May 23, 2011

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

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

Dear Mr. Feldman:

The Clearing House Association L.L.C. ("**The Clearing House**"),[1] the Securities Industry and Financial Markets Association ("**SIFMA**")[2], the American Bankers Association ("**ABA**")[3] and

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[1] Established in 1853, The Clearing House is the nation's oldest banking association and payments company. It is owned by the world's largest commercial banks, which collectively employ 1.4 million people in the United States and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the U.S. *See* The Clearing House's web page at www.theclearinghouse.org.

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

[3] 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. The majority of ABA's members are banks with less than $165 million in assets. Learn more at www.aba.com.

the Financial Services Roundtable (the "**Roundtable**")[4] respectfully submit this comment letter in response to the Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**" or the "**Act**")[5] published by the Federal Deposit Insurance Corporation (the "**FDIC**") in the *Federal Register* on March 23, 2011 (the "**Notice**").[6]

A well-implemented Title II[7] would provide a substantial contribution to the future. A transparent resolution regime that preserves going-concern value and financial-market stability while imposing market discipline would protect U.S. taxpayers, consumers of financial products, and the industry itself from future crises. At the same time, the resolution regime affects the present-day health of the financial industry. As The Clearing House, SIFMA and the ABA have noted in prior letters to you,[8] the decisions reflected in the FDIC's regulations implementing Title II will affect, among other things, the ability of major financial institutions to obtain and maintain capital and funding, to provide legal certainty to the counterparties with whom they deal, to avoid failure in the face of financial-market crises, and to attract and retain qualified personnel. Moreover, the implementation of Title II is intertwined with other major developments under the Act (including the process for developing "living wills," new capital requirements, and standards for securitization) and international efforts to prevent and mitigate crises. Piecemeal or uncoordinated development of Title II will result in inconsistent regulatory and resolution frameworks for covered institutions in the U.S. that will unnecessarily undermine the global competitiveness of U.S. institutions, compound the instability of the U.S.

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[4] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

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

[6] 76 Fed. Reg. 16324 (Mar. 23, 2011).

[7] Section, subsection and title numbers refer to corresponding portions of the Act in the form in which it was enacted or to the rule proposed in the Notice, as appropriate, unless the context otherwise requires.

[8] Letters from The Clearing House are available at http://www.theclearinghouse.org/reference/comment_letters/commentLetterDocs/071649.pdf (Feb. 2011), www.theclearinghouse.org/reference/comment_letters/commentLetterDocs/071378.pdf (Jan. 2011), and www.theclearinghouse.org/reference/comment_letters/commentLetterDocs/071045.pdf (Nov. 2010).

Letters from SIFMA are available at http://www.fdic.gov/regulations/laws/federal/2011/ 11c02Orderly.PDF (February 2011), http://www.fdic.gov/regulations/laws/federal/2010/ 10c38Orderliq.PDF (Jan. 2011), and http://www.fdic.gov/regulations/laws/federal/2010/ 10c28Orderliq.PDF (Nov. 2010).

Letters from the ABA are available at http://www.aba.com/NR/rdonlyres/DC65CE12-B1C7-11D4-AB4A-00508B95258D /71388/DenyetteFDICOLACommentLetter32811.pdf (Mar. 2011), http://www.aba.com/NR/rdonlyres/DC65CE12-B1C7-11D4-AB4A-00508B95258D/70539/cl_DFA_ordliquidation2011Jan18.pdf (Jan. 2011), and http://www.aba.com/NR/rdonlyres/DC65CE12-B1C7-11D4-AB4A-00508B95258D/69830/cl_FDICOrderlyLiquidationDFA2010Nov.pdf (Nov. 2011).

financial system in times of distress, and indirectly slow the U.S. economy. It is from a shared belief that a failure to realize the potential of Title II and coordinate its development with other regulatory efforts would have grave results that we respectfully submit the comments that follow.

We appreciate the measured tone of the Notice, which recognizes that implementation of Title II requires balancing several priorities. The Notice recognizes that Title II is meant both to end taxpayer-funded bailouts of creditors and other stakeholders *and* to mitigate systemic risks. The Notice also recognizes that a severe destabilization or collapse of the U.S. financial system could impose severe and lasting damage on the broader economy, including the labor market, by causing a severe contraction of the supply of money and credit over an extended period of time.

We also commend the FDIC's efforts to begin the systematic work of drawing "a 'roadmap' for creditors to better understand their substantive and procedural rights under Title II" and, especially, its efforts to coordinate its rulemaking with that of the Board of Governors of the Federal Reserve System (the "**Federal Reserve**") and other domestic and international regulators. Only a comprehensive approach that begins with a vision of how Title II will work in practice and coordinates the implementation of that vision with other regulators can fulfill the potential of Title II.

The Notice clarifies several issues that are important to both the FDIC and market efficiency, including how the preferential- and fraudulent-transfer provisions in Title II would be harmonized with the Bankruptcy Code; the priorities of administrative expenses and unsecured claims; the payment of post-insolvency interest; the obligations of bridge financial companies with respect to assumed claims and the use of any proceeds realized from the sale or other disposition of the bridge; certain details of the FDIC's administrative-claims process, including the procedures for seeking *de novo* judicial review of disallowed claims; and special rules for secured claims.

However, the Notice also includes some proposals that could undermine safety and soundness of institutions and market efficiency and may even be destabilizing during a financial panic. These include proposals for:

- presuming that senior executives or directors of a covered company[9] were "substantially responsible" for its failure and may therefore be ordered to forfeit up to two years of their compensation;

- treating claimants whose set-off rights are destroyed by the FDIC's exercise of its new authority under Title II in a manner that results in those claimants receiving less

[9] We use the term "covered companies" to refer both to those companies that actually are subject to a Dodd-Frank liquidation proceeding and to those that may be subject to such a proceeding under the Act.

for their claims than they would have received in a liquidation under Chapter 7 of the Bankruptcy Code;[10] and

- precluding most secured claimants from exercising rights against the pledged collateral during the 90-day period after the FDIC is appointed receiver and thereafter, without the consent of the FDIC—and without assurances that consent will be rapidly granted in appropriate categories of cases.

Furthermore, the Notice does not clarify, in many respects, how the FDIC intends to reconcile its duties to creditors and customers of a covered company with its powers to avoid or mitigate the serious adverse effects on financial stability in the United States that could be caused by the failure of a covered company and its "disorderly" liquidation or reorganization under the Bankruptcy Code during a financial crisis. For example, the Notice does not address how the due-process rights of secured and unsecured creditors will be protected against errors that the FDIC may make when (i) valuing assets or collateral, (ii) satisfying the Act's mandate that the value of the covered company be maximized for the benefit of creditors, (iii) fulfilling the Act's requirement that creditors receive no less than they would if the covered company had instead gone through a proceeding under Chapter 7 of the Bankruptcy Code (the "Minimum Recovery")[11], (iv) properly segregating customer assets and observing similar customer protections, and (v) applying the clawback rules in Section 210(o) of the Act in situations where similarly situated creditors are treated differently.[12] *Annex A* to this letter provides a selective list from the many remaining topics that the FDIC will need to resolve in future rulemakings that implement Title II.

This letter responds to questions posed in the Notice and makes certain additional recommendations with respect to the implementation of the Act. For ease of reference, we include the text of the questions below and provide our responses following each question.

Responses to Questions

1. The FDIC has proposed a two-year period for applying the 85 percent consolidated revenue test. Is there another more appropriate timeframe that the FDIC

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[10] We note that this issue may be addressed when the rules implementing the "Minimum Recovery" requirement of the Act are released. However, we believe that it is essential that the rules governing setoffs, standing alone, be conformed to the provisions of the Bankruptcy Code as much as possible and any uncertainty eliminated in view of the critical role that setoff plays in risk and financial management in financial institutions.

