



Americans for Financial Reform
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May 23, 2011

Hon. Sheila Bair, Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

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

Dear Ms. Bair:

American for Financial Reform (“AFR”) appreciates this opportunity to comment on the Notice of Proposed Rulemaking regarding Orderly Liquidation Authority. AFR is a coalition of over 250 national, state, local groups who have come together to advocate for reform of the financial industry. Members of the AFR include consumer, civil rights, investor, retiree, community, labor, religious and business groups along with prominent economists and other experts.

This rule implements elements of Title II of the Dodd-Frank Act, which gives the Federal Deposit Insurance Corporation (the “Corporation”) the authority to liquidate a failing covered financial company (CFC). The purpose of the orderly liquidation authority is laid out in Section 204(a) of the Dodd-Frank Act as follows:

“PURPOSE OF ORDERLY LIQUIDATION AUTHORITY.—It is the purpose of this title to provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard.”

The orderly liquidation authority includes the ability to recoup (“claw back”) compensation from managers who bear responsibility for the failure of the CFC. The goal of this claw back authority is further laid out in Section 204(a)(3):

“the Corporation and other appropriate agencies will 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.”

After the financial crisis of 2008, the public policy significance of reducing moral hazard in the financial sector, and the connection of this moral hazard to financial sector compensation practices, can hardly be doubted. The immediate cause of the financial crisis was the collapse of Bear Stearns and Lehman Brothers, which then revealed that other key financial institutions were likewise massively overextended and had taken unsustainable risks. A study by Harvard economists found that from 2000 to 2008 the five top executives of Bear Stearns and Lehmann had personally cashed in \$2.4 billion in performance-based

compensation (equity and bonuses), or \$240 million per executive.¹ None of this money has been repaid. Enormous amounts of performance-based compensation based purely on short-term performance, without any accountability for or tie to long-term outcomes encourages moral hazard, short-sightedness, and excessive risk-taking in the financial sector. As the non-partisan Financial Crisis Inquiry Commission stated in its conclusions on the causes of the crisis:

“Compensation systems—designed in an environment of cheap money, intense competition, and light regulation—too often rewarded the quick deal, the short-term gain—without proper consideration of long-term consequences. Often, those systems encouraged the big bet—where the payoff on the upside could be huge and the downside limited. This was the case up and down the line—from the corporate boardroom to the mortgage broker on the street.”

In implementing the claw back provisions of the orderly liquidation authority, the Corporation should be guided by the clearly stated public policy goals of the Dodd-Frank Act in reducing moral hazard in the financial system, as well as the overwhelming evidence that compensation systems at companies that failed and/or required government assistance during the financial crisis contributed to such moral hazard. In so doing, the Corporation should follow the directives in 204(a)(3) of the Dodd-Frank Act, which clearly states that all parties having responsibility for the condition of the failed CFC should bear losses consistent with their responsibility.

Furthermore, in weighing the economic consequences of the use of the claw back authority, the Corporation should be aware that compensation in the financial sector can very substantially exceed compensation in other sectors of the economy, thanks in part to the belief in implicit government guarantees. For example, the Council of Institutional Investors has found that during the 2003-2007 period, just prior to the most disastrous financial collapse since the Great Depression, median total compensation for Wall Street CEOs was two and half times (150 percent) higher than median total compensation for CEOs at Fortune 50 companies in the rest of the economy.² The claw back authority should be viewed as a necessary corrective to the economic externalities created by the ability of managers and employees of financial firms to profit excessively from short term risk-taking, enabled by creditors’ belief in potential government support for failing financial firms.

In sum, AFR believes the Corporation is justified in seeking a strong claw back authority, as this aligns with both the explicit statutory goals of the Dodd-Frank Act and the clear public policy need to address misaligned compensation incentives that was revealed during the financial crisis.

