MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

May 27, 2011

Via Email Filing

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

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

Dear Mr. Feldman:

Managed Funds Association ("MFA")[1] appreciates the opportunity to respond to the questions and issues raised by the Federal Deposit Insurance Corporation (the "FDIC") in connection with its notice of proposed rulemaking (the "Proposed Rule") on the implementation of certain provisions in Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") providing an orderly liquidation authority (the "OLA") for financial firms whose failure threatens the financial stability of the United States. This letter supplements MFA's letters dated November 18, 2010, January 18, 2011 and March 25, 2011 (the "Prior Letters"), and, in particular, addresses certain questions and issues that the FDIC's new Proposed Rule raises.

I. Section 380.8 of the Proposed Rule

Section 380.8, as proposed, would address the criteria to be employed in determining whether a company is predominantly engaged in activities that are financial in nature and, hence, is potentially subject to the OLA. In Questions 6 and 7 posed in connection with the Proposed Rule, the FDIC asks if that Section should be limited to companies that (a) are eligible under the Dodd-Frank Act for designation as nonbank financial companies supervised by the Board of Governors (Question 6) and/or (b) are designated as systemically important under the Dodd-Frank Act (Question 7). We believe the answer to both questions should be yes.

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.9 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

As stated in our Prior Letters, we believe that the Bankruptcy Code has generally worked quite well over an extended period of time in corporate liquidations and reorganizations. Accordingly, the financial markets have developed substantial confidence in the bankruptcy system. Creditors and other financial participants have extensive experience with the bankruptcy process, which is governed by a well-developed statute (and rules) and well-established case law. The introduction of the OLA – an entirely new liquidation regime with a far more "bare bones" statute and a much less transparent process – has created and will continue to create huge uncertainty in the markets. Under these circumstances, as explained more fully in our Prior Letters, it is important that the OLA be employed sparingly and, in particular, only when doing so is essential to protect the overall financial markets. Limiting the companies that are potentially eligible for the OLA to those that are systemically important nonbank financial companies will create greater certainty, engender greater confidence in the scope of the OLA, and serve the purposes Congress had in mind when it enacted Title II of Dodd-Frank: creating an extraordinary liquidation authority to be used sparingly only in those situations when it is absolutely required to protect the country's financial markets.

II. Priority Afforded Unsecured Claims of the United States

Question 9 asks if the priority afforded "amounts due to the United States" should be limited to "obligations backed by the full faith and credit of the United States." We are not certain that we understand this question because the phrase "obligations backed by the full faith and credit of the United States" normally denotes a situation where the government is the debtor, not the creditor. In any event, we do think it important for the FDIC to construe the priority afforded unsecured claims for amounts due to "the United States" narrowly. Doing so will both further the general policy of treating unsecured creditors equally and help harmonize the OLA with the Bankruptcy Code, under which the priorities for any unsecured claims are construed narrowly precisely because of the overall goal of treating all unsecured creditors equitably.[2] In this regard, we agree with the FDIC's determination not to include amounts owed to government-sponsored entities within the class of priority claims for amounts due to "the United States" and would urge the FDIC otherwise to construe this priority narrowly so it does not extend to quasi-governmental bodies (*e.g.*, the priority would not cover amounts owed to the Pension Benefit Guaranty Corporation).

III. Administrative Expenses for Creditors That Make a Substantial Contribution

Question 8 asks if there is a need for a provision comparable to Section 503(b)(4) of the Bankruptcy Code, which grants administrative expense status to claims for fees of attorneys and accountants of a creditor that makes a "substantial contribution" in a bankruptcy case. We believe the answer is yes. We encourage the FDIC to expand the Proposed Rule also to provide for the possibility, in appropriate circumstances, of the payment from the estate of the expenses

[2] *See Begier v. IRS*, 496 U.S. 53, 58 (1990 ("Equality of distribution among creditors is a central policy of the Bankruptcy Code.").

of such a creditor itself, as an administrative expense, as provided in Section 503(b)(3) of the Bankruptcy Code.[3]

As stated in our Prior Letters, the FDIC will engender greater confidence in the system, and the actual results of liquidations under the OLA will likely improve, if creditors with major stakes in the liquidation are permitted and encouraged to participate actively in the liquidation proceedings. We therefore encourage the FDIC to permit the formation of creditors committees, with the potential for such committees to retain counsel and other professionals to work with the FDIC as receiver, and to obtain payment of the expenses (including professional fees) of the committees out of the estate. Similarly, we believe that it would encourage beneficial creditor participation in the process if provisions similar to Sections 503(b)(3) and (4) were included in the Proposed Rule. Adding such provisions would help harmonize the OLA with the Bankruptcy Code, one of Congress' stated goals.

IV. Subordinated Claims and Post-Receivership Interest.

Section 380.21 of the Proposed Rule provides a waterfall setting forth the priority in payment of unsecured claims. It generally provides that subordinated claims have ninth priority, and post-insolvency interest has tenth priority. Section 380.25, in turn, specifies that the interest rate for post-insolvency interest will be, for any quarter, the average discount rate on three-month Treasury bills. We suggest the FDIC consider amending the Proposed Rule to make clear that, notwithstanding these general provisions, subordination agreements will be enforced in accordance with their terms even when doing so could lead to a distribution waterfall, and the payment of interest at rates, different from those specified in these Sections.

Subordinated creditors often agree to subordinate their right to payment from the debtor only to the right to payment of certain specified senior creditors – not all creditors – but also agree that the subordination in favor of the specified senior creditors extends to interest payable to the senior creditors that accrues at the senior creditors' contract rate during any insolvency proceeding involving the common debtor. Thus, when there are two issues of bonds – senior and junior – the junior bonds frequently subordinate themselves only to the senior bonds, not to other unsecured creditors (*e.g.*, trade creditors) of the debtor, and also agree that the subordinated bondholders will not be entitled to retain any payments until the senior bondholders have received payment of all amounts owed to them under the terms of the senior bonds, including post-insolvency interest at the contractual rate specified in the senior bonds. The Bankruptcy Code provides that such subordination agreements are enforceable in bankruptcy to the same extent that they are outside of bankruptcy.[4] To give a simple example, assume that there is $100 million of senior bond debt, $100 million of junior bond debt, and $100 million of other unsecured debt. If the debtor files for bankruptcy, distributions on unsecured claims will generally be made assuming a total claims denominator of $300 million. The senior bondholders will be entitled to two-thirds of all distributions (*i.e.*, distributions on their $100 million in claims and also on the junior bondholders' $100 million in claims) until they have been paid in full,

[3] 11 U.S.C. § 503(b)(3) & (4).

[4] 11 U.S.C. § 510(a).

including post-petition interest at their contractual rate. This practice respects the contractual rights and obligations of the various classes of creditors.

We encourage the FDIC to amend the Proposed Rule to adopt a provision akin to Section 510(a) of the Bankruptcy Code and to make clear that it controls in the event of any inconstancy with Sections 380.21 and 380.25. Doing so will help harmonize the OLA with the Bankruptcy Code, give effect to the contractual bargains to which different classes of creditors agreed, and thereby foster confidence in the OLA.

Conclusion

MFA appreciates the opportunity to respond to the FDIC's questions on this crucial set of topics. We recognize the importance of the OLA and are committed to continuing to work with the FDIC as it develops rules to implement Title II of Dodd-Frank. If you have any questions regarding any of these comments, or if we can provide further information with respect to these or other regulatory issues, please do not hesitate to contact Stuart J. Kaswell or me at (202) 367-1140.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO