April 29, 2011

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

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

Dear Mr. Feldman:

Students in the University at Buffalo Law School's New York City Program in Finance and Law respectfully submit this comment letter to the Federal Deposit Insurance Corporation ("FDIC").

This comment letter responds to the FDIC's recent Notice of Proposed Rulemaking ("Notice"), dated March 23, 2011, and discusses the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). In particular, we comment on four issues:

(I) Can the FDIC treat similarly situated creditors differently, and if so, to what extent;
(II) How will the FDIC ensure that a creditor of a covered financial company ("CFC") will receive no less than it would receive in a Chapter 7 Bankruptcy proceeding;
(III) How will the FDIC implement § 210(o)(1)(D)'s claw-back provision; and
(IV) What procedural rights and recourse does a creditor or other party have to challenge a FDIC decision?

We support the FDIC's efforts to clarify the orderly liquidation process and provide greater transparency of its actions to market participants. This comment letter discusses issues that we believe need further clarification.

I. ORDERLY RESOLUTION: § 210(b)(4)

This section will address the FDIC's authority to treat similarly situated creditors differently under § 210(b)(4) and its corresponding regulation, Rule 380.2. To evaluate this topic, the section will discuss: (1) Rule 380.2 as it relates to the Administrative Procedure Act ("APA") and (2) the text of § 210(b)(4) and Rule 380.2.

A. To ensure compliance with the APA, the FDIC should explain Rule 380.2's reasoning more thoroughly.

To ensure Rule 380.2 complies with the APA, the FDIC must strengthen its arguments supporting the rule's reasoning.[1] This is critical since a successful challenge to Rule 380.2 for failing to comply with the APA would result in the rule's invalidation and the FDIC's need to re-draft it.

---

[1] *See* 5 U.S.C. § 706 (2006).

If a party challenges an agency rule as violating the APA, courts apply an "arbitrary and capricious" standard of review.[2] Under this standard, a reviewing court cannot strike down an agency rule that is rational, considers relevant factors, and falls within the scope of authority statutorily delegated to the agency. While a court cannot substitute its own judgment for that of the agency, the standard requires more than minimal rational basis scrutiny.[3] In creating regulations, an agency must contemplate relevant data, "articulate a satisfactory explanation" for its rules,[4] consider alternatives,[5] and cannot create rules running "counter to" the evidence presented to it.[6] If an agency does not adhere to these principles in crafting a regulation, courts will find the regulation "arbitrary and capricious."

Additionally, the D.C. Court of Appeals has recently struck down two SEC regulations as "arbitrary and capricious" for lacking sufficient economic analysis to support the regulations' reasoning. *See NetCoalition v. SEC,* 615 F.3d 525, 544 (D.C. Cir. 2010) (vacating the SEC rule because the agency's determination that the exchange was subject to significant competitive forces constraining its ability to set fees was based on insufficient analysis); .*American Equity Investment Life Insurance Co. v. SEC,* 572 F.3d 923, 936 (D.C. Cir. 2009) (finding the SEC rule arbitrary and capricious because it failed "to analyze the efficiency of the existing state law regime").

While these decisions did not involve FDIC regulations specifically, they nonetheless indicate that in APA cases, the D.C. Circuit will more critically scrutinize the reasoning behind the regulations of independent regulatory agencies ("IRA"). Given this quasi-heightened standard of review, particularly with respect to economic analysis, the FDIC should offer stronger logic supporting Rule 380.2 to ensure APA compliance and prevent re-drafting.

Furthermore, President Obama recently issued Executive Order 13563, outlining ways that federal agencies should more closely scrutinize rules they craft.[7] It instructed agencies to base their rules on "the best available science," including economic evidence, and carefully evaluate costs and benefits from both a qualitative and quantitative perspective.[8] While this Order does not apply to IRA's like the FDIC,[9] it parallels the factors considered in courts' APA analysis, and is a standard the FDIC should strive to meet. Thus, we urge the FDIC to more thoroughly explain its logic in creating Rule 380.2.

