February 24, 2011

By electronic submission to www.fdic.gov

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

Re: Interim Final Rule Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**")

FR Docket No. 2011–1379

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] welcomes the opportunity to comment on the Interim Final Rule issued by the FDIC on January 25, 2011,[2] to implement certain provisions of the orderly liquidation authority contained under Title II of Dodd-Frank Act (the "**Interim Final Rule Release**").[3]

As we noted in our comment letters to the FDIC dated November 18, 2010 (the "**SIFMA 30-Day Comment Letter**") and January 18, 2011 (the "**SIFMA 90-Day Comment Letter**"), SIFMA believes that the new orderly liquidation authority in

[1] 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.

[2] Federal Deposit Insurance Corporation, Interim Final Rule Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 *Fed. Reg.* 4207 (Jan. 25, 2011).

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

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Title II of the Dodd-Frank Act is one of the most important new tools in the U.S. regulatory toolbox. In order for this new authority to work properly, the FDIC will need to issue rules and regulations that convince the market that Title II will be exercised in a consistent, transparent and predictable manner that strikes the right balance among preserving or restoring financial stability, maximizing the value of the enterprise, minimizing shareholder and creditor losses, preserving equal treatment among similarly situated creditors and maximizing market discipline.

Please see Annex A for our responses to the specific questions posed in the Interim Final Rule Release.

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SIFMA thanks the FDIC for the opportunity to respond to the FDIC's request for comments. If you have any questions, please do not hesitate to call me at 202-962-7400, or SIFMA's counsel, Randall D. Guynn, Davis Polk & Wardwell LLP, at 212-450-4239.

Sincerely,

Kenneth E. Bentsen, Jr.
Executive Vice President, Public Policy and Advocacy
Securities Industry and Financial Markets Association

Annex A

Solicitation for Comments on the Orderly Liquidation Authority

Questions on the FDIC Interim Final Rule with 60-Day Comment Period (by March 28, 2011)

1. Are there additional ways to reduce moral hazard and increase market discipline and to clarify that all creditors should assume that they will receive no additional payments and their recovery will be limited to what will be paid according to the order of priorities established under section 210(b)?

We strongly support the FDIC's efforts to reinforce market discipline and minimize moral hazard by trying to persuade the shareholders and creditors of a nonbank financial company that the FDIC will use its new authority in a manner that ensures they will ultimately bear any and all losses of the company's failure and will not be bailed out of those losses by ultimately shifting them to taxpayers. No institution should enjoy a funding advantage because the market believes it is too big or interconnected to fail.

However, the FDIC needs to balance its regulations and public statements on market discipline and moral hazard with equally prominent pronouncements about how it will use its new authority to achieve the other goals of Title II.

The purpose of Title II is to provide a means of liquidating a nonbank financial company in a manner that ***not only*** reinforces market discipline, minimizes moral hazard and eliminates taxpayer bailouts, ***but also*** achieves the following goals:

- maximizes the value of the company, avoids value destruction and preserves its going concern value for the benefit of its creditors and other stakeholders;
- minimizes shareholder or creditor losses;
- preserves equal treatment among similarly situated creditors, unless absolutely necessary to preserve or promote financial stability and reduce the risk of a substantial destabilization or collapse of the financial system; and
- minimizes the systemic risk of a contagion that could result in a substantial destabilization or even a collapse of the financial system and the social costs that would flow from such a systemic destabilization or collapse.

The FDIC has proposed and issued regulations and otherwise made repeated public statements confirming its resolve to exercise its new authority in a manner that reinforces market discipline and minimizes moral hazard by imposing all of the losses of a failed institution on its shareholders and creditors rather than allowing them to escape those losses through a taxpayer bailout. However, the FDIC needs to

balance those pronouncements with equally prominent pronouncements about how it will use its new authority to achieve the ***value maximization*** and ***financial stability*** goals of the statute in order for its statements on market discipline and moral hazard to be effective.

One reason is that the market knows that the Treasury Secretary is not lawfully permitted to appoint the FDIC as receiver of a failed nonbank financial company unless the Secretary is able to determine that:

- the liquidation or reorganization of the company under the Bankruptcy Code or other applicable insolvency law "would have serious adverse effects on financial stability in the United States;" ***and***

- the use of Title II by the FDIC "would avoid or mitigate such adverse effects."

Unless the FDIC articulates how it would use its new authority to do a better job than the Bankruptcy Code to "avoid or mitigate" the "serious adverse effects on financial stability" that a liquidation or reorganization under the Bankruptcy Code would cause, the Treasury Secretary will have no lawful basis for appointing the FDIC as receiver under Title II.

Title II is not self-executing, but instead gives the FDIC wide discretion over how its powers are used. Unless the FDIC articulates how it would exercise that discretion to do a better job than the Bankruptcy Code in preventing a destabilization of the system, the market will not believe that the Treasury Secretary will have any lawful basis for appointing the FDIC in the event of a failure. If the market does not believe the FDIC could lawfully be appointed, then the FDIC's statements about how it will use its new authority to reinforce market discipline and avoid moral hazard will not be effective.

Worse, the lack of such balancing statements, combined with the FDIC's statements about market discipline and moral hazard, could actually make taxpayer bailouts more likely by increasing the risk of a total collapse of the financial system during a financial panic like the one that occurred in the Fall of 2008. If creditors throughout the system fear that Title II might be invoked unlawfully and they could be worse off in a liquidation under Title II than a liquidation or reorganization under the Bankruptcy Code, they will run for the exits even earlier at the first sign of trouble at a major financial institution during a financial crisis. Such an accelerated run throughout the system could increase the likelihood and accelerate the destabilization or collapse of the financial system. This increased risk of a collapse could make a taxpayer bailout more likely to avoid the massive social costs of a total collapse of the financial system.

