of the Several States

Section 380.7(a) provides that "[a] senior executive or director shall be deemed to be substantially responsible for the failed condition of a covered financial company that is placed

into receivership under the orderly liquidation authority of the Dodd-Frank Act if: (1) He or she failed to conduct his or her responsibilities with the requisite degree of skill and care required by that position, and (2) As a result, individually or collectively, caused a loss to the covered financial company that materially contributed to the failure of the covered financial company under the facts and circumstances." Thus, the FDIC proposes to construe the phrase about an individual "substantially responsible for the failed condition" in section 210(s) of the Dodd-Frank Act to require four elements: (1) the individual is a senior executive or director, (2) the individual failed to conduct his or her responsibilities "with the requisite degree of skill and care required by that position," (3) the individual's failure caused a loss to the company, and (4) the loss materially contributed to the failure of the company.

The American people have a vital interest in the soundness of covered financial companies. The soundness of those companies depends in significant part upon the willingness of individuals with substantial business and financial experience and good judgment to serve in senior executive and director positions. People will not serve in those positions if they entail either insufficient compensation or undue risk. Generally, the company can set appropriate compensation, but the FDIC's regulations affect the degree of risk. As a result of the proposed FDIC regulation, a senior executive or director would have, in addition to the other risks associated with those positions, the risk of retroactively losing up to two years of compensation for failure, in certain circumstances, to conduct his or her responsibilities "with the requisite degree of skill and care required by that position." The FDIC regulation leaves unstated what degree of skill and care is "requisite."

If the FDIC intends by its reference to "the requisite degree of skill and care required by that position" to leave to case-by-case adjudication the determination of what degree of skill and care is "requisite" to a particular senior executive or director position, the FDIC increases significantly the degree of risk an individual assumes in taking a senior executive or director position, as the individual cannot assess in advance what a future adjudication might determine to be the degree of skill and care requisite in the position. Such an increase in risk decreases the likelihood of recruiting top-quality candidates to take those positions. If, however, the FDIC intends by its reference to "the requisite degree of skill and care required by that position" to incorporate the business judgment rule from the laws of the several States, see, for example, In re Citigroup Inc. Shareholder Derivative Litigation, 964 A. 2d 106, 124 (Del. Ch. 2009), then the FDIC does not increase the risk such an individual assumes. The FDIC should make clear that the degree of skill and care "requisite" is that supplied by the business judgment rule from the law of the State, U.S. territory, or District of Columbia, in which the company is incorporated or, in the case of limited liability companies or other non-corporate forms, is organized. For covered financial companies incorporated or otherwise organized outside the United States but doing business inside the United States, the regulation should use the business judgment rule of the law of the U.S. State, territory, or District in which the company's principal U.S. place of business is located.

Accordingly, the FDIC should revise subsection 380.7(a) to read as follows:

Sec. 380.7 Recoupment of compensation from senior executives and directors.

(a) *Substantially Responsible*. The Corporation, as receiver of a covered financial company, may recover from any current or former senior executive or director substantially responsible for the failed condition of the covered financial company any compensation received during the 2-year period preceding the date on which the Corporation was appointed as the receiver of the covered financial company, except that, in the case of fraud, no time limit shall apply. A senior executive or director shall be deemed to be substantially responsible for the failed condition of a covered financial company that is placed into receivership under the orderly liquidation authority of the Dodd-Frank Act if:

(1) He or she failed to conduct his or her responsibilities with the requisite degree of skill and care required by that position under the business judgment rule of the law of the State in which the company is incorporated or otherwise organized or, if not organized within a State, territory or District, the law of the State, territory, or District in which is located the company's principal place of business in the United States, and

(2) As a result, individually or collectively, caused a loss to the covered financial company that materially contributed to the failure of the covered financial company under the facts and circumstances.

Incorporating by reference the business judgment rule of the law of the State, territory or District avoids further discouraging individuals with substantial business and financial experience and good judgment from serving in senior executive and director positions and accords appropriate deference to the traditional role of the States in our Federal system.

B. Subsection 380.7(b) Should Exclude the Irrational Presumption of Substantial Responsibility Regarding Senior Company Officials

Nothing in subsection (b) of section 380.7 derives from the text of Section 210(s) of the Dodd-Frank Act. Instead, subsection 380.7(b) consists of presumptions created by the FDIC to make FDIC work easier. The presumptions in essence allow the FDIC, without proving anything, to take an individual's property, unless the individual proves that he or she exercised the requisite degree of skill or care. The rebuttable presumption of substantial responsibility in proposed section 380.7(b)(1)(i), concerning certain senior officers of a covered financial company, is irrational and therefore invalid; it is also bad for the economy.

Subsection 380.7 states:

(b) *Presumptions*. The following presumptions shall apply for purposes of assessing whether a senior executive or director is substantially responsible for the failed condition of a covered financial company:

(1) It shall be presumed that a senior executive or director is substantially responsible for the failed condition of a covered financial company that is placed into receivership under the orderly liquidation authority of the Dodd-Frank Act under any of the following circumstances:

(i) The senior executive or director served as the chairman of the board of directors, chief executive officer, president, chief financial officer, or in any other similar role regardless of his or her title if in

this role he or she had responsibility for the strategic, policymaking, or company-wide operational decisions of the covered financial company prior to the date that it was placed into receivership under the orderly liquidation authority of the Dodd-Frank Act;

(ii) The senior executive or director is adjudged liable by a court or tribunal of competent jurisdiction for having breached his or her duty of loyalty to the covered financial company;

(iii) The senior executive was removed from the management of the covered financial company under 12 U.S.C. 5386(4); or

(iv) The director was removed from the board of directors of the covered financial company under 12 U.S.C. 5386(5).

