American Bankers Association
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By electronic delivery to:

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th St, NW
Washington, DC 20429

Re: Interim Final Rule Implementing the Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

FR Doc. 2011-1379

Dear Mr. Feldman;

The American Bankers Association (ABA)[1] appreciates the opportunity to comment on the issues raised by the Federal Deposit Insurance Corporation's (FDIC) Interim Final Rule (IFR), which implements certain provisions of the FDIC's authority to resolve covered financial companies (orderly liquidation authority, or OLA) under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[2]

ABA supports the development of a mechanism for the orderly resolution of systemically important non-bank financial companies and appreciates the work of the FDIC to devote high-level attention to this important task. Part I of this letter responds to the need for greater dialogue among the banking trade associations, the financial services industry, and the FDIC during the OLA rulemaking and implementation in order to maximize the likelihood a successful orderly resolution program. ABA's responses to the specific questions posed for March 28, 2011, are addressed in Part II.

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities.

[2] FDIC's Interim Final Rule Implementing the Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. 76 Fed. Reg. 4207 (January 25, 2011).

Part I: Implementation of FDIC's Orderly Liquidation Authority – Continued Dialogue is Paramount.

ABA appreciates the FDIC's reliance on a sixty-day comment period to respond to the IFR rather than a shorter period. As stated in ABA's November 18, 2010, comments, a longer comment period allows the public, including institutions most immediately affected by public rulemakings, to have a better opportunity to evaluate, study, research, and comment on the complex issues presented. Ample opportunity for robust public comment is an essential part of the concept of "public rulemaking."

<u>OLA Rulemaking Should Incorporate Continued Dialogue with Industry</u>

During the January 18, 2011, FDIC Board of Directors meeting, FDIC Chairman Sheila Bair ended the meeting with a statement recognizing the need for continued dialogue with industry to encourage market confidence and certainty. She specifically suggested, with Director John Walsh's agreement, a roundtable with "investors, creditors, and others…" to discuss OLA implementation, particularly the treatment of similarly situated creditors and maximizing returns.

ABA strongly supports Chairman Bair's suggestion for FDIC-hosted industry roundtable focusing on the proposed OLA structure and implementation. Such a roundtable could be a valuable part of public consideration of the OLA program. Continued dialogue with industry through face-to-face meetings and public roundtables would complement the purpose of OLA rulemaking to "provide greater clarity and certainty about how key components of this authority will be implemented and to ensure that the liquidation process under Title II reflects the Dodd-Frank Act's mandate of transparency in the liquidation of failing systemic financial companies."[3]

Despite several OLA proposed rules, questions remain as to the details and the overarching architecture of the final regime that the FDIC is creating. A series of OLA roundtables focused on specific themes, such as the treatment of similarly situated creditors and valuation of collateral, would facilitate a more efficient exchange of ideas between the FDIC and industry as well as quickly clarifying many outstanding questions, and potentially, misconceptions that currently exist.

<u>Part II: Responses to Questions Posed for March 28, 2011, Comment</u>

Our comments to the IFR incorporate the ABA comments filed in response to the November 18, 2010, and January 18, 2011, proposed rules. ABA commented on many of the questions posed for March 28, 2011, in these prior comment letters. The comments below briefly summarize ABA's earlier statements and focus on new comments or issues that have arisen since the January 2011 comments were filed.

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[3] *See* Fed. Reg. 4208

<u>Question 1:</u> Are there additional ways to reduce moral hazard and increase market discipline and to clarify that all creditors should assume that they will receive no additional payments and their recovery will be limited to what will be paid according to the order of priorities established under section 210(b)?

ABA is a longtime supporter of the development of a comprehensive regime ensuring the orderly resolution of systemically important non-bank financial companies as an essential part of efforts to end completely the reality and the public perception of the existence of a too-big-to-fail policy. We advocated the end of too big to fail, including the market perception of its existence, during the legislative process that gave rise to the Dodd-Frank Act, and continue to support the development of a robust, bankruptcy-like regime through regulation and rulemaking.

In 2009, ABA announced a set of principles to guide the development of a robust systemic risk resolution process. Such a process should—

1. Create a workable liquidation regime that will stand up through a significant financial crisis;
2. Protect the taxpayer;
3. End too big to fail;
4. Be fair to financial firms of all sizes and business models, in terms of competitiveness and cost; and
5. Not impair the ability of financial markets to function effectively.[4]

Throughout the rule-writing process, ABA has continued to advance these principles and appreciates the FDIC's efforts to achieve these objectives. The too big to fail concept has profound moral hazard implications and serious competitive consequences for the industry as a whole. An effective and publicly recognized process for the resolution of any failing financial firm is an essential part of achieving the goal that no firm should be considered too big to fail. A failure to articulate an efficient liquidation process with predictable outcomes will impair the ability of financial markets to function effectively and fail to persuade the market that too big to fail has been eliminated as a policy option.