[11] For a discussion of the provisions in Title II guaranteeing creditors their Minimum Recovery, *see*, *e.g.*, www.theclearinghouse.org/reference/comment_letters/commentLetterDocs/071378.pdf (Jan. 2011).

[12] This issue would arise, for example, if the claims of some members of a class of creditors are transferred to a bridge entity or a creditworthy third party and others are not, or if some members of a class of creditors receive additional payments or other benefits as a result of the exercise of the FDIC's discretion under the Act while others do not.

should use to determine whether a company meets the 85 percent consolidated revenue test for the purposes of Title II?

The term "financial company" is defined in Title II to include any company organized under U.S. law that is "predominantly engaged" in activities that the Federal Reserve has determined to be "financial in nature or incidental thereto" for purposes of the Bank Holding Company Act (the "**BHC Act**"). The proposed rules clarify what it means for a company to be engaged in activities that are "financial in nature or incidental thereto" by incorporating the extensive list of activities in which a financial holding company is permitted to engage under the BHC Act. The proposed rules would define "predominantly engaged" in financial activities to mean that at least 85% of the total consolidated revenues of the company for ***either*** of its two most recently completed fiscal years were derived, directly or indirectly, from financial activities. We believe that the two-year period provides a reasonable basis for concluding that a company's involvement in financial activities is not transitory, while taking into account changes in revenues that do reflect a change in business mix.

The FDIC's proposed definition of "predominantly engaged in financial activities" under Title II is substantially identical to the Federal Reserve's proposed definition under Title I (although omitting the Federal Reserve's test based on gross assets, in view of the differences between Title I and Title II).[13] We believe that this similarity is appropriate, and we encourage the FDIC to apply the definition under Title II and any implementing regulations in a manner that is consistent with the FSOC's application of the definition under Title I and any implementing regulations.

For these reasons we believe that the same two-year timeframe should apply under these rules as do under those Federal Reserve rules implementing Title I.

2. Is there a more appropriate definition of "applicable accounting standards" than that used in the Proposed Rule?

Under proposed Section 380.8(b)(3), the accounting standards used to calculate a company's consolidated revenues would be "the accounting standards utilized by the company in the ordinary course of business in preparing its consolidated financial statements, provided that those standards are: (i) U.S. generally accepted accounting principles, (ii) International Financial Reporting Standards or (iii) such other accounting standards that the FDIC determines to be appropriate." This rule is consistent with the Federal Reserve's proposed rule in the Title I context, and we feel that it is generally appropriate.

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[13] Federal Reserve, Notice of Proposed Rulemaking and Request for Comment, Definitions of "Predominantly Engaged in Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company, 76 *Fed. Reg.* 7731 (Feb. 11, 2011).

The Notice explains that anchoring the definition in the "accounting standards utilized by the company in the ordinary course of business" eliminates the possibility that the determination of Title II eligibility will be made on the basis of financial statements other than those that are already being produced by the company, thus both preventing regulatory arbitrage and reducing regulatory burden.[14] These goals are important to the long-term stability and health of the financial industry, reducing both the risk of future crises brought on by the behavior of unregulated entities and the everyday costs of compliance. Limiting the "applicable accounting standards" to those "utilized by the company in the ordinary course of business" is an effective means to furthering these goals.

We believe that the FDIC should clarify the rule by providing that, in all cases, the "applicable accounting standards" will be the standards "utilized by the company in the ordinary course of business" *unless* the accounting standards in question have been designated as *in*appropriate by the FDIC.

In addition, for the reasons indicated in our response to Question 1, we urge the FDIC to finalize and apply the definition proposed in Section 380.8(b)(3) consistently with the parallel definition being developed under Title I.

3. The Proposed Rule includes a rule of construction regarding investments that are not consolidated. Is this rule of construction appropriate?

Under proposed Section 380.8(d)(1), revenues derived from an equity investment by a covered company in another company, the financial statements of which are not consolidated with those of the covered company under applicable accounting standards, are to be treated as revenues "derived from financial activities" for purposes of determining whether a company is predominantly engaged in financial activities, if the investee company is predominantly engaged in financial activities, as defined in the proposed rules. In other words, the rule of construction requires a "look-through" to investee companies that are predominantly engaged in financial activities. This rule is consistent with the Federal Reserve's rule in the Title I context, and we feel that it is generally appropriate.

This "look-though" rule will complicate the calculation of the "predominantly engaged" in financial activities test for funds and other companies that generally make non-controlling unconsolidated investments. In many cases it may also be difficult to evaluate, based on public information, whether or not an investee company is a financial company under the proposed rule. The FDIC should state that it will respect a determination made by an investor so long as

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[14] Notice at 12 ("First, the approach reduces the potential for companies to arbitrage the . . . revenue test by changing the accounting standards. . . . Second, by calculating consolidated revenues using the accounting standards that a company uses in the ordinary course of its business, the Proposed Rule also reduces the potential regulatory burden on companies.").

such determination is based on good-faith efforts, including those based on publicly available information with respect to the sources of revenues of the investee.

For the reasons indicated in our response to Question 1, we urge the FDIC to finalize and apply the definition proposed in Section 380.8(d)(1) consistently with the parallel definition being developed under Title I.

4. The Proposed Rule includes a rule of construction regarding *de minimis* investments. Is there a more appropriate approach to calculating and accounting for revenues that are derived from such *de minimis* investments?

Under proposed Section 380.8(d)(2), a company may exclude from its financial activities revenues those revenues related to certain minority, unconsolidated investments, but only up to 5% of the company's total annual financial revenues. In order to be counted toward the exclusion, the company must own less than 5% of any class of voting shares, and less than 25% of the equity, of the investee company. Also, the company's investment must not be held in connection with the conduct of a financial activity (such as, for example, investment advisory services or merchant-banking activities conforming to Section 4(k) of the BHC Act and Regulation Y promulgated thereunder). Finally, the investee company must not be a depository institution or subsidiary of a depository institution, bank or thrift holding company, foreign bank, broker-dealer, insurance company or certain other SEC- or CFTC-regulated financial institutions as enumerated in the proposed rules. This rule is consistent with the Federal Reserve's rule in the Title I context, and we believe that it is generally appropriate.

We note, however, that this rule is elective, insofar as a company "may" treat such revenues as not derived from financial activities. As an initial matter, it is not clear why this matter is within the discretion of the covered company, because the statute does not appear to permit a company to determine whether it is or is not subject to Title II. We suggest that the FDIC clarify how and when a company would make such an election and whether the FDIC would be bound by this election when making the determination as to whether the investor is, in fact, a covered company. We also suggest that the rule provide for a mechanism, such as a binding election that an investee can make through publicly available disclosure, that investors could rely on for determining whether the investee is "predominantly engaged in financial activities."

For the reasons indicated in our response to Question 1, we urge the FDIC to finalize and apply the definition proposed in Section 380.8(d)(2) consistently with the parallel definition being developed under Title I.

5. Section 380.7 of the Proposed Rule establishes standards for a determination that a senior executive or director is substantially responsible for the failure of a covered financial company. Under the Proposed Rule, the loss to the financial condition of the covered financial company must have materially contributed to the failure of the covered financial company. The FDIC is considering the use of additional qualitative and quantitative benchmarks to establish that the loss materially contributed to the failure of the covered

financial company. Financial indicators under consideration as possible benchmarks are assets, net worth and capital, and the percentage or magnitude of loss associated with these benchmarks that would establish a material loss and trigger substantial responsibility. The FDIC solicits comments on these and other potential benchmarks that may be used to effectively evaluate loss.