---

[2] *Id.* at § 706(2)(A); Chevron v. NRDC, 467 U.S. 837, 841 (1984).
[3] Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Auto Insurance Co., 463 U.S. 29, 30 (1983).
[4] *Id*; Goldstein v. SEC, 451 F.3d 873, 882 (D.C. Cir. 2006) (vacating the SEC's Hedge Fund Rule because the agency could not "adequately explain" why "client" should mean one thing when determining to whom fiduciary duties are owed, and something entirely different when determining whether an investment adviser must register under the Act).
[5] *See* Chamber of Commerce of U.S. v. SEC, 412 F.3d 133, 138 (D.C. Cir. 2005) (finding that the SEC's failure to consider alternatives to independent chairman condition violated the APA); Brookings Mun. Tel. Co. v. FCC, 822 F.2d 1153, 1169 (D.C. Cir. 1987) (finding agencies have "a duty to consider responsible alternatives to its chosen policy and to give a reasoned explanation for its rejection of such alternatives").
[6] Motor Vehicle Manufacturers, 463 U.S. at 43.
[7] EXEC. ORDER NO. 13,563, 76 F.R. 3821 (2011).
[8] *Id.* at § 1(a).
[9] *Id.* at § 7(a); 44 U.S.C. § 3502(5).

B. <u>§ 210(b)(4) and Rule 380.2 discuss the extent to which the FDIC can treat similarly situated creditors differently.</u>

Under § 210(b)(4), the FDIC can pay certain creditors more than other similarly situated creditors if necessary to: (1) maximize the value of the assets; (2) initiate and continue operations essential to implementation of the receivership and any bridge financial company to which assets may be transferred for future sale or disposition by the receiver; (3) maximize the present value of return from the sale or other disposition of the assets, and (4) minimize the amount of any loss on sale or other disposition.[10]

Rule 380.2 has narrowed § 210(b)(4)'s scope by identifying three types of creditors that can never receive additional payments from the FDIC: (1) long-term, unsecured senior debtholders;[11] (2) subordinated debtholders;[12] and (3) shareholders.[13]

1. The FDIC should further clarify "value maximization."

While § 210(b)(4) permits the FDIC to make additional payments to certain creditors to maximize value and minimize resolution costs, Rule 380.2 offers little explanation about how value or cost is calculated. What does it mean to maximize value and minimize costs? In bank resolutions under the Bankruptcy Code ("the Code"), a least-cost standard applies. This standard requires the FDIC to resolve a failed bank in a way that imposes the least cost on the insurance fund, where least-cost generally means cutting losses immediately.[14]

In contrast, Orderly Liquidation Authority ("OLA") encourages maintaining assets through a transfer to a bridge company to facilitate the winding down. The FDIC argues that preserving value via a bridge financial company prevents immediate and disorderly liquidation of collateral during a time of market distress, and avoids market destabilization. For example, in the Lehman Brothers bankruptcy, due to the lack of funding for continuing valuable contracts and counterparties' rights under the Code to terminate those contracts immediately, the bankruptcy estate lost billions.

While the FDIC has provided a rationale for why it is not using the "least-cost" standard, it has not offered any guidance as to how it will measure value in lieu of that standard. As such, we urge the FDIC to specify exactly how it will measure value. Without further clarification, the standard remains ambiguous and creates uncertainty among market participants.

2. The FDIC should not limit its ability to make additional payments to long-term debtholders.

Rule 380.2 identifies long-term unsecured creditors as parties that can never receive additional payments from the FDIC.[15] It defines "long-term" as a term exceeding 360 days.[16]

---

[10] Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) 12 U.S.C. § 210(b)(4); (d)(4) & 210(h)(5)(E).
[11] 12 C.F.R. § 380.2(a).
[12] *Id.* at § 380.2(b)(2).
[13] *Id.*
[14] *See* 12 U.S.C. § 1823(c)(4)(A) (2006).
[15] 12 C.F.R. § 380.2.

Because Rule 380.2 does not forbid additional payments for short-term unsecured creditors, it implies that it is possible for short-term creditors to receive such payments.[17]

Numerous commenters have argued that this preferential treatment of short-term creditors will cause long-term creditors to either (1) stop investing in companies subject to OLA, and instead rely more on short-term credit[18] or (2) extend credit to institutions subject to OLA at a much higher rate.[19] Accordingly, some of these commenters have requested that the FDIC not limit its ability to make additional payments to long-term debtholders.

However, the FDIC has rejected this claim, arguing that Rule 380.2 will not make short-term debt more likely to receive additional payments.[20] As general creditors, the FDIC emphasizes, short-term creditors would only be entitled to additional payments if the Board determines that such payments meet all the § 210(b)(4) requirements, including the requirement that the FDIC maximize value and minimize resolution costs.[21] It claims that these requirements are unlikely to be satisfied.[22] Consequently, the FDIC argues, creditors with short-term claims will usually receive the same pro-rata share of their claim as is provided to creditors with long-term claims. Therefore, potential credit providers will have no expectation of differing treatment regardless of whether they lend for periods under or over 360 days.[23]

However, as discussed in Section I-B-1, the § 210(b)(4) requirements concerning value maximization and cost minimizing are very ambiguous. Without certainty about what standard the FDIC will use to measure value or how it will apply the standard to short-term creditors, how can market participants know whether a specific creditor is likely to satisfy the § 210(b)(4) criteria? This unpredictability may cause long-term creditors to either stop investing in companies subject to OLA or extend credit to institutions subject to OLA at a much higher rate.