AFR Recommends that Section 380.7 of The Proposed Rule Be Strengthened To Meet The Statutory Purposes Laid Out For Resolution Authority

There are several parts of Section 210 of the Dodd-Frank Act that contain specific directives implementing the claw back authority. Sections 210(f) and (g) give the Corporation authority to pursue directors and officers for damages for gross negligence or other

¹ Lucian Bebchuk, Alma Cohen, and Holger Spamann, “The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000–2008,” Yale Journal on Regulation 27 (2010): 257–282.

² Lucian Bebchuk, Alma Cohen, and Holger Spamann, “The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000–2008,” Yale Journal on Regulation 27 (2010): 257–282.

intentional tortious conduct under state law. Section 210(s) gives the Corporation the authority to recoup compensation from any senior executive or director substantially responsible for the failed condition of the covered financial company. Section 210(s)(2) instructs the corporation to weigh the deterrent effect of such claw backs. This is a clear reference back to the purpose of the resolution authority in reducing moral hazard in the financial sector. Section 380.7 of the proposed rule implements Section 210(s) of the Dodd-Frank Act.

Section 210(s) is clearly meant to provide additional authority beyond the standard criminal liability in Section 210(f) and should be read in the light of the statement of purposes in Section 204(a). AFR is concerned that the current version of Section 380.7 of the rule may not fully implement these purposes.

In accordance with the Dodd-Frank Act, Section 380.7 limits claw backs to senior executives who bore “substantial responsibility” for the failed condition of the company. Section 380.7 lays out a presumption of substantial responsibility for those high-level executives who “had responsibility for the strategic, policymaking, or company-wide operational decisions of the covered financial company”.

However, managers at lower levels of the company – particularly those who trade or deal in risky financial instruments – could also bear some responsibility for the failure of a company. As stated in the conclusions of the Financial Crisis Inquiry Commission quoted above, there were serious moral hazard issues in Wall Street compensation systems “up and down the line -- from the corporate boardroom to the mortgage broker on the street”. This is especially true since traders, dealers, or salesmen at lower levels of the company can circumvent corporate policy, and because senior executives may not succeed in imposing limits that bind those below them. The recent Levin-Coburn report on the financial crisis described this situation at the failed Washington Mutual bank:

“[a]ny attempts to enforce [a] more disciplined underwriting approach were continuously thwarted by an aggressive, and often times abusive group of Sales employees within the organization.”

In light of this, AFR would favor a definition of ‘substantial responsibility’ that goes beyond the presumptive definition in section 380.7. This should include the establishment of quantitative benchmarks to establish whether a particular financial activity leading to a performance-based compensation award contributed to the failure of the company. For example, managers and executives in divisions or subdivisions of the company who did not have company-wide authority, but who oversaw activities that materially contributed to the failure of the company, should be subject to claw backs if the financial impact of their activities exceeds some threshold. Likewise, a trader or dealer who designed, sold, or purchased a large quantity of financial instruments that materially contributed to the failure of the company, and who received a significant amount of performance-based compensation for these activities, should have to repay some or all of this performance-based compensation. This should be true regardless of whether the individual was a ‘director’ or had company-wide authority.

This use of claw back authority would properly align incentives for attention to long-term risk throughout the company, and would fulfill the Dodd-Frank Act’s goals in addressing moral hazard in the financial sector. To avoid sweeping in employees who did not have sufficient decision making authority to have an impact, a quantitative threshold based on the company’s size or losses could be set for the level of total compensation and /or the total size of financial losses influenced by an employee’s actions that would render

compensation liable to claw back.

Sections 380.7(a)(1) and 380.7(b)(2) also state that the finding of substantial responsibility and eligibility for claw backs can be rebutted by a finding that the executive in question performed their duties with the “requisite skill and care”. AFR agrees that the Corporation should have the discretion not to take back compensation in cases where an employee was clearly not responsible for activities that led to company failure, or where the employee clearly tried to prevent such risky activities. Many examples have come to light of financial sector employees who forcefully raised internal concerns about risky practices.