The Act provides that the FDIC *may* "claw back" certain compensation from current or former senior executive or directors who are "*substantially responsible* for the failed condition of the covered financial company."[15] The Notice, in supporting the text of proposed Section 380.7, places this provision in the context of Section 204(a)(3) of the Act, which requires the FDIC to "take all steps necessary and appropriate to assure that all parties, including management, directors, and third parties, having *responsibility* for the condition of the financial company bear losses *consistent with their responsibility*, including actions for damages, restitution, and recoupment of compensation and other gains *not compatible with such responsibility*" (emphases added).

While we support the statutory provision, proposed Section 380.7 goes beyond the congressional mandate in several significant and punitive respects, most notably in the way it defines "substantially responsible" and in the way in which it proposes to use rebuttable presumptions.

Substantially Responsible: The proposed regulatory definition of "substantially responsible" is a significant expansion of the statutory language. This definition works by deeming a senior executive or director to be substantially responsible for the failed condition of a covered company if (i) he or she failed to conduct his or her responsibilities with the "requisite degree of skill and care required by that position" and (ii) as a result, he or she caused, individually or collectively, a loss to the covered company that "materially contributed" to its failure. Indeed, the use of the word "deem" is a signal that the FDIC has created a "legal fiction"; i.e., that one thing will be assumed to be something else. Specifically, that neither the standard of care nor the standard of causation are clear raises serious concerns.

The proposed regulation would establish an exceedingly vague and expansive standard of care. The standard of care is defined as the "requisite degree of skill and care required by that position." Based on this language, what that standard of care is remains unclear. Would it be negligence, gross negligence, failure to comply with the business-judgment rule, or some other standard? The FDIC would do better by referring to a standard of care already established and understood by the markets and the legal community, rather than attempting to fabricate a new standard from whole cloth, for infrequent application in extraordinary circumstances. Without a clear standard of care, the regulation is subject to challenge as being unconstitutionally vague. While courts rarely strike down statutes or regulations as being unconstitutionally vague, the stigma that could attach to being held responsible for the collapse

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[15] Section 210(s)(1) (emphasis added).

of a systemically important financial institution during a global financial crisis and the punitive nature of the proposed sanction make this rule akin to a criminal law and could thus expose this portion of the proposed rule to a vagueness challenge unless the FDIC amends the proposed rule to specify an appropriate standard of care.

The proposed regulation would also dilute the statutory standard of causation from being “substantially responsible” for causing the “failed condition” to having only caused a “loss” that “materially contributed” to the institution’s failure. This seems inconsistent with the language of the statute, which requires proof of substantial responsibility for the failed condition, and not merely for a loss that materially contributed to the failed condition. Substantial responsibility carries the implication of but-for causality, and the implication that no other causative factor was greater than the one in question. Alternatively, one could say that the mismanagement at issue was the primary and necessary cause of the covered company’s failure. Unless the FDIC revises this standard to be closer to the statutory language, this aspect of the proposed rule may be vulnerable to judicial challenge as an unreasonable interpretation of the statute under the arbitrary-and-capricious and abuse-of-discretion standards.

The fundamental issue is that it is entirely conceivable that a covered company could become subject to a Dodd-Frank orderly liquidation authority (“**OLA**”) proceeding as a result of contagion, panic, or a run on other similar institutions, not the culpable malfeasance of its management team. For example, a parent company could be at risk if a subsidiary bank faces a depositor run. The insured depository may survive because of access to liquidity facilities and, should it fail, be resolved under the FDIC’s applicable resolution regime. However, the parent company could consequently come under OLA even though the underlying cause—the deposit run—resulted from broad market phenomena, rather than a failure by it or its subsidiary to implement effective liquidity-risk management or similar measures.[16] Similarly, if there were to be market-wide panic selling of the types of assets held by a financial institution, temporarily depressing asset prices, such an institution could appear insolvent through no fault of its own. In bank insolvencies, the FDIC itself has acknowledged that in many instances the decisions behind an institution’s failure will be innocent, even if mistaken, noting that between 1985 and 1992 (corresponding to the height of the S&L crisis) only 24% of bank failures led to FDIC claims against directors or officers.[17]

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[16] A similar scenario unfolded in September 2008, when investors staged a broad run on money market mutual funds after the Lehman Brothers failure caused one such fund—The Reserve Fund—to recognize losses on Lehman Brothers commercial paper and lower its share price below $1. The prudence of the management of the Reserve Fund aside, it is difficult to argue that the management of numerous other money market mutual funds was culpably deficient—yet such funds faced catastrophic runs that nearly led to their collapse. Only the extraordinary government interventions of the time, including an extension of a form of “deposit insurance” to money-market mutual funds, stemmed the runs and restored stability to this sector. For a contemporary account of these events, see http://money.cnn.com/2008/09/29/news/economy/money_market/index.htm.

[17] *See* “Professional Liability Lawsuits” at http://www.fdic.gov/bank/individual/failed/pls/index.html.

Use of Presumptions: The proposed rule presumes that any covered-company executive or director who has the misfortune to be in office at the time of failure is "responsible" for purposes of Section 210(s).[18] The somewhat tenuous support that the FDIC provides for the use of a rebuttable presumption in this context suggests that the FDIC may have anticipated the unfairness inherent in this presumption. The use of a rebuttable-presumption in the proposed rule may be based on no principle other than administrative convenience and the recognition that, even with all the documentary evidence available, it may be difficult to prove that a particular executive or officer actually *was* responsible for a company's failed condition. Unlike the presumption in proposed Section 380.7(b)(1)(ii), this presumption requires no fair hearing and no weighing of the context before its application. Rather, an executive or director in this situation will be placed in the untenable position of funding his or her defense against a receiver that his or her actions were not the cause of the financial company's failure—and, presumably, to do so without access to the compensation previously paid to that officer or director during the preceding two years. By contrast, the receiver, who is already granted extraordinary deference and freedom from ordinary judicial review, will be acting with the benefit of 20/20 hindsight and have access to all company records—and funding from the assets of the covered company—to marshal in support of its presumption.

We believe that the use of a "job title" presumption is inappropriate and the references to presumptions in other contexts are inapposite. Presumptions are appropriate where direct, particularized evidence is not efficiently obtainable, which is why they are used in the other contexts cited in the NPR. Thus, presumptions are used in Social Security black-lung disability cases, where multiple confounding medical factors may make it impossible to prove with certainty exactly how a coal miner contracted a lung disease, or in employment-discrimination cases, where the true motive of the employer is often unascertainable. We do not believe that the FDIC will find itself in a similar position if a covered company were to fail.[19] If certain employees bear substantial responsibility for the failed state of a covered company, the FDIC should be able to prove this directly; it ought to avoid taking unjustified shortcuts. If the FDIC cannot make a case on the evidence available to it, then there is an extremely good chance that there is, in fact, no case to be made.

Accordingly, we believe that a presumption of substantial responsibility that hinges solely on the job title of the executive in question, such as the one at proposed Section 380.7(b)(1)(i), is fundamentally unjustifiable and counterproductive. Far from encouraging safety and soundness, market efficiency or financial stability, the proposed rules on recovering compensation from senior executives and directors could seriously undermine safety and soundness, market efficiency and financial stability, especially under adverse

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[18] Proposed Section 380.7(b)(1)(i).

