American SECURITIZATION FORUM

May 23, 2011

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

cc:

Michael Krimminger, General Counsel
R. Penfield Starke, Senior Counsel
Legal Division

Via email to: Comments@FDIC.gov

Re: Comments on Part 380 – Orderly Liquidation Authority (the "Proposed Rule")

Ladies and Gentlemen:

The American Securitization Forum ("ASF")[1] is submitting this letter in response to the request for comments by the Federal Deposit Insurance Corporation (the "FDIC") on the Proposed Rule, which would implement certain provisions of its authority to resolve "covered financial companies" (each, a "Covered Financial Company") under Title II (Orderly Liquidation Authority, or "OLA") of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act"), set forth in the Notice of Proposed Rulemaking published in the Federal Register on March 23, 2011 (the "Notice of Proposed Rulemaking").

This letter addresses the following items relating to the Proposed Rule:

1. Confirmation that the Proposed Rule succeeds in harmonizing the application of the FDIC's avoidance powers as receiver under Section 210(a)(11) of the Act with the analogous provisions of the Bankruptcy Code.

2. A proposal for a third rule of construction relating to revenues derived from a company's equity investment in an unconsolidated company that is a securitization trust

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

or a special purpose fund which holds and services (or arranges for the servicing of) pools of specified asset classes.

3. Whether or not the definition of "amounts owed to the United States" under Section 280.23(a) of the Proposed Rule clearly excludes government-sponsored entities such as Fannie Mae, Freddie Mac or Federal Home Loan Banks.

4. Inconsistency in the payment of post-insolvency interest on oversecured claims under the Proposed Rule versus the payment post-petition interest on oversecured claims under the Bankruptcy Code.

5. Treatment of covered bonds as secured claims under Sections 380.50-55 of the Proposed Rule.

Harmonization of Section 210(a)(11) of the Act with the Bankruptcy Code

The ASF believes that Section 380.9 of the Proposed Rule successfully addresses the concerns set forth in the ASF's letter to the FDIC, dated December 13, 2010,[2] and conforms with the letter dated December 29, 2010, from the FDIC's Acting General Counsel to the ASF.[3] The ASF would like to thank the FDIC for its speed and cooperation in harmonizing the application of the FDIC's avoidance powers as receiver under Section 210(a)(11) of the Act with the analogous provisions of the Bankruptcy Code. The implementation of Section 380.9 of the Proposed Rule will assuage the concerns among participants in the consumer and commercial credit industries and will facilitate the continued smooth flow of credit to consumers and to businesses.

Rule of Construction for Special Purpose Securitization Entities

In connection with its establishment of standards for determining if a company is predominantly engaged in financial activities, Section 380.8(b)(2) of the Proposed Rule defines "financial activity" to include "any activity, wherever conducted, described in section 225.86 of the Board of Governors' Regulation Y or any successor regulation" and sets forth a test that considers whether or not the consolidated revenues of the company for either of its two most recent fiscal years were derived, directly or indirectly, from financial activities. The activities described in section 225.86 of Regulation Y include:

- Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly;[4]

- Making, acquiring, brokering, or servicing loans or other extensions of credit;[5]

[2] *See* http://www.americansecuritization.com/uploadedFiles/asf_orderly_liquidation_letter_to_fdic_12_13_10.pdf.

[3] *See* http://www.americansecuritization.com/uploadedFiles/FDICGeneralCounselLetterreOLA-12-29-10.pdf.

[4] *See* Bank Holding Company Act, 12 U.S.C. § 1843(k)(4)(D) (2002); *also see* 12 C.F.R. § 225.86(c) (1999).

[5] *See Id*. § 225.86(a)(1); *also see Id*. § 225(b)(1).

- Engaging under contract with a third party in asset management, servicing and collection of assets of a type that an insured depository institute may originate and own;[6]

Section 380.8(d) of the Proposed Rule goes on to set forth two rules of construction (the "Rules of Construction") governing the application of the two-year test to revenues derived from a company's equity investments in unconsolidated entities – (1) that revenues derived from a company's equity investment in an unconsolidated investee company which is itself predominately engaged in financial activities would be considered revenues derived from financial activities and (2) that revenues derived from certain *de minimis* equity investments in an unconsolidated investee company would categorically *not* be considered revenues derived from financial activities, regardless of the nature of the investee company's business. An equity investment may qualify as *de minimis* under the second Rule of Construction if, among other requirements, the investing company owns less than (i) 5% of any class of outstanding voting shares and (ii) 25% of the total equity of the investee company after such equity investment is made.

Given the definition of "financial activity" under the Proposed Rule discussed above, any securitization trust or any special purpose fund which pools and services (or arranges for the servicing of) any number of assets classes, such as residential mortgage loans, commercial mortgage loans, automobile loans and leases, credit card receivables or asset-backed securities could be considered to be predominantly engaged in financial activities. Therefore, pursuant to the Rules of Construction, the revenues received by a company from any direct investment made in (i) fixed income securities issued by a securitization trust which are not debt in form[7] or (ii) the equity of a special purpose fund described above, if such investment is not considered to be *de minimis* under the second Rule of Construction, could be considered revenues derived from financial activities, even if such investee companies are unconsolidated.

