American Bankers Association
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By electronic delivery to:

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

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

FR Doc. 2010-26049

Dear Mr. Feldman;

The American Bankers Association (ABA)[1] appreciates the opportunity to comment on the second set of issues raised by the Federal Deposit Insurance Corporation's (FDIC) Notice of Proposed Rulemaking (NPR) to "implement certain provisions of its authority to resolve covered financial companies under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")."[2]

The ABA supports a robust process to ensure the orderly resolution of systemically important non-bank financial companies. We have long advocated the end of "too big to fail," including the market perception of its existence. A comprehensive resolution mechanism for non-bank financial institutions is essential to achieve this goal. Towards that end, we offer suggestions in Part I this letter on general principles that we believe should provide the foundation for any such resolution mechanism while raising specific issues in Part II and Part III that need to be clarified in the final rule.

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

[2] *Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.* 75 Fed. Reg. 64173 (2010) (to be codified at 12 C.F.R. pt. 380). The NPR relies on a bifurcated comment period, with the first set of responses due Thursday, November 18, 2010 and the second set due Tuesday, January 18, 2011.
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<u>Part I: Implementation of FDIC's Orderly Liquidation Authority - Clarity and Certainty is Paramount</u>

Within the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),[3] Congressional intent to have a bankruptcy-like process for resolving non-bank financial firms is explicit. Section 209 of Title II creates the mandate "to seek to harmonize applicable rules and regulations promulgated…with insolvency laws that would otherwise apply to a covered financial company."[4] It was the desire of Congress that traditional bankruptcy should serve as the basis of the orderly liquidation authority (OLA), and OLA should reflect bankruptcy practices and produce bankruptcy-like outcomes. The purpose of borrowing from bankruptcy to form the basis of OLA is to create a resolution regime bringing clarity and certainty to the marketplace, while providing a structure supporting the careful unwind of a complex financial company. If the resulting OLA structure lacks clarity and brings further uncertainty to routine transactions, then this uncertainty will be priced into credit decisions, resulting in an increased cost of funds, competitive imbalances, and restricted credit availability.

As the FDIC undertakes the task of developing specific proposals to implement the OLA, we ask that the FDIC keep the following principles in mind.

<u>OLA Resolution Should Have Bankruptcy-Like Outcomes</u>

For the substantial majority of financial company failures, traditional bankruptcy should be the default method of resolution. OLA should be invoked only when "such action is necessary for purposes of the financial stability of the United States…."[5] In practice, the OLA regulations should reflect the rationale and predictability of traditional bankruptcy. The market is comfortable with the knowable outcomes achievable through bankruptcy and, thus, OLA should endeavor to have bankruptcy-like outcomes for creditors and counterparties. Only when creditors can routinely predict outcomes will the OLA have the necessary clarity and certainty to be an efficient resolution tool and will distortions in the market caused by the resolution program be minimized.

<u>Collaboration Among Agencies Is Necessary for Certainty and Clarity in OLA Rulemaking and Implementation</u>

To avoid the unintended consequences of piecemeal rulemaking, the OLA should be developed within a comprehensive process involving the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Federal Reserve, and other relevant regulators with bank and non-bank oversight.

[3] 12 U.S.C. § 5301 (2010).
[4] 12 U.S.C. §5389 (2010). *Rulemaking; Non-Conflicting Law.*
[5] 12 U.S.C. §5386(1) (2010). *Mandatory Terms and Conditions for all Orderly Liquidation Actions.*

Clarity and certainty cannot arise from the disjointed implementation of a myriad of disconnected procedures and regulations. A collaborative rulemaking and implementation would allow the agencies to coordinate supervisory expectations to assure a consistent and efficient approach. The final product should be a comprehensive policy integrating the important elements of systemic risk regulation.

OLA Implementation Must Avoid the Perception of a Government Bailout

The implementation of OLA must be carefully executed to avoid the taint or even expectation of a government "bailout." Under Title II, all the financial companies identified as systemically important are subject to increased regulation, and the cost of OLA resolution is to some extent covered by industry assessments. Care should be taken to design and implement a program that convinces Congress, the administration, the media, and especially the public that an FDIC-managed resolution under OLA neither is a government bailout nor endangers taxpayer funds.