However, the standard in the rule of “requisite skill and care” seems far too broad and vague. Routine levels of “skill and care” at a failed financial company subject to this provision were demonstrably not sufficient to prevent the company from failing and endangering the financial stability of the United States. Similarly, the routine levels of ‘skill and care’ exercised at major Wall Street firms prior to the 2008 financial crisis were deeply insufficient. As cited above, Section 204(a)(3) of the Dodd-Frank Act calls for the Corporation to take “ all steps necessary and appropriate to assure that all parties...having responsibility for the condition of the financial company bear losses consistent with their responsibility”. There should not be an easily available escape clause from this requirement.

Therefore, any exception should require that managers who earned large amounts of compensation for engaging in activities that led to the failure of a covered financial company demonstrate that their “skill and care” substantially exceeded the norm for their company, and that they made a strong and active effort to restrain imprudent practices at the failed company. We recommend that the Corporation redraft Sections 380.7(a)(1) and 380.7(b)(2) to make this higher standard clear.

We appreciate the opportunity to comment on the proposed rule. If you have any questions, please contact Marcus Stanley, the Policy Director at Americans for Financial Reform, at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,

Americans for Financial Reform

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

National Organizations

- A New Way Forward
- AARP
- Accountable America
- Adler and Colvin
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Family Voices
- American Income Life Insurance
- Americans for Democratic Action, Inc.
- American Sustainable Business Council
- Americans United for Change
- Business for Shared Prosperity
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Community Law Center
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute
- Good Business International
- Help Is On the Way, Inc
- HNMA Funding
- Home Actions
- Housing Counseling Services
- Information Press
- Institute for Global Communications

- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Keystone Research Center
- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- The Leadership Conference on Civil and Human Rights
- MoveOn.org Political Action
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Investment Professionals
- National Association of Neighborhoods
- National Coalition for Asian Pacific American Community Development
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Institute
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National People's Action
- National Council of Womens Organizations
- National Workright Institute
- Next Step
- OMB Watch
- Opportunity Finance Network
- Partners for the Common Good
- PICO
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Responsible Endowments Coalition
- Sargent Shriver Center on Poverty Law
- Scam Victims United
- SEIU
- Sojourners
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Carrots and Sticks Project
- The Fuel Savers Club
- The Seminal
- UNET
- Union Plus
- United for a Fair Economy
- U.S. PIRG
- Unitarian Universalist for a Just Economic Community
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Veterans Chamber of Commerce
- We The People Now
- Western States Center
- Woodstock Institute
- Working America

- World Business Academy
- World Privacy Forum

State Organizations

- 207 CCAG
- 9 to 5, the National Association of Working Women (CO)
- AARP Rhode Island
- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans for Responsible Lending
- Arkansas Community Organizations
- Arkansas Public Policy Panel
- Association for Neighborhood and Housing Development (NY)
- Audubon Partnership for Economic Development LDC (New York, NY)
- Aurora NAACP
- BAC Funding Consortium Inc. (Miami, FL)
- Beech Capital Venture Corporation (Philadelphia, PA)
- Bell Policy Center (CO)
- California PIRG
- California Reinvestment Coalition
- Center for Media and Democracy
- Center for NYC Neighborhoods
- Century Housing Corporation (Culver City, CA)
- Changer(NY)
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund (Chicago, IL)
- Chicago Community Ventures (Chicago, IL)
- Chicago Consumer Coalition
- Citizen Potawatomi CDC (Shawnee, OK)
- Club Change of Martin County (Florida)
- Coalition on Homeless Housing in Ohio
- Coffee Party of Pensacola, Florida
- Coffee Party of Union Square, New York City
- Colorado AFL-CIO
- Colorado Center on Law and Policy
- Colorado Immigrants Rights Coalition
- Colorado PIRG
- Colorado Spring NAACP
- Community Action of Nebraska
- Community Capital Development
- Community Capital Fund (Bridgeport, CT)
- Community Capital of Maryland (Baltimore, MD)
- Community Development Financial Institution of the Tohono O'odham Nation (Sells, AZ)
- Community Redevelopment Loan and Investment Fund, (Atlanta, GA)
- Community Reinvestment Association of North Carolina
- Community Resource Group (Fayetteville, AR)
- Connecticut Association for Human Services
- Connecticut Citizen Action Group
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (New York, NY)
- Cooperative Fund of New England (Wilmington, NC)
- Corporacion de Desarrollo Economico de Ceiba (Ceiba, PR)
- CWA 7777 (CO)
- Delta Foundation, Inc. (Greenville, MS)
- Economic Opportunity Fund (EOF) (Philadelphia, PA)
- Empire Justice Center (NY)
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing Enterprises, Inc. (Berea, KY)