(2) The presumption under paragraph (b)(1)(i) of this section may be rebutted by evidence that the senior executive or director performed his or her duties with the requisite degree of skill and care required by that position. The presumptions under paragraphs (b)(1)(ii),)(iii) and (iv) of this section may be rebutted by evidence that the senior executive or director did not cause a loss to the covered financial company that materially contributed to the failure of the covered financial company under the facts and circumstances.

(3) The presumptions do not apply to:

(i) A senior executive hired by the covered financial company during the two years prior to the Corporation's appointment as receiver to assist in preventing further deterioration of the financial condition of the covered financial company; or

(ii) A director who joined the board of directors of the covered financial company during the two years prior to the Corporation's appointment as receiver under an agreement or resolution to assist in preventing further deterioration of the financial condition of the covered financial company.

(4) Notwithstanding that the presumption does not apply under paragraphs (b)(3)(i) and (ii) of this section, the Corporation as receiver still may pursue recoupment of compensation from a senior executive or director in paragraphs (b)(3)(i) and (ii) of this section if they are substantially responsible for the failed condition of the covered financial company.

In subsection 380.7(a), the FDIC proposes to establish a four-element test for determining the existence of "substantial responsibility": (1) the individual is a senior executive or director, (2) the individual failed to conduct his or her responsibilities "with the requisite degree of skill and care required by that position," (3) the individual's failure caused a loss to the company, and (4) the loss materially contributed to the failure of the company. Then the FDIC proposes in subsection 380.7(b)(1)(i) that, if the individual involved served as chairman of the board, chief executive officer, president, chief operating officer, or in any similar role in a covered financial company that goes into receivership, the FDIC will automatically presume the existence of the second, third and fourth elements -- lack of skill/care, causation of loss, and material contribution to company failure -- and in subsection 380.7(b)(2) force on the individual the duty of proving that he or she performed his or her duties with the requisite degree of skill and care.

The mere fact that an individual held a particular position in the company says nothing about what skill or care he or she exercised, whether he or she caused a loss, or whether any loss that

was caused contributed materially to a company failure. The presumption in subsection 380.7(b)(1)(i) is therefore irrational and invalid. Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 28 (1976)("We have consistently tested presumptions arising in civil statutes such as this, involving matters of economic regulation, against the standard articulated in Mobile, J. & K. C. R. Co. v. Turnipseed, 219 U.S. 35, 43 (1910): 'That a legislative presumption of one fact from evidence of another may not constitute a denial of due process of law or a denial of the equal protection of the law, it is only essential that there shall be some rational connection between the fact proved and the ultimate fact presumed, and that the inference of one fact from proof of another shall not be so unreasonable as to be a purely arbitrary mandate.'"); Garvey v. National Transportation Safety Board, 190 F. 3d 571, 579 (D.C. Cir. 1999)(rationality requirement for presumption applied in case involving regulation issued pursuant to Federal statute).

In addition to its flaw of irrationality, the presumption is economically flawed. Subsection 380.7(b)(1)(i) in essence creates a presumption of strict liability for recovery of compensation from an individual who served as chairman of the board, chief executive officer, president, chief operating officer, or in any similar role in a covered financial company that goes into receivership, unless the individual proves he or she exercised the requisite skill and care. Such a regulation would discourage individuals with substantial business and financial experience and good judgment from serving in senior positions in covered financial companies because of the undue risk the FDIC would impose. By making it more difficult for companies to attract top talent to their senior positions, the FDIC would reduce the likelihood of the economic success of the companies.

Accordingly, the FDIC should revise paragraphs (1) and (2) of subsection 380.7(b) to read as follows:

> (b) *Presumptions*. The following presumptions shall apply for purposes of assessing under subsection (a) of this section whether a senior executive or director is substantially responsible for the failed condition of a covered financial company:
>
> (1) It shall be presumed that a senior executive or director is substantially responsible for the failed condition of a covered financial company that is placed into receivership under the orderly liquidation authority of the Dodd-Frank Act under any of the following circumstances:
>
> (i) The senior executive or director is adjudged liable by a court or tribunal of competent jurisdiction for having breached his or her duty of loyalty to the covered financial company;
>
> (ii) The senior executive was removed from the management of the covered financial company under 12 U.S.C. 5386(4); or
>
> (iii) The director was removed from the board of directors of the covered financial company under 12 U.S.C. 5386(5).
>
> (2) The presumptions under paragraphs (b)(1)(i), (ii) and (iii) of this section may be rebutted by evidence that the senior executive or director did not fail to conduct his or her responsibilities with the requisite degree of skill and care required by that position, did not cause a loss to the covered financial company, or that any loss he or she caused did not materially contribute to the failure of the covered financial company under the facts and circumstances.

As so revised, paragraphs (1) and (2) of subsection 380.7 are rational and consistent with section 210(s) of the Dodd-Frank Act.

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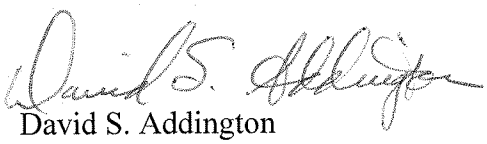
For the reasons set forth above, The Heritage Foundation asks that the Federal Deposit Insurance Corporation withdraw proposed sections 380.1(b)(i) and 380.7(a), (b)(1), and (b)(2) of title 12 of the Code of Federal Regulations and substitute in lieu thereof the texts for those provisions recommended above.

Sincerely,



David S. Addington
Vice President for Domestic and Economic Policy