Part II: Responses to Questions Posed for November 18, 2010, Comment

The responses to the October 18, 2010, OLA proposal were bifurcated into two comment periods. The NPR posed specific questions for two concurrent comment periods of 30 and 90 days, ending November 18, 2010, and January 18, 2011, respectively. In ABA's November 18, 2010 response, we requested additional time to respond to questions regarding the definition of "long-term senior debt" (Question 1)[6] and valuation of collateral (Question 5).[7]

Definition of "Long-Term Senior Debt"

ABA recommends that the FDIC not adopt the rule defining long-term senior debt as proposed. It would be preferable to postpone defining long-term debt, short-term debt, and their treatment under OLA until the implications of the selected definition are well understood and the banking industry has a comprehensive understanding of OLA and how it will be implemented.

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[6] Question 1 for the November 18, 2010 comment letter. "Should long term senior debt be defined in reference to a specific term, such as 270 or 360 days or some different term, or should it be defined through a functional definition?" *Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.* 75 Fed. Reg. at 64179.

[7] Question 5 for the November 18, 2010 comment letter. "Under the Dodd-Frank Act, secured creditors will be paid in full up to the extent of the pledged collateral and the proposed rule specifies that direct obligation of, or that are fully guaranteed by, the United States or any agency of the United States shall be valued for such purposes at par value. How should other collateral be valued in determining whether a creditor is fully secured or partially secured?" *Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.* 75 Fed. Reg. at 64180.

As proposed, the differing treatment of long-term and short-term creditors creates incentives for investors to restructure their investments in order to secure a preferential creditor position under OLA resolution rules. As a result, the preferential treatment of short-term credit may drive up the cost of long-term credit and thus create incentives for banks to rely more on credit of shorter duration. Moreover, because each creditor understands which resolution regime offers the best outcome for the investment, long-term creditors may hesitate to invest in companies subject to OLA, while short-term creditors would prefer investing in OLA covered financial companies. It would be better if investment decisions were based upon economic factors rather than regulatory ones.

If the FDIC chooses to adopt a rule defining long-term debt, the rule could be limited to regulatory capital instruments or only apply to debt as defined by the remaining maturity. Limiting the definition to regulatory capital instruments would be a workable solution because these instruments commonly have a term of long duration and are intended to absorb losses. Alternatively, long-term senior debt could be defined by *remaining* maturity of more than 360 days, rather than defined by the term of maturity as of the date of issuance as proposed. Both of these options would avoid the unintended consequences described and avoid creating a perception of regulatory preference for short-term debt.

Valuation of Collateral

Adoption of a collateral valuation rule should be postponed pending a more detailed proposal and discussion with industry. From a creditor's perspective, the outcomes of the proposed OLA valuation regime needs to be fully understood before it can be adopted. Specifically, the banking industry needs to understand how OLA valuation will differ from valuation processes in bankruptcy, and how the possible outcomes will differ under OLA as compared to bankruptcy. A rule should not be approved until industry has time to consider and evaluate a detailed proposal describing a comprehensive valuation mechanism.

Part III – Responses to the Questions Posed for January 18, 2011

I. ***Additional Rulemaking.*** *What other specific areas relating to the FDIC's orderly liquidation authority under Title II would benefit from additional rulemaking?*

There are several areas where additional clarity and specificity are needed to bring certainty and stability the OLA resolutions.

Definition of "Essential Operations"

Guidance is needed to understand better the meaning of "essential operations" under OLA. FDIC insured financial institutions and potential creditors of OLA-covered financial companies require a clear definition of operations likely to be considered essential to the "implementation of the receivership or a bridge financial company."[8] Activities deemed essential should be identified prior to resolution to bring transparency to the resolution process and give potential creditors a clear understanding of the funds needed to maintain an OLA resolution to final wind down and the likelihood of recovery from the OLA resolution estate.

The examples given in the notice of proposed rulemaking (NPR) of essential operations are reasonable but may not reflect the complexity of a large multinational financial company. In addition to the "payment of utility and other service contracts and contracts with companies that provide payment processing services[,]" essential services may include the operations specified in the *Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System (Paper)*.[9] Proposed in 2003 in response to the post-September 11 risk environment, the interagency paper identified "business continuity objectives…[and] sound practices to ensure resilience of the U.S. financial system, which focus on minimizing the immediate systemic effects of a wide-scale disruption on critical financial markets."