To avoid this problem, the FDIC should not give preferential treatment to short-term creditors, and should not limit its ability to make additional payments to long-term debtholders. To improve this rule, we urge the FDIC to adopt one of two proposals made by the American Bankers Association. First, the FDIC could limit the definition of "long-term" to regulatory capital instruments, which commonly have a term of long duration and are intended to absorb losses.[24] Second, the FDIC could define "long-term senior debt" by *remaining* maturity of more than 360 days, rather than by the term of maturity as of the date of issuance as proposed.[25]

---

16 *Id*. at § 380.2(a).
17 *Id.* at § 380.2.
18 Supplementary Information to the Interim Final Rule: Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.
19 Managed Funds Association, Letter to the FDIC (January 2011).
20 Supplementary Information to the Interim Final Rule.
21 § 380.2(b)(4).
22 *See id.*
23 *See id.*
24 January 18, 2011: American Bankers Association comment letter to FDIC; *available at* http://www.aba.com/NR/rdonlyres/DC65CE12-B1C7-11D4-AB4A-00508B95258D/70539/cl_DFA_ordliquidation2011Jan18.pdf.
25 *Id.*

II. CONCERNS ABOUT HOW MUCH CREDITORS WILL RECOVER RELATIVE TO A CHAPTER 7 BANKRUPTCY LIQUIDATION

The Act guarantees that creditors will recover no less from the CFC than they would have received in a liquidation under the Code.[26] With such a guarantee in place ensuring recovery of at least as much as if the CFC had been liquidated under the Code, the OLA process will theoretically provide creditors greater compensation than the Code. However there is nothing in the proposed rules to indicate how the FDIC will accurately determine what each creditor would have received had the company liquidated in bankruptcy. This is especially concerning considering other provisions within the Act allowing the FDIC to treat similarly situated creditors differently in certain circumstances.[27]

Moreover, because the FDIC lacks experience administering Chapter 7, a mechanism by which to ensure creditors will receive as much or more than they would have under the Code should be written into the regulations in order to ensure compliance with § 210(d)(2)(B) as well as to provide clarity and transparency to the OLA process. Finally, we request that the FDIC clarify and address what impact, if any, the absence of a creditor's committee like the type established pursuant to the Code[28] will have on resolution outcomes to creditors in the context of complying with § 210(d)(2)(B) of the Act.

A. <u>How can the FDIC treat similarly situated creditors differently?</u>

As discussed above, the Act allows the FDIC to treat similarly situated creditors differently under specific circumstances, similar to the critical vendor provision under the Code.[29] This provision in essence allows certain creditors to recover amounts that would have otherwise been distributed to other creditors. By shrinking the pool of available assets for the rest of the group of creditors for the benefit of another, ensuring that all creditors nevertheless receive what they would have in a Code liquidation becomes a real concern.

We respectfully request that the FDIC provide clarity as to how it intends to ensure all creditors receive at least as much as they would under the Code while simultaneously providing additional recover to certain similarly situated creditors. Payments to an individual creditor above what a group of similarly situated creditors would have otherwise received comes from the finite pool of the covered financial company's assets, meaning that less money will be available to the rest of the group. The FDIC should describe how it intends to predictably exercise these apparently competing provisions of § 210 harmoniously.

---

[26] Dodd-Frank Act § 210(d)(2)(B) (The Act provides that the FDIC's liability to creditors "shall equal the amount that such claimant would have received if the Corporation had not been appointed receiver with respect to the covered financial company, and the covered financial company had been liquidated under Chapter 7 of the Bankruptcy Code, or any similar provision of state insolvency law applicable to the covered financial company").
[27] *See* Dodd-Frank Act § 210(b)(4).
[28] 11 U.S.C. § 1102.
[29] Dodd-Frank Act § 210(b)(4).

B. The absence of a creditors' committee is problematic.

The Code provides for establishing creditors' committees that represent and pursue the interests of the represented creditors.[30] Creditors' committees allow individual creditors to rely on the committee to act on its behalf during the liquidation process. Committees act as a single voice for a group of creditors. The absence of a provision for establishing creditors' committees under the Act raises questions about streamlining the claims process. Unless it consolidates representation of creditors, the FDIC could potentially be overwhelmed as it deals with each creditor individually.