The ASF believes that such a result was not intended and, if not remedied, would deter investment in asset-backed securities and securities issued by investments funds which, in either case, are not debt in form. Therefore, the ASF requests that the FDIC implement a third rule of construction that would permit a company to treat revenues it derives from any equity investments in an unconsolidated investee company as *not* derived from financial activities, if such investee company is not an operating company but is a securitization trust or a special purpose fund which directly or indirectly holds and services (or arranges for the servicing of) pools of specified asset classes, such a residential mortgage loans, commercial mortgage loans, automobile loans and leases, credit card receivables or asset-backed securities.

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[6] *See* 12 C.F.R. § 225.86(a)(1); *also see Id*. § 225(b)(2)(vi).

[7] By way of example, most securities issued by Fannie Mae and Freddie Mac are grantor trust certificates or participation certificates which are equity in form.

We note that the proposed rule regarding risk retention contains a definition of "ABS interest," which is essentially defined to be the investment-type securities, whether or not debt in form, issued by special purpose vehicles, and which excludes "common or preferred stock, limited liability interests, partnership interests, trust certificates, or similar interests that: (i) [a]re issued primarily to evidence ownership of the issuing entity; and (ii) [t]he payments, if any, on which are not primarily dependent on the cash flows of the collateral held by the issuing entity." What we are suggesting is that the investment-type securities which are of the sort contemplated by the proposed "ABS interest" definition not be taken into account as "equity investments in unconsolidated entities," even if they are in equity form.

It is important to note that operating companies, such as servicers and investment managers, which service and manage the types of assets described above are likely to qualify as being predominately engaged in financial activities under the Proposed Rule. Therefore, the revenues derived from a company's equity investments, if not *de minimis*, in such unconsolidated operating companies would be considered revenues derived from financial activities pursuant to the Rules of Construction, and the proposed third rule of construction would not affect this result.

Amounts Owed To the United States

According to the Section entitled "Amounts Owed to the United Sates" in the Notice of Proposed Rulemaking, the Proposed Rule does not provide that the obligations to government-sponsored entities ("GSEs") such as Fannie Mae, Freddie Mac and Federal Home Loan Banks would be among the class of claims which qualify as amounts owed to the United States under Section 380.21(a)(3) of the Proposed Rule. However, Section 380.23(a) of the Proposed Rule defines the term "amounts owing to the United States" for purposes of Section 380.21(a)(3) of the Proposed Rule as "all amounts due to the United States or any department, agency or *instrumentality* of the United States government. . ." (emphasis added). Because GSEs such as Fannie Mae, Freddie Mac and Federal Home Loan Banks are, for some legal purposes, considered "instrumentalities" of the United States,[8] there seems to be an inconsistency between description under "Amounts Owed to the United States" in the Notice of Proposed Rulemaking and Section 380.23(a) of the Proposed Rule. The ASF requests that the final rule specifically address whether or not amounts owed to GSEs would qualify as "amounts owing to the United States" as used in Section 380.21(a)(3) of the Proposed Rule.

Post-Insolvency Interest

Section 380.25 of the Proposed Rule sets forth a statutory rate (the "Statutory Rate") at which post-insolvency interest on allowed claims, whether secured or unsecured, is calculated. By contrast, under the Bankruptcy Code, post-petition interest is addressed in two different manners depending on whether or not an allowed claim is secured or unsecured. Under Section 726(a)(5) of the Bankruptcy Code, post-petition interest is paid on an unsecured claim at the "legal rate." Under Section 506(b) of the Bankruptcy Code, post-petition interest is paid on certain secured claims which are oversecured at the rate and in accordance with the terms specified in the contract under which the claim arose (the "Contract Rate"), up to the amount by which the claim is oversecured.

The ASF understands that the Statutory Rate set forth in Section 380.25 of the Proposed Rule conforms to the rate applied by the FDIC in connection with claims under the Federal Deposit Insurance Act for ease of administration and because bankruptcy courts, in interpreting the meaning of "legal rate" under Section 726(a)(5) of the Bankruptcy Code, have not established a uniform post-petition rate to be applied to unsecured claims.

[8] *See e.g.*, *Rust v. Johnson*, 597 F.2d 174, 178 (9th Cir. 1979) (holding Fannie Mae to be a federal instrumentality); *Mendrala v. Crown Mortg. Co.*, 955 F.2d 1132, 1138-41 (7th Cir. 1992) (holding Freddie Mac to be a federal instrumentality for estoppel purposes); *Ass'n of Data Processing Serv. Orgs., Inc. v. Fed. Home Loan Bank Bd.*, 568 F.2d 478, 480 (6th Cir. 1997) (holding Federal Home Loan Banks to be federal instrumentalities). The issue is perhaps also more unclear given the current conservatorship status of Fannie Mae and Freddie Mac.