[19] In major financial failures, there is typically an abundance of documentary evidence, as well as the time, resources and motivation to analyze it. *See*, *e.g.,* the Lehman Brothers examiner's report, available at http://lehmanreport.jenner.com/.

financial conditions. The proposed rules could make it difficult for nonbank covered companies to retain or attract the best talent when general financial conditions deteriorate. Indeed, their vague and arguably unfair provisions would create powerful incentives for senior executives and directors with the best options to head for the exits at the first sign of trouble, lest a substantial portion of their compensation be at risk despite carrying out their responsibilities in good faith and in accordance with the business-judgment rule and any reasonable standard of skill and care. Such a rule could encourage a revolving door of senior executives and directors seeking to avoid recoupment, a situation that would undermine, rather than promote, stability.[20] In short, rather than minimize moral hazard and maximize market discipline, the proposed rule could weaken the quality of senior management and directors just when nonbank covered companies (and the government) need the best talent most.

Similarly, the proposed rule relating to executives and directors recruited when a financial company is already failing is so narrowly drafted as to overcome its very purpose, and could discourage the recruitment of new executives to turn around the company. For example, while executives hired for the purposes of effecting a turnaround within two years of the covered company's ultimate failure are protected under Section 380.7(b)(3), the fate of an executive hired to effect a three-year turnaround plan (which ultimately fails) is unclear. Furthermore, simply re-emphasizing that such executives and officers are subject to the basic rule and vulnerable to recoupment—although clearly true—makes these persons' escape from the burden of the presumptions of guilt seem sufficiently remote that it may be difficult to persuade potential "rescue" specialists to rely on the exemptions.[21]

Furthermore, we believe that the presumptions based on removal from office, contained in proposed Sections 380.7(b)(1)(iii) and (iv), are inappropriate under the statute. Sections 206(4) and 206(5) of Dodd-Frank call for the removal of directors and officers who are "responsible" for the failed state of the covered company. By contrast, Section 210(s) calls for the clawback of the salaries of those directors and officers who are "substantially responsible" for such a failure. Congress clearly meant to apply a higher standard in cases of recoupment, as compared to the standard applied in cases of removal. If the FDIC is able to prove that an executive is "responsible" for a failure, there is no reason why it could not also directly prove that the executive is "substantially responsible," if that degree of culpability actually exists.

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[20] Indeed, because the proposed presumption includes any senior executive "in any similar role regardless of his or her title if he or she had responsibility for the strategic, policy-making or company-wide operational decisions of the covered financial company prior to the date that it was placed into receivership," it could well cast numerous other executives and managers into legitimate doubt concerning their compensation, prompting an even wider exodus.

[21] Moreover, by limiting the exemption to new hires, retention and promotion of recognized turn-around experts already in the covered company's employment—in non-senior-management roles, for instance—would be severely hampered.

The proposed rule unduly limits the ability of a covered senior executive or director to rebut any of these presumptions. The only available avenue of rebuttal is to prove "by evidence" that he or she "did not cause a loss to the covered company under the facts and circumstances." The rule would not permit the use of relevant evidence showing, for example, that other factors were predominantly responsible for the failure of the covered company instead of the presumptively culpable executive. Moreover, the proposed rule does not identify a standard of proof for rebutting these presumptions.

Finally, we note that the statute, at Section 210(s)(2), requires the FDIC to weigh the financial and deterrent benefits of a recovery from senior executives and directors against the cost of executing the recovery in deciding whether to seek recovery from a particular senior executive or director. Nothing in the proposed rule explains whether or how the FDIC will make such a determination. We suggest that the FDIC add a provision in the proposed rule clarifying that such a cost-benefit analysis is required to be conducted in pursuing recoupment under the rule.

8. In what ways can the definition of administrative expenses under the Dodd-Frank Act be further harmonized with bankruptcy law and practice? Section 503(b)(4) of the Bankruptcy Code expressly provides for the payment of attorneys' and accountants' fees and expenses. Is there a need for a comparable provision in these rules, in light of the procedures for administration of the claims process described in the Proposed Rule?

We believe the definition of administrative expenses under the proposed rules should be harmonized with the Bankruptcy Code as much as possible, and, as part of that harmonization, we would support including a provision comparable to Section 503(b)(4) of the Bankruptcy Code in the proposed rules.

Among other things, that section allows for the payment, as an administrative expense, of reasonable attorney and accountant fees for certain creditors and creditors' committees, including those that have made a "substantial contribution" to the administration of the Chapter 11 proceeding.

At first glance, and as currently proposed, neither the Act nor the existing and proposed rules implementing it appear to provide significant roles for creditors' committees in the liquidation process. We believe that discouraging the participation of such committees would be a mistake. For reasons expressed in the November and January comment letters submitted by SIFMA,[22] we believe that active participation in the administration of the Title II process by creditors through committees will further OLA's goals, which include maximizing the value of the business and mitigating financial instability. Committees to coordinate creditors could help with the claim-filing and -determination process. Acting collectively, creditors could also

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[22] *See* http://www.fdic.gov/regulations/laws/federal/2010/ 10c38Orderliq.PDF (Jan. 2011) and http://www.fdic.gov/regulations/laws/federal/2010/ 10c28Orderliq.PDF (Nov. 2010).

facilitate dispositions of significant businesses or assets, recapitalizations that preserve market utilities and going-concern value, and similar transactions.

Furthermore, as previously suggested, we believe that it will be necessary to provide for collective action by committees or groups of creditors in some circumstances, such as in the determination of the Minimum Recovery amount for a liquidation under Title II. We believe that the services of professionals representing creditors involved in such proceedings should be treated as administrative expenses.

We urge the FDIC to be open to the utility—to the FDIC itself and to the purposes of the Act—of creditors' committees in the course of a Title II liquidation proceeding. Accordingly, we urge the FDIC to develop its rules so as to accommodate participation by groups of creditors.

9. Should "amounts due to the United States" be limited to obligations backed by the full faith and credit of the United States? To the extent that amounts due to the United States includes amounts that are not obligations issued by the FDIC to the Secretary of the Department of Treasury under the Dodd-Frank Act, how will the additional assessments authorized by section 210(o) of the Act be applied?

Proposed Section 380.21 pulls together into a coherent scheme the provisions in Title II establishing the priority of claims in a Title II liquidation proceeding. "Amounts owed to the United States" are given third priority in this scheme. This term is defined in proposed Section 380.23 to include repayments of certain official extensions of credit and government guarantees, unsecured tax liabilities, and amounts owed to any Federal Reserve Bank. Federal agencies are also, by this rule, allowed to waive priority, so long as they do not reduce their priority below the level given to regulatory capital instruments. The FDIC cannot create, and should not seek to create, further "super priorities" beyond those required by the statute.

Section 210(o)(1)(B) provides that industry-wide assessments are to be used to repay "the obligations issued by the Corporation to the Secretary under this title" if the receivership estate cannot repay such obligations out of its own resources within 60 months of their issuance. We believe that these obligations—to be met by assessments if need be—are to be found only in the first-priority class defined under Section 380.21 ("debt incurred by or credit obtained by the Corporation as receiver for a covered company, provided that the Corporation has determined that it is otherwise unable to obtain unsecured credit for the covered company from commercial sources"). Back taxes and existing obligations to Federal Reserve Banks are clearly not included within Section 210(o)(1)(B)'s designation of obligations to be satisfied by the application of industry-wide assessments under Title II, and assessments should not be used to repay those obligations. Only obligations by the FDIC to the Treasury, for repayment of emergency funds provided by the Treasury to run a receivership, are to be repaid using assessments.