In the event the FDIC prefers to administer claims on a creditor-by-creditor basis, we respectfully request explanation as to how the FDIC plans to effectively deal with each creditor fairly and expeditiously. We request establishment of a mechanism similar to the creditors' committee under the Code which would streamline the claims process and reduce the time and expense of administering claims for relevant parties. Unified representation also helps satisfy the provision that creditors receive at least as much as they otherwise would have been entitled to under Chapter 7 of the Code.

C. How will the FDIC ensure that creditors will receive no less than they would under Chapter 7 of the Code?

The FDIC does not routinely administer bankruptcy proceedings, let alone have experience determining what a creditor will receive from a liquidating debtor under the Code. We believe the FDIC should model its procedure for determining how much each creditor will receive under Chapter 7 of the Code by looking to the Code itself. This way, the FDIC can establish a benchmark by which to measure whether its distribution mechanism complies with the requirements of § 210(d)(2). For instance, applying the Code directly will produce the amount a similarly situated creditor would expect to receive had the case in fact been dealt with under the Code. With such a benchmark established, the FDIC will then go about calculating how much each creditor will receive under the Act. If any amount falls below the benchmark number calculated using the Chapter 7 formula, the FDIC will immediately recognize the discrepancy and be able to deal with it. In that regard, the FDIC should propose regulations that are flexible enough to allow for predictably reevaluating outcomes to creditors in the event that its calculation procedures produce outcomes below what the creditor would have received in bankruptcy, as measured against the Chapter 7 benchmark.

The Code has well-defined provisions which produce predictable, widely understood outcomes. Rules that mimic the Code's provisions—including mechanisms for valuing collateral, protecting creditors, and providing procedures through which creditors may challenge payment distribution on grounds that they did not receive what they would have in bankruptcy—would provide predictability to the OLA process and be more likely to mimic the results of a bankruptcy, thus satisfying § 210(d)(2). These provisions should clearly illustrate the basis upon which a determination that similarly situated creditors need not be treated differently will be made. They should also provide clear limits on the extent of the FDIC's discretion in that regard, as well as what it will do to ensure that additional payments to one creditor do not violate the rights of a similarly

[30] 11 U.S.C. § 1102.

situated creditor who received less, but was entitled to receive as much as it would have in a Code liquidation.

We respectfully request that the FDIC incorporate provisions into its regulations mimicking the Code to the extent necessary in order to provide clarity, predictability, and compliance with § 210(d)(2). Incorporating provisions of the Code not only increases the confidence in the process of the parties involved, by establishing clearly understood rules for liquidation, but it also provides a level of specificity that gives creditors a sense of exactly what resolution outcomes will be and how they will be reached. Finally, crafting regulations around the Code ensures that there will be virtually no instances in which a creditor receives less than it would under Chapter 7 of the Bankruptcy Code.

III. IMPLEMENTING THE CLAW-BACK PROVISION

This section will examine how the FDIC will implement its claw-back powers under § 210(o)(1)(D). To evaluate this topic, this section will discuss: (1) who will be subject to the claw-back provision; (2) how long parties will be subject to the provision; (3) whether certain creditors are favored over others; and (4) the amount the FDIC can claw back.

A. It is difficult to foresee which institutions will be subject to the claw-back provision.

Institutions that receive additional payments from the FDIC beyond what the institutions would have been entitled to in a liquidation proceeding are subject to a claw-back provision. If the FDIC cannot meet its obligations issued to liquidate the CFC, the FDIC must claw-back additional payments made to claimants to fund the resolution of the CFC.[31] Parties have no guidance as to whether they will be subject to a claw-back assessment because the provision: (1) has an unclear exception; (2) creates uncertainty for short-term debt issuers and investors; and (3) creates uncertainty for transferees of the recipients of additional payments.

1. The FDIC should clarify when additional payments are "necessary to initiate and continue operations essential to implementation of the receivership."

While additional payments that are "necessary to initiate and continue operations essential to implementation of the receivership" are exempt from the claw-back provision,[32] these terms are not defined. If an institution contracts with a CFC during a resolution, how will the institution determine whether it will fit within this exception and escape the claw-back provision's reach? If the FDIC negotiates with an institution to provide funding or services for the CFC's resolution, it seems logical that the institution will see its involvement in the resolution as "essential to implementation of the receivership." The CFC is necessarily in dire financial condition and any funds or services extended to it could be perceived as essential. However, the FDIC retains discretion to determine whether payments made are essential to implementation of the receivership.