However, because the calculation of post-insolvency interest on claims of secured creditors of a Covered Financial Company under the Proposed Rule would be inconsistent with the calculation of post-petition interest on claims of secured creditors of the same Covered Financial Company under the Bankruptcy Code, the ASF requests that the FDIC implement a rule similar to that in Section 506(b) of the Bankruptcy Code, which would allow for the payment of post-insolvency interest on claims of secured creditors at the Contract Rate, up to the amount by which such claim is oversecured, in order to create parity in the treatment of secured creditors under OLA and under the Bankruptcy Code.

Measure of Damages for Repudiation or Disaffirmance of Debt Obligation

The ASF notes that Section 210(c)(3)(D) of the Act requires, in connection with a claim for damages resulting from repudiation by the FDIC of a debt obligation of a Covered Financial Company under OLA, at a minimum the payment of accrued interest on such debt, presumably at the Contract Rate (although this is not explicitly stated in the statute), in certain circumstances. However, this result is nevertheless not in parity with the result achieved under Section 506(b) of the Bankruptcy Code.

Pursuant to Section 210(c)(3)(D) of the Act, if the FDIC repudiates or disaffirms any debt for borrowed money or evidenced by a security of a Covered Financial Company, the creditors of such debt will have a claim that "shall be no less than" the amount lent plus accrued interest (presumably at the Contract Rate), as of the date the FDIC was appointed receiver of the Covered Financial Company and to the extent such debt is oversecured, accrued interest (again, presumably at the Contract Rate) through the date of repudiation or disaffirmance of such debt by the FDIC. Thereafter, post-insolvency interest would be paid on such claim at the Statutory Rate under the current Proposed Rule.

Pursuant to Section 506(b) of the Bankruptcy Code, if the same Covered Financial Company files for bankruptcy, the same creditors would have a claim for the amount lent plus accrued interest at the Contract Rate as of the date of petition and post-insolvency interest will be paid on such claim at the Contract Rate indefinitely (but, of course, not beyond the date of payment in full), up to the amount by which the claim is oversecured.

The difference is this: Under OLA, at a minimum, interest accrues on repudiated debt which is oversecured at the Contract Rate only through the date of repudiation and thereafter accrues at the Statutory Rate (which could be lower than the Contract Rate); under the Bankruptcy Code, interest accrues on the same oversecured debt at the Contract Rate through the date on which such debt is paid in full.

We further note that Section 210(b)(5) of the Act states: "This section [that is, Section 210] shall not affect secured claims or security entitlement in respect of assets or property held by the covered financial company, except to the extent that the security is insufficient to satisfy the claim, and then only with regard to the difference between the claim and the amount realized from the security."

Therefore, in connection with the measure for damages resulting from the repudiation or disaffirmance of a debt obligation by the FDIC under Section 210(c)(3)(D) of the Act, the ASF asks that the FDIC adopt a rule similar to that in Section 506(b) of the Bankruptcy Code which will (a) clarify that accrued interest on such debt will be calculated at the Contract Rate and (b) if such debt is oversecured, allow for the payment of accrued interest on such debt through the date of payment (and any reasonable fees, costs, or charges), up to the amount by which such debt is oversecured. We further ask that, following a repudiation or dissaffirmance, the date of payment be established as a date which is not later than the next following regularly-scheduled payment date under the debt obligation, provided that such date is at least five business days following the date of the repudiation or dissaffirmance; otherwise, a date which is not later than the second following regularly-scheduled payment date under the debt obligation.

Drafting Error in Section 210(c)(3)(D) of the Act

The words "pursuant to paragraph (1)" at the end of Section 210(c)(3)(D) of the Act appear unnecessary and incorrect, given the substance of the provision in its entirety. In order to eliminate any confusion that such words may cause in the interpretation of Section 210(c)(3)(D) of the Act, the ASF requests that the FDIC confirm that the words "pursuant to paragraph (1)" are the result of a drafting error and should be disregarded.

Treatment of Covered Bonds as Secured Claims

The Notice of Proposed Rulemaking, under the Section titled "Secured Claims," specifies that Sections 380.50-55 of the Proposed Rule, in addressing the treatment of secured claims, encompass covered bonds. The ASF requests that the FDIC refrain from addressing the treatment of covered bonds under the Proposed Rule. No Covered Financial Company which may be subject to the requirements of OLA may effectively issue covered bonds under the current law. The ASF believes that any issues which might arise under OLA in connection with a covered bond issued by such a Covered Financial Company should await any relevant guidance as may be provided in future legislation which will dictate the manner in which such Covered Financial Companies may issue covered bonds.

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

Sincerely,

Tom Deutsch

Tom Deutsch
Executive Director
American Securitization Forum