We also believe that the rule should contain an express provision confirming that its priority scheme is not intended to supersede or impair the rights of secured creditors under

Title II but instead applies to the allocation of the assets of the covered company only after giving effect to the rights of secured creditors.

The priority given to employees' wages in proposed Section 380.21(a)(4) raises concerns as well. This provision (following Section 210(b)(1)(C)-(D) of the Act) gives relative priority to amounts earned by employees "not later than 180 days before the date of appointment of the receiver," possibly *denying* priority to wages earned during the 6 months before the failure of the covered company while granting it to any unpaid earlier-earned wages. In contrast, Section 507(a)(5) of the Bankruptcy Code explicitly *grants* special priority to wages earned in the period just before a bankruptcy. We urge the FDIC to seek a solution that would protect rank-and-file employees, whether by rulemaking or by seeking legislative action.[23]

10. How should the value of lost setoff rights be determined?

While contractual setoff rights are generally preserved under Section 210(a)(1)(G)(iii) of the Act, Section 210(a)(12)(F) provides for circumstances under which the FDIC may sell or transfer assets of a covered company free and clear of setoff rights that would not be enforceable against a transferee of the assets under applicable non-insolvency law (namely, common-law rights of setoff). However, as partial compensation for its lost setoff rights, any claimant whose setoff rights were destroyed by the FDIC's actions has a claim against the receivership that is senior to general creditors but junior to all other more senior claims. The question that must be addressed is how to value that priority claim.

In determining the value of lost setoff rights, it is important to consider the purpose of Section 210(a)(12)(F). We understand that the provision in the Act permitting such free and clear transfers was included in order to facilitate the FDIC's ability to obtain full value for transferred assets or to create a viable bridge entity while fully preserving contractual rights of setoff. The provision was not included for the purpose of disadvantaging creditors with non-contractual rights of setoff or to deprive them of the benefit of their setoff rights except insofar as necessary to achieve those goals.

Nonetheless, the Notice recognizes that the FDIC's permissible actions have the potential to result in a recovery for a setoff claimant that is lower than that which would have been received in a liquidation under Chapter 7 of the Bankruptcy Code because "in bankruptcy setoff claims are functionally treated similar to a security interest." The release describes the preferential treatment given to setoff claimants as "adequate protection" that "should normally provide value to setoff claimants equivalent to the value of setoff under the Bankruptcy Code."

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[23] This issue, distinct from that relating to officers' and directors' compensation, would affect the employees charged with the day-to-day operations of the financial institution. These employees' continued involvement, which the FDIC has sought to protect elsewhere, could be critical to the preservation of value of the affected institution.

Section 210(b)(4)(B) of the Act permits the FDIC to deviate from the fundamental rule of equal treatment for similarly situated creditors, but only if every claimant receives its Minimum Recovery entitlement; *i.e.,* what it would have received in a liquidation under Chapter 7 of the Bankruptcy Code. A claimant's Minimum Recovery entitlement is not subject to, or qualified by, the FDIC's power to transfer assets free and clear of any setoff rights under Section 210(a)(12). Nor does this entitlement appear to be overridden or necessarily satisfied if the claimant receives "adequate protection" or priority over general creditors.

Section 210(b)(4)(B) is crystal clear: "all claimants that are similarly situated" must "receive not less than the amount provided in paragraphs (2) and (3) of subsection (d)." The amount provided in Section 210(d)(2) is "the amount that such claimant would have received if . . . (A) the [FDIC] had not been appointed receiver with respect to the covered financial company; and (B) the covered financial company had been liquidated under chapter 7 of the Bankruptcy Code . . . ." This Minimum Recovery entitlement is an unqualified, absolute baseline of recovery and would apply even if setoff is destroyed.

Because a setoff claimant would have received the full value of its setoff rights in a liquidation under Chapter 7 of the Bankruptcy Code, it should have a deficiency claim against the FDIC for any shortfall between what the setoff claimant actually received under Title II and what it would have received under Chapter 7.

11. How do the differences in the post insolvency interest rules contained in § 380.25 and those established under bankruptcy law and practice materially affect creditors? How would the provisions of section 506(b) of the Bankruptcy Code allowing certain fees and expenses to be paid to oversecured creditors to the extent of the value of their collateral be implemented in an orderly resolution under the Dodd-Frank Act, if it is applicable? What would be the impact on creditors if a similar rule is adopted under the Dodd-Frank Act? Or if one is not adopted?

Proposed Rule 380.21(a)(10) provides that post-insolvency interest to creditors is to be accorded a payment priority just above that of equity. Proposed Rule 380.25(b) specifies that the rate for such interest is the most recent three-month Treasury-bill rate, calculated quarterly on a simple-interest basis. We believe that this rate is historically much lower than the standard rate utilized under the Bankruptcy Code and do not see any reason that a rate different from the rate utilized under the Bankruptcy Code should be adopted.

With respect to secured creditors, Section 506(b) of the Bankruptcy Code permits a creditor who has a perfected security interest to recoup interest and any reasonable fees, costs or charges due under the secured contract, to the extent that the collateral for which the creditor bargained proves sufficient to cover those amounts (and the costs of the trustee for preserving, or disposing of, the collateral). The creditor is entitled, under the Bankruptcy Code, to be paid in accordance with his or her existing contractual arrangement with the debtor, to the extent that the perfected collateral securing the contract covers such payment. Proposed Rule 380.25, in contrast, would deprive the creditor of its right to the bargained-for collateral, eliminating any claims for fees and diluting its claim for interest by granting similar claims to

those other creditors who did not seek to protect themselves through security interests beforehand. In the context of an over-secured creditor, this result would violate the Minimum Recovery principle.

We do not believe that Congress intended Title II to have this effect on secured creditors. Section 210(b)(5) expressly provides that Section 210, which provides for the powers and duties of the FDIC acting as receiver of a covered company, "shall not affect secured claims or security entitlements 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." Section 209 provides that the FDIC:

> shall, in consultation with the Council, prescribe such rules or regulations as the Corporation considers necessary or appropriate to implement this title, including rules and regulations with respect to the *rights*, *interests*, and *priorities* of creditors, counterparties, security entitlement holders, or other persons with respect to any covered financial company or any assets or other property of or held by such covered financial company.[24]

Section 209 further provides that such rules or regulations, "[t]o the extent possible," should be harmonized with the Bankruptcy Code or other insolvency rules that would otherwise apply to a covered company.[25] Furthermore, where there is any ambiguity as to the treatment of a creditor or secured entitlement holder with respect to an asset or other property held by such covered company, and the FDIC finds it necessary and appropriate, Section 209 directs the FDIC to resolve such ambiguity while to the extent possible preserving the treatment of such creditors or secured entitlement holders under the otherwise applicable insolvency regime.[26] These statutory directives express the unambiguous Congressional intention that Title II, except as expressly provided, not affect secured creditors or secured entitlement holders.

We urge the FDIC to adopt regulations that clarify not only that the interest, reasonable fees, expenses and charges that accrue on a secured claim after the appointment of the FDIC as receiver will be treated the same as they would under the otherwise applicable insolvency

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[24] Section 209 (emphases added).

[25] Section 209 ("To the extent possible, the Corporation shall seek to harmonize applicable rules and regulations promulgated under this section with the insolvency laws that would otherwise apply to a covered financial company.").