[31] Dodd-Frank Act § 210(o)(1)(D)(i).
[32] *Id.*

The FDIC should specifically enumerate situations which will qualify as exempt from the claw-back provision. Potential counterparties and creditors of the CFC will be more willing to provide funds or services to resolve the CFC if this exception from the claw-back provision is clearly defined. The resulting contractual certainty will lower the cost to the FDIC for administering the receivership.

2. Short-term debt issuers and investors face uncertainty determining if additional payments made to them will be subject to the claw-back provision.

Rule 380.2(b)(1) permits the FDIC to make additional payments to creditors holding the CFC's debt securities with maturities of less than one year.[33] These short-term securities are important sources of liquidity for financial markets and are often found in investment portfolios of different types of investors. Uncertainty as to whether these additional payments will be subject to the claw-back provision will adversely affect both short-term debt issuers and investors. For companies that issue short-term debt to operate under normal market conditions, the cost of securing this financing will rise and liquidity in short-term debt markets will decline.

Short-term debt investors face similar uncertainty. Investment funds sometimes classify short-term debt securities as "cash equivalents." If unsophisticated investors hold securities classified as "cash equivalents" and are assessed under the claw-back provision, public confidence in financial markets will decline. Many individuals now manage their own retirement accounts through government-sponsored defined contribution retirement plans, and lower confidence in financial markets may deter such investments. If the public is less willing to invest in financial markets, effective ways for ordinary investors to save for their retirement decrease.

3. It is unclear whether transferees of additional payments will be subject to the claw-back provision.

How will the FDIC claw-back payments from an institution that, after receiving an additional payment from the FDIC, uses the proceeds to buy other securities or pay its own creditors? If a CFC is resolved under Title II, it is likely that additional payments will be made to actors that frequently buy and sell securities in financial markets. Recipients of additional payments from the FDIC may be transacting simultaneously with counterparties unrelated to the resolution. The additional payment recipient's non-FDIC counterparties face uncertainty about whether the FDIC's claw-back provision will reach the counterparty as a transferee of the FDIC. The FDIC should emulate § 550 of the Code to clearly define liability for transferees of avoided transfers.[34] Market actors already are familiar with the Code and using its time-tested approach as a starting point will provide certainty to actors regarding the reach of the FDIC's claw-back power.

---

[33] 12 C.F.R. § 380.2(b)(1).

[34] 11 U.S.C. § 550(b) provides a defense to transferee liability for "(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or (2) any immediate or mediate good faith transferee of such transferee."

B. <u>Parties' exposure to the claw-back provision endures too long after a resolution.</u>

Recipients of additional payments from the FDIC are subject to claw-back assessments "if such assessments are necessary to pay in full the obligations issued by the [FDIC] to the Secretary…within 60 months of the date of issuance of such obligations."[35] If the Treasury Secretary approves, the FDIC may extend the five year time period if the "extension is necessary to avoid a serious adverse effect on the financial system of the United States."[36] Because recipients of additional payments will be parties who hold securities maturing in less than one year, exposing those investors to liability for five years (or potentially longer) injects uncertainty into short-term debt markets. How will investors who hold short-term debt know whether the payments they receive from the FDIC can be reinvested without being subject to the claw-back provision?

By their nature, short-term debt investors hold securities nearing maturity. When the maturity date arrives, the investor expects the principal amount of the security to be repaid so that the capital can be reinvested in other securities. The low interest yields of short-term debt influence investors to reinvest the proceeds in other short-term debt instruments shortly after receiving the premium repayments. The high turnover within short-term debt portfolios provides valuable liquidity to financial markets. Exposing these investors to claw-back assessments will disincentivize investment in short-term debt because investors who receive additional payments will not know definitively whether they can reinvest the proceeds. Must the recipient hold the proceeds in escrow until the FDIC certifies the resolution is fully funded, or five years has passed, or even longer should the Secretary grant an extension?

Short-term debt investors have low profit margins and turn over their securities portfolios rapidly. Subjecting these investors to a five year time period during which the full value of their portfolios may not be able to be fully invested may cause short-term debt investors to exit the market, thereby reducing liquidity and raising the cost of short-term debt financing.