There are significant similarities in the activities identified as essential in the Paper and NPR. Both identify clearing, settlement, payments activities, and back-office operations as essential. However, the Paper goes further to include back-up sites and data centers as well as staffing redundancy and routine testing of back-up facilities as essential. Of particular importance is whether the sale of retail products and the conduct of trading activities will be identified as essential under OLA. A strong argument can be made that these activities, although excluded in the Paper, are likely essential under OLA (and thus could require long-term funding from the resolution estate to maintain) to maximize the company's sale value as a "potentially valuable business operation[.]"[10] Considering the Dodd-Frank Act's mandate to "maximize the value of assets"[11] and the need of creditors to predict the likelihood of recovery, it is important that the FDIC provide further guidance on how these activities would be treated in resolution, which of these activities would be identified as essential, and whether the activities would be transferred into a bridge company.

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[8] *Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.* 75 Fed. Reg. at 64177.

[9] *Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System* (2003). Fed. Reserve Doc. No. R-1128. U.S. Depart. Of Treas. Doc. No. 03-05. Securities and Exchange Commission (SEC) Release No. 34-47638; File No. S7-32-02.

[10] The FDIC has similar authority under the Federal Deposit Insurance Act to "to continue operations after the closing of failed insured banks if necessary to maximize the value of assets…" *Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.* 75 Fed. Reg. at 64177.

[11] *Id.*

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International Coordination

The financial institutions that are most likely to be subject to OLA resolution are probably large, complex, multinational corporations with global operations. Of particular concern to such institutions is how the FDIC will collaborate with foreign regulators "so that cross-border operations of the covered financial company can be liquidated consistently, cooperatively, and in a manner that maximizes their value and minimizes the costs and negative effects on the financial system."[12] Such agreements will have an acute affect on internationally active financial institutions, and thus they are particularly interested in the details that will govern the FDIC's control of foreign assets and winding down of foreign operations. Increased transparency and cooperation with the banking industry is crucial as the FDIC moves towards cross-border resolutions and develops a framework for shared supervision.

II. ***Harmonization with Insolvency Laws.*** *Section 209 of the Dodd-Frank Act requires the FDIC, "to the extent possible" to harmonize applicable rules and regulations promulgated under this section with the insolvency laws that would otherwise apply to a covered financial company. What are the key areas of Title II that may require additional rules or regulations in order to harmonize them with otherwise applicable insolvency laws?*

The harmonization of OLA with existing insolvency laws, particularly the Bankruptcy Code, is of paramount importance to bring clarity and certainty to the proposed resolution process.

Valuation of Collateral

The OLA valuation rule need not mirror the bankruptcy code in text, but should reflect the bankruptcy code in outcome. Creditors will find certainty and clarity in valuation procedures that produce similar outcomes whether resolved through traditional bankruptcy or under OLA. A valuation rule designed to parallel bankruptcy outcomes should incorporate bankruptcy-like rules, such as:

- Relying on fair market value for valuation of US government securities as collateral;
- Allowing credit bids from secured creditors when FDIC valuation is believed to be too low; and

[12] 75 Fed. Reg. at 64177.

- Creating an administrative remedy for creditors to dispute an OLA outcome on the grounds that, contrary to Section 210(d)(2)(B), creditors received less than they would have received under Chapter 7 of the Bankruptcy code.[13]

Valuation in bankruptcy is a complex process guided by precedent and well-understood procedures. Before an OLA valuation rule can be adopted, industry needs a bankruptcy-like comprehensive rule addressing common aspects of collateral valuation. Among the specific questions that should be answered in an OLA valuation rule are:

- Is a creditor obligated to sell collateral to the FDIC? May the creditor opt to take possession of collateral and sell it?

- If collateral is sold to a bridge company or third party, does the creditor merely receive the proceeds of the sale? Or is the creditor guaranteed to receive the full value of the collateral, even when the sale price was less than full value? If full value is guaranteed, which party covers the difference between a low sale price and a full price valuation?

- If a creditor can sell the collateral, which valuation determines the creditor's residual unsecured claim, the valuation or the sale price?

- When is collateral valued? Upon appointment of the FDIC as OLA receiver? Or, when collateral is liquidated?

- What are the limitations of the FDIC's discretion to pay claims and dividends? How will similarly situated creditors receive Chapter 7-like recovery if the FDIC is not obligated to set aside reserves to assure claimants are treated similarly?

- Will the FDIC implement procedures to preserve collateral similar to a removal of stay under the Bankruptcy Code? What process is available to creditors to compel the preservation of value if collateral is deteriorating?