[26] *Id*.

regime,[27] but also that, where the otherwise applicable regime would be the Bankruptcy Code, those accruals will be secured to the extent that the underlying claim was over-secured.[28]

With respect to *un*secured creditors, we believe that the FDIC should adopt a rule allowing for the use of the rate that would have applied under the Bankruptcy Code. The Bankruptcy Code provides for interest payments on unsecured claims "at the legal rate from the date of the filing of the petition."[29] Courts have adopted varying constructions of the "legal rate" to which creditors are entitled under Chapter 7 of the Bankruptcy Code, at times using the rate provided for in the contract, the federal judgment rate, and the applicable state judgment rate.[30] Using the three-month Treasury-bill rate could deny creditors the Minimum Recovery to which they are entitled under the Act and would upset creditors' reasonable expectations based on the Bankruptcy Code. Proposed Section 380.25(b) should be revised to provide treatment consistent with the Bankruptcy Code. In particular, where a contract provides for a method to calculate interest, we believe that such method should apply in order to preserve counterparties' expectations, and under no circumstances should shareholders receive distributions before creditors receive interest due in accordance with their contractual rights.[31] Denying creditors their contractual recovery while compensating shareholders would, inter alia, violate the principles of Section 206, which mandates that "[i]n taking action under this title, the Corporation shall . . . ensure that the shareholders of a covered financial company do not receive payment until after all other claims . . . are fully paid."

12. What, if any, additional provisions should be included in the proposed Rule regarding the administrative process for the determination of claims?

The proposed rules would purport to deny a court jurisdiction over a claim against the covered company or its assets unless the claimant has exhausted its administrative remedies. The rules should unambiguously specify what constitutes the exhaustion of such administrative remedies.

The proposed rules also provide that an aggrieved claimant may file suit for the *de novo* review of a denied claim in the district or territorial court of the United States for the district in which the principal place of business of the covered company is located or, in the case of an

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[27] Section 210(a)(1)(I).

[28] These arrangements are especially sensible when the borrower is a financially sophisticated party that has dedicated resources for managing interest-rate risk—a group into which most, if not all, covered companies fall.

[29] 11 U.S.C. § 726(a)(5). Such payments follow in priority all other payments under § 726(a), except for payments to equity holders.

[30] *See*, *e.g.*, Official Comm. of Unsecured Creditors v. Dow Corning Corp. (*In re* Dow Corning Corp.), 456 F.3d 668, 678-79 (6th Cir. 2006) (applying the contractual rate of default interest to claims for unsecured debt).

[31] *See In re* Allegheny Intern. Inc., 118 B.R. 282, 314-15 (Bankr. W.D. Pa. 1990) (providing for post-petition interest at the contracted-for rate and collecting supporting cases).

action on a claim begun before the appointment of the FDIC as receiver, continue the litigation in the court in which the action was pending. The FDIC should also clarify whether such venue is the exclusive forum in which a claimant may file suit or merely a non-exclusive option.

Proposed Section 380.34(c)-(d) provides that each claimant must file a claim individually. The proposal provides an exception for indenture trustees, who may file a single claim on behalf of the trust or pool that it represents. An analogous provision should be added for agent banks in syndicated loan transactions and similar arrangements where one party represents a group of creditors under the terms of a pre-existing contract.

Furthermore, as we have indicated in prior letters and above, we believe it will be essential for the FDIC to establish some form of collective determination mechanism to resolve common factual and legal questions in appropriate cases. Even if each individual claimant must file its own claim to be eligible to receive a distribution, we believe that the FDIC can, at the same time, permit a single transparent collective proceeding for each common question of fact or law that is implicated by numerous related individually filed claims. This procedure will reduce the administrative costs of the receivership, prevent duplication of effort and arguments, allow for the most sound and thorough resolution of the question at issue, speed the claims-resolution process, and ensure predictability, fairness and equal treatment of similarly situated creditors. Moreover, in the event that the FDIC elects to recapitalize an institution in OLA receivership by converting existing debt to equity, the FDIC must have some mechanism to deal in a coordinated fashion with the creditors who, as a class, will potentially become the new owners and operators of the institution.[32]

Proposed Section 380.35(b)(2) provides that claimants who do not receive notice "in time to file [their] claim before the bar date" are excused from the bar date and may have their claims paid so long as their claims are filed "in time to permit payment." The FDIC should clarify that notices received less than 30 calendar days before the bar date will be deemed to be not in time to file a claim by the bar date and thus place the recipient claimant within the protection of Section 380.35(b)(2).

Finally, we believe that proposed Section 380.37(c), which deems a claim denied if the FDIC does not rule on it within 180 days, undermines the goals of certainty and efficiency in the context of a receivership proceeding. The time for judicial review should only commence upon affirmative notification of the denial of a claim. The FDIC should use an alternative method to ensure its timeliness, not one that runs the risk of inadvertent forfeiture of claims or rights of appeal.

13. Proposed section 380.33 requires the FDIC to publish a notice to creditors to present their claims and specifies that the notice shall be published in one or more newspapers of general circulation where the covered financial company has its principal

[32] We are submitting to the FDIC contemporaneous comments that more fully consider the recapitalization option.

place or places of business. If the covered financial company is a multi-national organization, how should the principal place(s) of business be determined? Should a publication notice be published in each country in which the covered financial company does business?

Proposed Section 380.33 requires the FDIC to mail notices to creditors whose claims and contact information appear on the books and records of the covered company, publish certain notices to creditors in one or more newspapers of general circulation in the place where the covered company has its principal place of business, and post such notice to the FDIC website. The principal place of business should be determined with reference to representations that the covered company makes in its public securities disclosures (if any) as to its headquarters. If such sources are unavailable, the FDIC should adopt a center-of-main-interests test, looking to where the majority of executive decisions are made, and order publication in that place. If a covered company does business in multiple countries, the FDIC should look to the rules of those foreign countries in which the covered company does business, with respect to insolvencies and notices, when determining the appropriate forum in which to publish notice.

In addition to the suggestions above, we also recommend that the FDIC adopt additional provisions requiring it to send such notices to major financial news and press-release outlets, such as The Wall Street Journal, PR Newswire and Bloomberg, as bankruptcy courts tend to order in larger cases. For companies with extensive international operations, the FDIC should also adopt a rule requiring publication in specified major international financial newspapers, such as The Financial Times. Such notices should also be prominently posted to the main website of the covered company, if such a website exists, in addition to the FDIC website. The FDIC should retain explicit authority to order additional forms of notice when the facts and circumstances of a particular Title II proceeding justify such notice, similar to the authority of the bankruptcy courts under Bankruptcy Rule 2002.

14. In the event that publication notices are published in other countries, what standards should be applied to identify appropriate “newspapers of general circulation” to satisfy this regulatory requirement?

Please see our response to Question 13 above.

If a foreign country in which a covered company does a substantial volume of business does not have rules governing notice by publication in newspapers in case of an insolvency, the FDIC should publish such notices, in English as well as the official language of that jurisdiction, in the newspaper with the largest circulation in the city that is host to the country’s largest stock exchange, measured by the total market capitalization of all the listed companies. If the aforementioned newspaper is not published in the English language, the FDIC should publish an additional notice in the English-language newspaper that has the largest circulation in that city.

15. Should the consent provisions of subparagraphs 210(c)(13)(C) and (q)(1)(B) of the Act be interpreted as not applying to a secured creditor who has possession of or control over collateral before the appointment of the receiver pursuant to a security arrangement?