The FDIC should clearly define expectations for recipients of additional payments or consider shortening the claw-back period for certain securities. To define expectations of recipients of additional payments, the FDIC can build from the Code's treatment of transferee liability in avoidance actions.[37] Even if the FDIC's language or duration is not similar to the Code's, the approach is sound: announce that certain relationships or transactions are subject to the claw-back provision and provide affirmative defenses to liability. Shortening the claw-back period would align the implementation of a resolution with the implementation of a case under the Code, where the look-back window for avoidance actions can be ninety days,[38] one year,[39] or two years.[40] The approaches crafted by the Code utilize decades of legislative reform and judicial precedent to

---

[35] Dodd-Frank Act § 210(o)(1)(B).
[36] *Id.* § 210(o)(1)(C).
[37] 11 U.S.C. § 550.
[38] *See* 11 U.S.C. § 547(b)(4)(A) (enumerating look-back window for preferential transfers).
[39] *See* 11 U.S.C. § 547(b)(4)(B) (enumerating look-back window for preferential transfers to insiders).
[40] *See* 11 U.S.C. § 548(a)(1) (enumerating look-back window for fraudulent transfers).

provide certainty to the marketplace; the FDIC should use these Code provisions as a template from which to promulgate rules to similarly provide certainty.

C. <u>The FDIC has broad discretion to treat similarly situated creditors differently in claw-back situations.</u>

Section 210(b)(4), and subsections (h)(5)(E) and (d)(4) provide the FDIC broad discretion in determining whether a creditor receives favorable treatment over other similarly situated creditors. When the FDIC promulgates rules adjusting its discretion to treat similarly situated creditors differently by making additional payments, the FDIC should announce whether the additional payments will be subject to the claw-back provision. While in many (or maybe in all) instances the FDIC may intend to subject additional payments to the claw-back provision, stating its intent clearly will provide the marketplace with more certainty with which to structure relationships and transactions. If the FDIC decides that particular relationships or transactions will not be subject to the claw-back provision, market actors can structure their behavior accordingly to conduct business in an efficient manner.

Rule 380.2(b) prohibits shareholders, long-term senior debtholders, and subordinated debtholders from receiving additional payments from the FDIC.[41] The rule empowers the FDIC to make additional payments to short-term debtholders but is silent regarding its ability to claw-back the payments. This silence detracts from the FDIC's attempt to provide certainty by limiting its discretion to make additional payments because the rule simply transfers uncertainty from multiple asset classes to one asset class—short-term debtholders. The FDIC should amend Rule 380.2(b) to state clearly whether it intends to subject additional payments to the claw-back provision. Even if the FDIC deems additional payments subject to the claw-back provision, the marketplace will benefit from knowing definitively and can price the subject securities accurately to reflect the claw-back risk.

D. <u>Recipients of additional payments are unaware what percentage or amount can be clawed back by the FDIC.</u>

If the FDIC assesses claw-back payments, the assessment will be the difference between the aggregate amount paid by the FDIC to the claimant and the amount the claimant would have received in a liquidation.[42] Recipients of additional payments from the FDIC have no way to calculate their exposure to a subsequent claw-back assessment because the FDIC maintains such broad discretion in making additional payments to claimants,[43] and because it is impossible for these recipients to determine whether the CFC's resolution ends up being fully funded.

When promulgating rules adjusting its discretion to make additional payments, the FDIC should clearly announce whether the additional payments will be subject to the claw-back provision. Surely, the FDIC will not know whether a resolution will be self-funding at the time an additional payment is made. However, if a particular relationship or transaction will be subject to the claw-back provision, the FDIC should enumerate that fact to recipients of the additional payments to provide the marketplace with certainty.

---

41 12 C.F.R. § 380.2(b).
42 Dodd-Frank Act § 210(o)(1)(D)(i).
43 *Id.* §§ 210(b)(4), 210(d)(4), and 210(h)(5)(E).

IV. JUDICIAL REVIEW AND DUE PROCESS CONCERNS UNDER THE ACT

Several provisions of the Act permit the FDIC to take action that may impair the rights of a creditor but do not provide a creditor an opportunity to seek relief from that action.[44] As a result, the FDIC should promulgate rules that clarify a creditor's procedural rights. In particular, the FDIC should further explain procedures already in place, including: (1) how the FDIC determines a financial company is "in default or in danger of default" and (2) whether circuit courts may review district court rulings on FDIC action. Moreover, the FDIC should create procedures that allow a creditor to seek judicial review of any FDIC action, such as claim valuations and claw-backs of additional payments. By creating procedures and providing detailed guidance of how they will work, the FDIC will alleviate many creditors' due process concerns.