Increased clarity, certainty, and transparency, particularly as to treatment of creditors and collateral, is paramount to create an OLA regime with the credibility to end the perception that some firms are too big to fail, and creditors will be to some degree rescued. Also of great importance is a clear understanding of the OLA concept of recovery "no less than what may have been received in Chapter 7."[5] Industry needs to comprehend how the FDIC will make this determination. Mere unilateral, subjective determinations of a recovery as "equal to" Chapter 7 will neither reassure creditors nor lend credence to the viability of OLA as a true systemic tool.

[4] Testimony of Edward L. Yingling on behalf of the American Bankers Association before the Committee on Financial Services, United States House of Representatives, October 20, 2009.

[5] Dodd-Frank Act §210(b)(7)(B) and (d)(2).

Indeed, it will likely reinforce the enduring market perception, demonstrated by actual official actions during the recent financial turmoil (cited by lawmakers during the crafting of the Dodd-Frank Act), that in times of stress government authority will be exercised so that some creditors will receive better treatment than others.

Title II was intended not only to end moral hazard but also to assure stability in time of financial stress. We believe that OLA proposals to date fall short of meeting the dual purposes of Title II. The discussion often focuses on moral hazard, but devotes inadequate attention to ensuring the creation of a functioning systemic tool. An OLA regime, appropriately developed, needs to curb moral hazard and work to promote financial stability without drawing upon the taxpayer. Until the market is shown a robust infrastructure that legitimately could resolve a complex, multinational financial company, the OLA will lack credibility and fail to end moral hazard. The mere existence of the resolution authority will not reduce moral hazard; a detailed, credible, objective OLA regime may.

Another tool to reduce moral hazard is reiterating the important role of bankruptcy as the preferred resolution process for the majority of non-bank and bank holding companies. Creditor assumptions that bankruptcy is the default resolution process, for even the largest firms, will minimize the extent to which creditors “game” the system by structuring investments to secure preferential creditor positions under OLA resolution rules.

<u>Question 2:</u> Subsection 380.2 precludes any “additional payments” under the statute to holders of long term debt, which is defined as debt with a term in excess of 360 days. What are the positive and negative consequences that this may have for market stability? What effect might this have on long term debt and its role in funding for financial companies? Is additional flexibility needed? Are there additional ways to counteract any impression that shorter term debt is not at risk? Does using a term of 360 days adequately distinguish longer term from shorter term debt? Should a different period be used?

As stated in ABA’ s comment letter of January 18, 2011, ABA recommends that the FDIC not adopt the rule defining long-term senior debt as proposed, as it raises all of the largely unanswerable follow-on issues that are raised in this series of questions. The interim final rule definition of long-term debt as having a term in excess of 360 days should be withdrawn pending further dialogue with industry as to the intended and unintended consequences of the definition.

Generally, the OLA treatment of debt should not be determined by the debt term. Classes of long-term debt, such as long-term hedges and other risk mitigation tools, are essential to critical business functions and should not receive treatment differing from short-term debt. To treat a hedge in excess of 360 days differently fails to recognize the importance of hedging to a stable business model. Such treatment may cause the cost of long-term hedges to increase and undermine bank efforts to manage risk efficiently. Not all financial firms are destined for failure, and they should not be required to undermine the risk-management usefulness of their healthy activities as if they were.

The differing treatment of short-term debt also threatens to place the banking industry out of step with the Basel III standards,[6] heightened prudential supervision standards under the Dodd-Frank Act,[7] and FDIC assessments,[8] which focus on longer-term debt for loss absorption. The proposal's reliance on term encourages creditors simply to manipulate debt terms and creates a perception of regulatory preference for short-term debt. This is contrary to sound financial practices where long- and short-term debt is selected, not based on regulatory preference or treatment in liquidation, but to balance risk.

<u>Question 3:</u> What additional guidelines would be useful in creating certainty with respect to establishment of fair market value of various types of collateral for secured claims?

The valuation of collateral continues to be one of the most controversial pieces of the OLA rule. Secured creditors are asking for (1) clear bankruptcy-like rules for valuation, and (2) greater input in the valuation process. Input from secured creditors should occur earlier in the process, with a greater number of opportunities to appeal valuation, or gain possession of capital. Under the interim final rule as proposed, a secured creditor's only remedy is to file suit under §210(a)(4) to contest the Receiver's determination. Limiting secured creditor involvement to reactive litigation and judicial procedures will likely increase the cost of resolution, hinder efficient liquidation, and drive up the cost of credit on the front end.