We believe that the consent provisions of Sections 210(c)(13)(C) and 210 (q)(1)(B) should not be interpreted as applying to a secured creditor who has possession of, or control over, collateral before the appointment of the receiver pursuant to a security arrangement, particularly in cases where ongoing performance of the obligation is impaired. Requiring FDIC consent in such situations, particularly where the expedited process for obtaining consent allows the FDIC as much as 90 days to consent, would tie up collateral and liquidity precisely when counterparties are most likely to need such liquidity. Such a rule would be further destabilizing in a financial crisis, as even secured creditors will be motivated to run from financial institutions that they perceive to be at risk of being subject to OLA, thereby precipitating the firm's downward spiral. We note that creditors under Title II are at much greater risk than they would be under the Bankruptcy Code because under Title II they do not enjoy a right to "adequate protection" while the stay is pending. An interpretation favoring liberal consent procedures is consistent with the FDIC's rule in bank insolvencies, where even creditors who are *not* in possession of collateral are able to exercise remedies upon a default during the 90-day stay period.[33] This interpretation is thus likely to be consistent with creditor and market expectations. At a minimum, creditors should have the advantage of a self-lifting stay of modest duration, as discussed in Question 16.

16. What, if any, additional provisions should be included in the Proposed Rule governing the treatment of secured claims and property that serves as security? Specifically, are there any additional provisions that are necessary or appropriate regarding obtaining consent from the receiver to exercise rights against the collateral, and the sale or redemption of collateral by the receiver? Should collateral be valued at the time it is surrendered, sold, or redeemed by the receiver, or some other time? Is it necessary to provide that after repudiation a security interest will no longer secure the contractual repayment obligation but will instead secure any claims for repudiation damages?

The proposed rules would require the FDIC to treat the portion of any claim that exceeds the fair market value of the collateral securing the claim as an unsecured claim. The proposed rules do not contain any express procedures for a secured claimant to seek judicial review of any disputes over the FDIC's determination of the fair market value of the collateral.

The proposed rules regarding both the sale of collateral by the FDIC and the redemption of property from the security interest should be expanded to contain express procedures for a secured claimant to seek judicial review of any disputes over whether the FDIC's sale was structured to receive, and did receive, the fair market value for the collateral and any disputes over the FDIC's determination thereof.

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[33] *See Advisory Opinion: Self-Help Liquidation of Collateral by Sec[ured] Claimants in Insured Depository Institution Receiverships* (FDIC-89-49) (Dec. 15, 1989); *see also Statement of Policy on Foreclosure Consent and Redemption Rights* (FDIC 5000-3100) (July 2, 1992) available at www.fdic.gov/regulations/laws/rules/5000-3100.html (favoring routine consent).

Proposed Section 380.51 provides that the FDIC may grant consent for secured creditors to take possession of, or initiate foreclosure proceedings against, the collateral securing their claims, but that the granting of such consent is entirely at the discretion of the FDIC. While the FDIC is to act "as expeditiously as possible" in such cases, we believe that a more specific deadline is appropriate. The FDIC should provide that any request for consent will be deemed granted at the end of 30 days unless it is granted sooner or denied within that time, with a reasonable explanation for the denial. This deadline would provide needed certainty to counterparties of a covered company and comports with bankruptcy law, which provides for lifting the automatic stay within 30 days of a creditor request, unless a judge denies such relief after a hearing. Furthermore, we ask the FDIC to commit to taking all reasonably necessary steps to preserve, maintain and insure collateral that falls under its control during the course of an OLA proceeding. In addition, we ask the FDIC to acknowledge that Section 210(c)(8)(A) creates special rules concerning the liquidation of collateral that secures qualified financial contracts and that the proposed rule will not be construed in a manner that interferes with this statutory scheme.

Regarding the timing of valuations, as we discuss more fully below at Question 17 and stated in our prior letters, we believe that the timing of the valuation of collateral should be tied to the purpose of the valuation. For secured creditors, it would be appropriate to value the collateral at the inception of a receivership for the purposes of determining any request for adequate protection. The value of the collateral should be assessed again at the time it is redeemed or disposed of, as the valuation may be unfairly depressed at the covered company's failure and the later valuation may more fairly reflect the value of the collateral.

Finally, though it is implicitly clear that a security interest, after repudiation of the underlying contract, ought to secure a claim of repudiation damages concerning the same contract, we feel that it is helpful to state this explicitly, as the proposed rule does at Section 380.52(a). We thus support the inclusion of this provision in the final rule.

17. What, if any, provisions should be changed or added to the expedited relief procedures for secured creditors who allege irreparable injury if the ordinary claims process is followed?

The requirement that the FDIC make a determination whether to allow or disallow a claim, or any portion thereof, or subject the claim to the normal administrative claims process within 90 days after such request for expedited relief is made is consistent with the statutory language in Section 210(a)(5) of the Act. However, it is difficult to see how a 90-day response period constitutes "expedited treatment" under the likely facts and circumstances, given how quickly collateral values can drop during a financial crisis, which is when Title II is most likely to be invoked. Something more along the lines of 24 or 48 hours would appear to be more consistent with the notion of expedited treatment under such facts and circumstances.

In addition to, or as a partial alternative to, super-expedited relief, the FDIC should adopt procedures allowing for the immediate provision of adequate protection for secured creditors, particularly those who will not be able to proceed against their collateral quickly. In

bankruptcy practice this provision is key to striking the appropriate balance between the needs of the estate, which might require the continued use of pledged assets in order to retain its going-concern value, and the needs of secured creditors, who require protection against the potentially irretrievable diminution of collateral value. Such protection is critical for convincing secured lenders to provide financing on appropriate terms. Secured credit might otherwise become less available, or secured creditors would be incentivized to craft hair-triggers to allow them to proceed against collateral shortly in advance of the commencement of insolvency proceedings. This latter possibility would be especially disruptive during times of market stress. We also recommend, as we discuss above at Question 16, that the FDIC enact provisions that concern the granting of consent to proceed against collateral and that reflect bankruptcy practice.

Additional Suggestion

We would like to draw the FDIC's attention to a technical issue in the drafting of the definition of the term "nonbank financial company" and to urge the FDIC to consult with the Federal Reserve to promulgate a solution. As we discuss above, a company must derive 85% of its revenues from financial activities to be considered for liquidation under OLA, and both the statute and regulations define financial activities by reference to Section 4(k) of the BHC Act and Regulation Y promulgated thereunder. Specifically, Section 4(k) and Regulation Y are meant to broaden, somewhat, the limited authority of BHCs to engage in lines of business beyond banking, narrowly defined, by identifying certain activities as financial in nature (or incidental thereto) and thus appropriate for BHCs. But many of these activities are not of obvious systemic significance to the financial system. A company that derives 85% or more of its revenue from providing management-consulting, check-courier, or website-security-certificate services[34] would be a nonbank financial company under the statutory and regulatory definitions applicable here but most likely an inappropriate candidate for enhanced supervision under Title I or FDIC liquidation under Title II. We believe that an explanation emphasizing the need for systemic importance in the Title II OLA context, similar to the emphasis placed on systemic importance in the Title I prudential-supervision context, would assure the market that these unexpectedly included companies will not be subject to OLA liquidation.

Conclusion

In conclusion, we would like to reiterate the three overarching principles that we believe should guide the FDIC (in consultation with the FSOC) when developing OLA rules in the months ahead. First, predictable, transparent, fair and well-integrated procedures must be established by the FDIC with respect to its OLA powers. Without unduly constraining its discretion and flexibility under OLA, the FDIC should provide a transparent framework in which it would exercise its judgment under Title II. Second, the substantive approaches and functional results pursued by the FDIC should, to the greatest extent practicable, reflect those that would apply

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[34] *See* 12 C.F.R. §§ 225.28, 225.86.

to a covered company under the Bankruptcy Code and, in all cases, work toward guaranteeing the Minimum Recovery. Any firm that is potentially subject to one of two conflicting or incompatible insolvency regimes is, ex ante, effectively subject to both at the same time, as customers, creditors and counterparties seek to structure their relationships to accommodate both sets of rules. Unless managed with utmost care, such a circumstance can easily lead to confusion, inefficiency, wasted resources, and destabilizing surprises at inopportune moments. Third, and finally, the regulations adopted under Title II must reduce, or at least not enhance, the likelihood of failure; reducing moral hazard and managing systemic risk must be complementary, not conflicting, activities.