A. Clarifications of due process procedures are needed.

1. The determination of "in default or in danger of default" needs further explanation.

Section 203 of the Act permits the FDIC to seize a financial company "in default or in danger of default." A financial company is "in default or in danger of default" if the Treasury Secretary determines any of the following subparagraphs ("Factors") has, is, or is likely to occur: (A) a bankruptcy action is ongoing or imminent; (B) the financial company has or is likely to deplete all of its capital and cannot avoid future depletion; (C) the financial company's assets are, or likely to be, insufficient to meet creditor obligations; and (D) the financial company cannot pay, or is likely to be unable to pay, its obligations in the normal course of business.[45]

The Act and the Notice, however, do not explain how the Treasury Secretary, the FDIC, and the Federal Reserve Board will determine whether these Factors have, are, or are likely to occur. Although a "likely to occur" standard provides the FDIC tremendous flexibility, it poses a significant challenge for market participants to evaluate their financial positions. For example, how close must a financial company be to insolvency for the FDIC to consider the financial company "in danger of default"? Therefore, the FDIC should propose a new rule that explains how it will make determinations based on events "likely to occur." In particular, the FDIC should create and release specific calculations and matrices to the extent possible and applicable to the particular Factor. For more subjective evaluations, the FDIC should provide more guidance on how it will make its decisions. Greater detail of the evaluation process will not only help eliminate uncertainty for market participants but also will provide for more effective judicial review under § 202.[46]

2. Can a CFC appeal a district court decision?

If the FDIC denies a claim, a creditor may file a claim in the district or territorial court of the United States where the CFC's principal place of business is located.[47] This subparagraph, other related provisions of the Act, and the Notice, however, do not explicitly provide for judicial appeal of the district court's decision. Normally, as a matter of right, a party may appeal a district court

---

[44] *See, e.g.*, *id.* § 210(c)(3)(E).
[45] *Id.* § 203(c)(4).
[46] *See id.* § 202(a)(1)(A)(iii).
[47] *Id.* § 210(a)(4)(A).

decision to circuit court. Without an express guarantee of that right, creditors who seek relief from a FDIC determination will remain uncertain about their due process rights. Therefore, the FDIC should propose a rule which guarantees circuit court review of all district court decisions which address FDIC action under the Act.

B. The FDIC should create due process procedures and guidelines.

1. The FDIC should explain how it will assess claims and make valuations.

Several provisions of the Act grant the FDIC considerable authority to assess claims and make valuations. For example, the FDIC may pay contingent claims based on an estimation of the claim's value and the likelihood of the claim becoming fixed.[48] Currently, the Act and the Notice do not explain how the FDIC will value a contingent claim or how the FDIC will determine the likelihood of a claim becoming fixed. Also, the Act guarantees that creditors will receive no less than they would receive in a Chapter 7 Bankruptcy proceeding.[49] But, neither the Act nor the Notice describes how the FDIC will determine what a creditor would otherwise receive in a Chapter 7 proceeding. To promote greater transparency and reduce uncertainty, the FDIC should explain its procedures for its valuation processes.

In addition, no provision in the Act allows a creditor to challenge a FDIC valuation. Because an adverse valuation will lead to a greater pecuniary loss, a creditor should have the right to seek judicial review of that valuation. If a creditor lacks this right, FDIC action under these provisions of the Act may not comport with due process guarantees under the 5th Amendment to the Constitution.[50] As a result, the FDIC should create procedures for parties to seek legal redress from adverse FDIC determinations in federal court. Adequate access to judicial review will not only satisfy due process but will also help alleviate uncertainty for market participants.

Because the FDIC will likely use its Title II authority sparingly, the FDIC should allow a district court to review all FDIC actions *de novo*. The FDIC may never exercise its Title II powers, but if it does, the FDIC and the district court reviewing its actions will have little or no precedent under the Act to determine what constitutes arbitrary and capricious action. Thus, a *de novo* review standard is more appropriate in OLA cases.

As an alternative to drafting new rules, the FDIC may wish to incorporate similar provisions from the Code which provide judicial review. Because these provisions adequately protect the legal rights of interested parties, applying similar provisions to Title II is a reasonable alternative to creating new rules.

---

[48] *Id.* § 210(c)(3)(E).
[49] *Id.* § 210(d)(2)(B).
[50] *See, e.g.*, Mathews v. Eldridge, 424 U.S. 319 (1976); *see also* Wolff v. McDonnell, 418 U.S. 539, 557-58 (1974) (requiring some form of hearing to satisfy due process before an individual is finally deprived of a property interest).

2. The FDIC should allow parties to challenge FDIC claw-backs.

Like the Code, the Act allows the FDIC to avoid fraudulent and preferential transfers under certain conditions.[51] In addition, the FDIC may claw-back additional payments to creditors if the FDIC requires additional funds to repay its obligations to the Treasury Department.[52] In each case, neither the Act nor the Notice allow a party to challenge a FDIC ruling. As previously mentioned, FDIC actions that deprive a party of a property interest and are not subject to judicial review may not satisfy due process. Therefore, the FDIC should promulgate a rule that allows parties to seek judicial relief from FDIC action taken pursuant to these provisions.