Securitization Transactions

Under the rule as proposed, the FDIC can avoid secured transfers under the applicable Uniform Commercial Code. For insured depository institutions, there is a safe harbor for securitized transactions developed under the *Securitization Rule*[14] of the Federal Deposit Insurance Act.[15]

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[13] Section 210(d)(2)(B) (codified at 12 U.S.C. 5390(d)(2)(B)) of the Dodd-Frank Act "requires that all creditors of a class must receive no less than what they would have received in a case under Chapter 7 of the Bankruptcy Code." 75 Fed. Reg. at 64177.

[14] *12 C.F.R. § 360.6(f) added at 65 Fed. Reg. 49191, August 11, 2000, effective September 11, 2000; amended at 74 Fed. Reg. 59068, November 17, 2009.* "The FDIC shall not seek to avoid an otherwise legally enforceable securitization agreement or participation agreement executed by an insured depository institution solely because such

A preferred treatment for non-bank financial companies, which do not have a transaction safe harbor, would be to allow securitization transactions to be completed under an OLA rule mirroring the treatment of these transactions under the Bankruptcy Code.

Insomuch as the rationale for the safe harbor is specific to insured depository institutions that have access to and are assessed to support the DFI, only these institutions should have the regulatory safe harbor. Bank securitization transactions that fulfill safe harbor conditions are not be subject to the FDIC's "authority to disaffirm or repudiate contracts to reclaim, recover, or recharacterize as property of the institution or the receivership…."[16] The creation of these enhanced safe harbor conditions was rationalized as necessary "to protect the Deposit Insurance Fund…and the FDIC's interests…by aligning the conditions for the safe harbor with better and more sustainable securitization practices by insured depository institutions…."[17] The FDIC safe harbor created for bank transfers of assets is inappropriate and unjustified for non-bank financial companies and should not be extended to such companies under the OLA rules.

III. ***Setoff.*** *What are the key issues that should be addressed to clarify the application of the setoff provisions in section 210(1)(12)? How should these issues be addressed?*

Under § 210(a)(12)(F) of the Dodd-Frank Act, the FDIC has the authority to transfer assets and destroy a creditor's setoff rights. In comparison, a creditor has superior rights under the Bankruptcy Code where setoff is treated similarly to a secured creditor and cannot be destroyed by sale or transfer. As mentioned previously, creditors would benefit from the certainty provided by OLA regulations that have outcomes similar to the Bankruptcy Code.

As proposed, banks are concerned about the potential detrimental effect of setoff rights under Title II. For purposes of accounting and regulatory capital, uncertain setoff may result in increased capital requirements for covered financial institutions and their creditors. These restrictions also may prove detrimental to U.S. financial institutions participating in clearing and trading systems that require enforceable setoff rights in resolution.

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agreement does not meet the "contemporaneous" requirement of sections 11(d)(9), 11(n)(4)(I), and 13(e) of the Federal Deposit Insurance Act (12 U.S.C. 1821(d)(9), (n)(4)(I), 1823(e)."

[15] *Final Rule on Treatment by the FDIC as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation After September 30, 2010.* 75 Fed. Reg. 60289 (2010).

[16] *Id.* at 60287.

[17] 75 Fed. Reg. 60287.

IV. ***Payments to creditors "similarly situated".*** *Section 210(b)(4), (d)(4), and (h)(5)(E) address potential payments to creditors "similarly situated" that are addressed in this Proposed Rule. Are there additional issues on the application of this provision, or related provisions, which require clarification in a regulation?*

The OLA mechanism is shaped by an overriding emphasis on maximizing value and minimizing losses. This standard is articulated in §210(b)(4) of the Dodd-Frank Act, giving the FDIC authority to "pay certain creditors of a receivership more than similarly situated creditors"[18] if necessary to maximize value and minimize losses. Specifically, the statute states that the FDIC must first determine that inequitable treatment of similarly situated creditors is necessary:

(i) to maximize the value of the assets of the covered financial company;…
(iii) to maximize the present value return from the sale or other disposition of the assets of the covered financial company; or
(iv) to minimize the amount of any loss realized upon the sale or other disposition of assets of the covered financial company….