- Fitness and Praise Youth Development, Inc. (Baton Rouge, LA)
- Florida Consumer Action Network
- Florida PIRG
- Forward Community Investments (Madison, WI)
- Funding Partners for Housing Solutions (Ft. Collins, CO)
- Georgia PIRG
- Grow Iowa Foundation (Greenfield, IA)
- Homewise, Inc. (Santa Fe, NM)
- Humanitas Community Development Corporation
- Idaho Chapter, National Association of Social Workers
- Idaho Community Action Network
- Idaho Nevada CDFI (Pocatello, ID)
- Illinois PIRG
- Impact Capital (Seattle, WA)
- Indiana PIRG
- Indiana University PIRG
- Information Press (CA)
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc. (Mayville, NY)
- Keystone Research Center
- La Casa Federal Credit Union (Newark, NJ)
- Low Income Investment Fund (San Francisco, CA)
- Long Island Housing Services NY
- MaineStream Finance (Bangor, ME)
- Maryland PIRG
- Massachusetts Consumers' Coalition
- Massachusetts Fair Housing Center
- MASSPIRG
- Michigan PIRG
- Midland Community Development Corporation (Midland, TX)
- Midwest Minnesota Community Development Corporation (Detroit Lakes, MN)
- Mile High Community Loan Fund (Denver, CO)
- Missouri PIRG
- Montana Community Development Corporation (Missoula, MT)
- Montana PIRG
- Mortgage Recovery Service Center of L.A.
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital (Trenton, NJ)
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City AIDS Housing Network
- Next Step (MN)
- NOAH Community Development Fund, Inc. (Boston, MA)
- Nonprofit Finance Fund (New York, NY)
- Nonprofits Assistance Fund (Minneapolis, MN)
- North Carolina Association of Community Development Corporations
- North Carolina PIRG
- Northern Community Investment Corporation (St. Johnsbury, VT)
- Northside Community Development Fund (Pittsburgh, PA)
- Ohio Capital Corporation for Housing (Columbus, OH)
- Ohio PIRG
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance (Charlottesville, VA)
- Rhode Island PIRG
- Rights for All People
- The Rocky Mountain Peace and Justice Center
- Rural Community Assistance Corporation (West Sacramento, CA)

- Rural Organizing Project OR
- San Francisco Metropolitan Transportation Authority
- Seattle Economic Development Fund dba Community Capital Development
- SEIU Local 105 (Colorado)
- SEIU Rhode Island
- Siouxland Economic Development Corporation (Sioux City, IA)
- Southern Bancorp (Arkadelphia, AR)
- TexPIRG
- The Association for Housing and Neighborhood Development
- The Fair Housing Council of Central New York
- The Help Network
- The Loan Fund (Albuquerque, NM)
- Third Reconstruction Institute (NC)
- V-Family, Inc.
- Vermont PIRG
- Village Capital Corporation (Cleveland, OH)
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty – Florida
- Washington Community Action Network
- WashPIRG
- Westchester Residential Opportunities Inc. NY
- Wigamig Owners Loan Fund, Inc. (Lac du Flambeau, WI)
- WISPIRG

Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Env. Planning
- Hayden & Craig, PLLC\
- The Holographic Repatterning Institute at Austin
- Mid City Animal Hospital (Phoenix, AZ)
- UNET