3. The FDIC should clarify its procedures for recoupment of senior executive and director compensation.

Similarly, the FDIC may recoup up to two years (prior to the date of receivership) of executive compensation from senior executives and directors whom the FDIC finds substantially responsible for the failed condition of a CFC.[53] The Notice states that "senior executives and directors who perform their responsibilities with the requisite degree of skill and care will not be required to forfeit their compensation."[54] The Notice, however, does not explain what constitutes the "requisite degree of care and skill." Is this standard the same as a director's duty of care generally required under state corporation law?[55] If so, do the same or similar defenses apply?[56] The FDIC should clarify this standard and further define what, if any, defenses are available to a senior executive or director.

Furthermore, the Act and the Notice do not provide a means for senior executives and directors to challenge the FDIC's determination of fault. Again, to satisfy due process, the FDIC should provide a means for senior executives and directors to challenge FDIC findings of fault.

4. Denied expedited claim requests should receive expedited review.

Section 210 of the Act allows a creditor to seek an expedited ruling on its claim under certain conditions.[57] One of those conditions requires that the creditor allege it will suffer an "irreparable injury" if the FDIC uses its normal claims procedure under paragraph (3).[58] Like paragraph (4),

---

51 Dodd-Frank Act § 210(a)(11).
52 *Id.* § 210(o)(1).
53 *Id.* § 210(s)(1).
54 Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 16,234, 16,329 (March 23, 2011) (to be codified at 12 C.F.R. pt. 380).
55 *See, e.g.*, *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996) (holding that when a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation, only a sustained or systematic failure of the board to exercise oversight will establish the lack of good faith that is a necessary condition of liability).
56 *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2011) (establishing authority for the business judgment rule).
57 Dodd-Frank Act § 210(a)(5).
58 *Id.* § 210(a)(5)(A)(ii).

paragraph (5) permits a creditor to challenge the FDIC's denial of its expedited claim in district and territorial courts.[59] That provision, however, does not require the court to hear the creditor's claim on an expedited basis. The Notice does allow a secured creditor to seek expedited relief outside the administrative claims process but does give unsecured creditors the same rights.[60] To prevent potential irreparable injury to an unsecured creditor, the FDIC should propose a rule using similar language in § 202, authorizing district and territorial courts to hear all claims brought under this paragraph on an expedited basis.[61]

5. The FDIC should consider the effect of an injunction or stay on a receivership pending an appeal.

If the D.C. District Court authorizes the Treasury Secretary to appoint the FDIC as receiver for the financial company, § 202 prohibits the granting of a stay or injunction of the orderly liquidation process, even when an appeal of the D.C. District Court's decision is pending.[62] As a result, the FDIC may immediately begin liquidating the CFC's assets. The intention behind this provision makes sense. If market conditions dictate an immediate sale of the CFC's assets, the FDIC can sell the CFC's assets without waiting for final disposition of the appeals process. Certainly, greater flexibility regarding the timing of an asset sale will help maximize value and minimize losses. But in practice, this provision may cause significant problems if the CFC successfully appeals its entry into receivership. In that instance, it is possible that the FDIC may liquidate significant portions of the CFC's assets before the CFC wins its appeal. What happens to the CFC's assets that the FDIC sells? Does the FDIC void the sale and return the assets to the CFC? If not, the CFC may leave receivership in worse financial shape than before the CFC entered it, potentially necessitating re-entry into receivership. The FDIC should evaluate this possibility and develop procedures to handle it in case it occurs. Otherwise, an absence of clear rules may further destabilize markets and scare off potential buyers of the CFC's assets.

[The remainder of this page is intentionally left blank]

---

[59] *Id.* §§ 210(a)(5)(B)(iii), 210(a)(5)(C).
[60] Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 16,234, 16,344 (March 23, 2011) (to be codified at 12 C.F.R. pt. 380).
[61] *See, e.g., id.* § 202(a)(2)(A)(iii).
[62] *Id.* § 202(a)(1)(B).

V. CONCLUSION

We thank the FDIC for the opportunity to comment on its Notice and on the Act.

Very respectfully,

Stephen Bennett
stephenb@buffalo.edu
University at Buffalo Law School, SUNY, Class of 2012

Andrew Devine
apdevine@buffalo.edu
University at Buffalo Law School, SUNY, Class of 2012

Karen Oddo
karenodd@buffalo.edu
University at Buffalo Law School, SUNY, Class of 2012

Brian Sadonis
bsadonis@buffalo.edu
University at Buffalo Law School, SUNY, Class of 2012