A fundamental point that needs to be made is that the existence of this provision is prone to perpetuating the market perception of the continuation of too-big-to-fail, that is, that government action will result in more favorable treatment for creditors of firms subject to OLA than for creditors of firms that are not likely to be subject to it. The FDIC should take steps that convince market participants that such unequal treatment will be unavailable in practice. Instead, the proposal preserves that very likelihood, to the probable market disadvantage of firms not considered by the market as being candidates for OLA coverage.

In the context of the preservation of that feature of too-big-to-fail, further clarification is needed as to how the FDIC will operate under a "maximizing value" standard and how the FDIC will determine if value has been maximized. In addition to the needed clarification, the OLA regulation should establish an appeal process for creditors and other parties if there is a disagreement as to whether value has been maximized or if actions in receivership threaten to undermine the value of the receivership estate or bridge company.

Of particular interest to the banking industry is whether OLA resolutions will operate under the same "least cost" standard that guides the non-OLA resolution of FDIC-insured financial institutions. The application of such standard should be open to independent verification. Historically, the FDIC has sought to maximize value in receivership under a "least cost" framework that adheres to the principle of "first loss is best loss." Title II does not create a similar restriction for OLA resolutions, but rather encourages maintaining assets through transfer to a bridge company to facilitate a methodical winding down of operations.

[18] *Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.* 75 Fed. Reg. at 64177.

ABA has advocated for a similar long-term approach to non-OLA bank resolutions where appropriate to result in least cost more broadly measured, which is with all factors and consequences of FDIC action taken into account in the evaluation. This is especially important for the management of hard assets in a price-depressed market.[19] Considering the size of the institutions subject to OLA-resolution, the FDIC should consider extending the short-term management of assets and operations to hard assets, real estate, and non-bank branch improvements. When vacant properties saturate the market and credit is tight, a quick sale of hard assets at distressed prices may overwhelm the market, further depress values, and result in even greater losses to the FDIC. Rather than quickly moving real estate to public auction, it may be prudent in OLA resolutions to retain these assets within the institution's portfolio or by transfer to a bridge company for a period of up to twelve months prior to sale. Short-term management of hard assets, with the goal of relieving downward pressure and stabilizing prices, may result in higher sale prices fully consistent with the Title II obligation to maximize value and minimize losses.

Corporate Governance

Under §210(h)(2)(F) of the Dodd-Frank Act,[20] the FDIC may regulate the corporate governance of bridge financial companies. The FDIC should promulgate rules with the goal of bringing clarity and certainty to potential counterparties. Specifically, the rules should address a bridge company's corporate authority and how transactions will be managed if the bridge company is liquidated before a transaction is concluded. These corporate governance rules will reduce the lingering uncertainty about the implementation of the Dodd-Frank Act and assist the recognition of bridge companies as robust market participants.

V. ***Contingent Obligations.*** *Regarding actual direct compensatory damages for the repudiation of a contingent obligation in the form of a guarantee, letter of credit, loan commitment, or similar credit obligation, should the Proposed Rule be amended to specifically provide a method for determining the estimated value of the claim? In addition to the statutory considerations in valuation, including the likelihood that the contingent claim would become fixed and its probable magnitude, what other factors would be appropriate? If so, what methods for determining such estimated value would be appropriate? Should the regulation provide more detail on when a claim is contingent?*

[19] *See* ABA letter to Mr. Mitchell Glassman, Director, Division of Resolutions and Receiverships, FDIC (June 30, 2009).
[20] 12 U.S.C. 5390(h)(2)(F).

Letters of Credit

The rule as proposed offers an improvement over current bank resolution practices by recognizing (1) perfected security interests up to the amount of the claim if the claim is unknown at the time of failure, and (2) contingent claims placed on collateral post-failure. Post-failure claims are common because a letter of credit (LOC) remains outstanding for the account of the applicant bank or customer throughout the duration of the LOC.

Collateralized LOCs are essential to the efficient operation of domestic markets and global trade. Banks underwrite small business credit risk and issue LOCs for trade transactions, guarantees, and bid and performance bonds. These extensions of credit and guarantees allow small businesses to participate fully in international and domestic commerce in markets where a company's small size may be perceived as too risky but for the security provided by a bank LOC backed by pledged collateral.

Applicant banks are willing to collateralize LOCs with cash, but issuing and confirming banks are reluctant to issue LOCs – despite the offer of collateral – due in part to the FDIC's "claw back" receivership practices. As a result, small businesses miss business opportunities because they are unable to post local performance guarantees based upon a standby LOC.

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

Sincerely,

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Senior Counsel