In this light, we urge the FDIC to do the following:

(1) utilize publicly available financial information to determine whether a financial company is or is not subject to Title II to permit creditors to assess and manage their risks in dealing with financial companies,

(2) reject its proposed rule presuming incumbent officers and directors to be "substantially responsible" for the failure of a covered company,

(3) conform its procedural rules to the existing practice under the Bankruptcy Code by permitting collective action by creditors in certain proceedings, including those relating to the determination of the Minimum Recovery,

(4) limit the priority granted to claims of the United States to the group of claims granted priority by the Act, rather than expand those preferred claims to entities that are not actually agencies of the United States Government,

(5) determine the value of lost setoff rights, and the extent of the priority granted to a creditor harmed by such a loss, by reference to the time at which the right of setoff is lost, and further protect those creditors, consistent with the statute, by recognizing all setoff rights that could be exercised by such a creditor outside of a Title II proceeding,

(6) conform the post-insolvency interest rules to the practice in existence under the Bankruptcy Code by confirming the secured status of interest due to oversecured creditors and permitting unsecured creditors to utilize their contractual rate in calculating their claim to post-insolvency interest,

(7) permit collective actions by syndicate agents and other agents representing groups of creditors before the commencement of a Title II proceeding,

(8) provide notice to creditors through publication in widely recognized domestic and foreign publications and systems,

(9) permit secured creditors to exercise rights of self-help to the same extent as is permitted under the FDIA and establish a deadline by which the FDIC will act on requests of secured creditors for leave to exercise remedies (where that leave is required),

(10) refer to the procedures in existence under the Bankruptcy Code to determine when collateral will be valued for various purposes during a proceeding, and

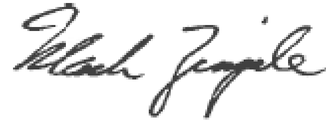
(11) otherwise continue to conform the proposed rules under Title II to those in effect under the Bankruptcy Code wherever not precluded under the Act.

The Clearing House, SIFMA the ABA and the Roundtable appreciate your consideration of the views expressed in this letter, and we welcome the opportunity to meet with you on an ongoing basis to discuss the issues raised by Title II. To that end, we have included, in Annex A, a list of selected topics that we believe to be of great importance and look forward to discussing with you. We believe that the understanding of the application of the new liquidation authority will continue to develop as the full range of entities and transactions that must be addressed by the new regime is worked through by regulators, creditors and other parties.

* * *

If you have any questions, please do not hesitate to contact The Clearing House, SIFMA, the ABA and the Roundtable by e-mailing or calling Mark Zingale (Mark.Zingale@TheClearingHouse.org / (212) 613-9812), Kenneth E. Bentsen, Jr. (kbentsen@sifma.org / (202) 962-7400), Wayne Abernathy (wabernat@aba.com / (202) 663-5222) and Brian Tate (brian@fsround.org / (202) 589-2417), respectively.

Very truly yours,



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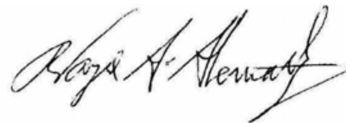

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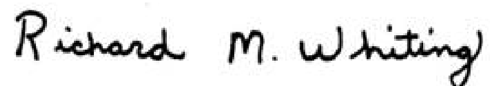

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The Clearing House Association Bank Regulatory Committee

The Clearing House Association Government and Legislative Affairs Committee

The Clearing House Association CFO Summit Committee

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ANNEX A

Selected Important Matters That Should Be Addressed by Further FDIC Rulemakings

1. How unsecured creditors will be assured due process, including the ability to challenge disputed asset valuations by the FDIC or failure by the FDIC to comply with its duties to maximize the value of a covered company for the benefit of its creditors, minimize losses to shareholders and creditors, and provide creditors with their minimum-recovery entitlement.

2. How customers and secured creditors will be assured adequate due process, including challenging, or allowing them to take actions to protect themselves against, any disputed asset or collateral valuations by the FDIC or any failure by the FDIC to segregate assets belonging to customers and secured creditors from assets available to satisfy the claims of unsecured creditors.

3. How the clawback rules in Section 210(o) would work in the case of creditors who receive additional payments from the FDIC or whose claims are assumed by a creditworthy third party or bridge financial company, if some creditors or claims of the same class do not or are not.

4. The relationship between the Title I "living wills" process and Title II OLA, including the extent to which a living will must ignore the possibility of OLA and focus exclusively on a winding up under the Bankruptcy Code and the extent to which living wills should be tailored to provide information that is specifically useful under Title II but less obviously useful in a bankruptcy context.

5. The status of the FDIC's efforts to coordinate Title II with international and foreign authorities; if an OLA proceeding is commenced, whether the FDIC's authority over, and management of, a covered company should be recognized and protected by relevant foreign authorities; the relevance of jurisdiction of incorporation or headquarters of the covered company; and the FDIC's (and other federal regulators') willingness to recognize a foreign special liquidation proceeding.

6. The FDIC's view regarding "bail-in" and contingent convertible capital instruments, including to what extent, and under what terms, such instruments can be a part of a credible living will, how the FDIC will manage these instruments during an OLA proceeding, and whether such a proceeding would be deemed to trigger their conversion even if, by their own terms, they have not been triggered by the time a proceeding begins.

7. Further procedures outlining the conduct of bridge entities, including commencement and termination of the bridge, management of the bridge during its operation, treatment of contracts between the bridge and third parties, and the process for

deciding which assets and liabilities are transferred to the bridge and which left behind in the receivership estate.

8. The need to develop a mechanism for determining the amount that would have been received by the various creditors in a Chapter 7 liquidation of the covered company, in order to assign a value to the Minimum Recovery, and the need to develop a timeline for making of such payments.

9. The relationship between the upfront payment mechanism under 12 U.S.C. 5390(b)(4), (d)(4), or (h)(5)(E), the assessment mechanism under the Act, and the Minimum Recovery; whether the FDIC will use its authority to borrow from the Treasury to fund Minimum Recovery payouts; how any assessments necessary to repay that borrowing will be timed, apportioned and funded; and whether Minimum Recovery payouts will be deemed "additional payments" for the purposes of the Section 210(o)(1)(D)(i) clawback.

10. The interaction between the Minimum Recovery rule and the FDIC's ability to transfer assets and liabilities to a bridge at its discretion, including whether transferred liabilities whose holders receive more than their Minimum Recovery will be deemed to have received "additional payments" for the purposes of the Section 210(o)(1)(D)(i) clawback.

11. The need for rules and procedures for coordinating between the liquidations of a bank and its nonbank affiliates (i.e., if the FDIC acts as receiver of more than one estate, how it will coordinate its multiple roles).

12. The status of efforts to develop regulations governing liquidation of broker-dealer subsidiaries of covered companies, in coordination with the SEC, to maintain investor confidence in these broker-dealers.

13. The need for clarification of application of QFC provisions to "cleared" derivatives and coordination with the CFTC rulemaking process for futures commission merchants.

14. The need for clarification regarding the treatment of custodial assets held by nonbanks in an OLA proceeding.

15. The impact of Title II on securitization, including the need for a conduit safe harbor in the context of the avoidable-transfer provisions.