ABA's suggestions to bring more certainty to OLA valuations are—

1. Offer creditors an opportunity to comment or appeal initial valuations prior to a final determination;
2. Permit creditors to avail themselves of a "credit bid" process; and
3. Develop a transparent, objective standard for valuation and appeals of valuation.

Where a secured creditor is concerned that the value of collateral is impaired by the resolution proceeding, there should be a mechanism to allow the secured creditor to (i) take possession of their collateral, (ii) sell the collateral, or (iii) fix the amount of their secured claim for payment purposes. In bankruptcy, the right of the creditor to object to valuation and take possession of the collateral is called a "credit bid." The concept of credit bids should be incorporated into the OLA infrastructure to build more opportunities for creditor input into the valuation process.

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[6] The Basel III standards, developed by the Basel Committee on Banking Supervision, require banks to hold minimum common equity equal to 4.5 percent of risk-weighted assets, Tier 1 capital equal to 6 percent, and total capital equal to 8 percent. The standards also require banks to hold an additional "conservation buffer" equal to 2.5 percent in each category. Basel III standards are scheduled to be phased in for U.S. banks by January 1, 2013.

[7] Title I of the Dodd-Frank Act gives the Board of Governors of the Federal Reserve broad powers to establish prudential standards and disclosure requirements for large bank holding companies and significant nonbanks. The new prudential supervisory framework must be more stringent that the rules applied generally and must address several areas of oversight, including capital, liquidity, concentration limits, and risk management, among others.

[8] Notice of Final Rule Regarding Assessments, Large Bank Pricing. 76 Federal Register 10672 (February 7, 2011). In the FDIC final rule, the FDIC favors bank issuance of long-term unsecured debt to provide loss absorption for deposits.

Where there is no easily referenced market price for an asset, the regulations should at least prescribe minimum standards for valuation. For risk management purposes, industry needs guidance to predict outcomes under a hypothetical Chapter 7 valuation. The absence of a standard for valuation and a predicable appeals regime will make it very difficult for creditors to know how to price risk, with the likely result being that creditors will build in a cushion to protect themselves against foreseeable scenarios and in so doing ratchet up the cost of credit

ABA recognizes that the task of identifying or creating valuation standards will be difficult, but failing to do so will lead to an artificial and inefficient inflation in the cost of credit to accommodate heightened regulatory risks. Industry would prefer to have a set of guidelines, even if imperfect, that can be used to formulate long-term planning for risk management purposes. The development of guidance could benefit from industry roundtables or other collaborative dialogue.

<u>Question 4:</u> Should the date of appointment of the receiver be used as the valuation date for all types of collateral or only government securities or other publicly traded securities?

The date of receivership should not be used as the valuation date for collateral or securities. The limited purpose of OLA dictates it not be used except in times of severe financial turmoil. Given the likelihood that the date of receivership will coincide with significant market turmoil and a notable decline in market values, using the date of receivership for valuations will serve to undervalue collateral, may worsen the impact of the financial turmoil on other market actors, and depress widespread market values. That was amply illustrated in the recent financial turmoil.

The use of the date of appointment of the receiver for valuation purposes, or valuations made at any time prior to the secured creditor's rights being extinguished, only should be used for administrative convenience and not to fix the final amount of a secured creditor's recovery, unless the secured creditor consents to such treatment.

<u>Question 5:</u> Who should receive the benefit or burden of market fluctuation between the date of appointment of the receiver and the date of payment of a claim? For example, if a claim is for $100, and the collateral is valued at $98 on the date of appointment of the receiver, and at $102 at the date of payment of the claim, should the claimant receive $98 plus an unsecured claim of $2, should they receive the full value of their secured claim of $100, or should they receive the full value of the collateral, i.e., $102?

In these situations, ABA would support the incorporation of general principles under the Bankruptcy Code. In bankruptcy, the secured creditor is entitled to the full value of collateral, regardless of whether the value of collateral increases or decreases after bankruptcy is filed. Generally, a secured creditor's collateral is valued as of the date on which their rights to the collateral are severed.

Question 6: Should the FDIC designate a specific time during the term of the receivership to estimate contingent claims?

Again, the OLA would be best served by closely adhering to the Bankruptcy Code. Commonly, under bankruptcy, the rule does not prescribe a time for contingent claims to be estimated but allows estimation to avoid undue delay in the administration of the case.

ABA appreciates the opportunity to comment on this interim final rule. Please contact the undersigned at (202) 663-5333 or at ddepierr@aba.com with questions. Thank you for considering our comments and recommendations.

Sincerely,

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