2. Subsection 380.2 precludes any ''additional payments'' under the statute to holders of long term debt, which is defined as debt with a term in excess of 360 days. What are the positive and negative consequences that this may have for market stability? What effect might this have on long term debt and its role in funding for financial companies? Is additional flexibility needed? Are there additional ways to counteract any impression that shorter term debt is not at risk? Does using a term of 360 days adequately distinguish longer term from shorter term debt? Should a different period be used?

As stated in our comment letter dated November 18, 2010, we believe that the FDIC should withdraw Rule 380.2(b). We believe the FDIC should not impose an absolute prohibition on making payments or credits to the holders of any particular class of claims or impose special FDIC Board approval requirements on exercising any of the statutory authorities given to the FDIC to make payments or credits to anyone if necessary to preserve or restore U.S. financial stability during a financial panic. While we believe that the FDIC should preserve the equal treatment of similarly situated creditors unless absolutely necessary to preserve or restore financial stability, we believe that the rule, as proposed, could unduly interfere with the FDIC's ability to exercise its powers in a manner that strikes the right balance among financial stability, value maximization, loss minimization, creditor fairness and market discipline. If such payments or credits could stem a run by creditors or keep liquidity flowing during a financial panic, the FDIC should preserve the option to make them.

We also believe that making a sharp distinction between long-term and short-term creditors could have unintended and even unforeseen adverse consequences on the market. These might include creating incentives for investors to restructure their investments to fit within the short-term category or distortions in the cost of long-term credit upward and the cost of short-term credit downward.

At a minimum, the FDIC should limit the absolute prohibition to regulatory capital instruments. Such instruments are, by definition, expected to absorb losses, and the holders of such instruments have almost no ability to run because of the perpetual or very long-dated nature of their instruments. Such a more limited prohibition also seems more consistent with the text of Title II, which provides that the only liabilities that may not be assumed by a bridge financial company are liabilities that count as regulatory capital.[4]

[4] *Id.* § 210(h)(1)(B)(i).

The FDIC should also clarify that the rule would not prohibit the FDIC from taking either of the following actions:

- making any payments or credits to any creditors, as long as such payments or credits are consistent with the equal treatment of similarly situated creditors; or

- taking any other action under the statutory provisions that give the FDIC discretion to depart from the general rule of equal treatment for similarly situated creditors, including transferring any claims to a viable third party or bridge financial company, as long as the FDIC makes no payment or credit.

The FDIC needs to preserve its discretion to take these other actions to the extent necessary to strike the appropriate balance among financial stability, value maximization, loss minimization, equal treatment of similarly situated creditors and market discipline.

3. What additional guidelines would be useful in creating certainty with respect to establishment of fair market value of various types of collateral for secured claims?

As stated in our comment letter dated November 18, 2010, if any secured creditor disagrees with the fair market value of its collateral as determined by the FDIC, the secured creditor should have the right to credit bid for the collateral up to the face amount of the claim. If the right to credit bid is exercised, the creditor's claim would be reduced by the amount of the credit bid, whereupon the FDIC would be required to turn the collateral over to the creditor. The option to credit bid gives the secured creditor an important protection from a valuation of the collateral at an amount that the secured creditor believes to be insufficient. This option would be consistent with the FDIC's duty under Section 209 to harmonize Title II with established practices under the Bankruptcy Code. It will also create greater certainty and fundamental fairness, and avoid any potential violations of the Takings Clause of the Fifth Amendment to the Constitution, in carrying out this aspect of Title II.

4. Should the date of appointment of the receiver be used as the valuation date for all types of collateral, or only government securities or other publicly traded securities?

Rather than mandate by rule that the valuation would occur at the time of the appointment of the receiver, which may result in "bottom of the market" valuations, we believe that the timing of the valuation of collateral should be consistent with the rules under the Bankruptcy Code.

Under Section 506(a) of the Bankruptcy Code, the value of the secured and unsecured portions of a claim "shall be determined in light of the purpose of the

valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest."[5] In practice, the valuation for purposes of distributions will generally be measured at the confirmation hearing with the intention of valuing the collateral as of the effective date of the plan.[6]

For purposes of Title II, we believe that the value of the collateral should be the higher of the value at the date of the appointment of the receiver and the date of the sale or other disposition of the collateral by the FDIC as receiver. This will allow the secured creditor to reap the benefit of any appreciation in value between the appointment of the FDIC as receiver and the ultimate disposition of the collateral. It will also assure creditors that they will not suffer due to any depreciation in value during the period of the receivership, due to mismanagement or otherwise. Such a rule would be market stabilizing, by eliminating any incentive for secured creditors to pull their collateral and their credit at the first sign of weakness at an institution that may be subject to Title II. It would also be consistent with the minimum recovery right and the treatment of secured creditors under the Bankruptcy Code, which provides that (i) as a condition to the use of their collateral, secured creditors are entitled to receive adequate protection to protect them from any diminution in value of the collateral during the bankruptcy case, and (ii) in connection with a sale by the debtor of the collateral or for purposes of determining distributions under a plan, the secured creditor benefits from any increase in the value of the collateral up through the date of determination.

5. Who should receive the benefit or burden of market fluctuation between the date of appointment of the receiver and the date of payment of a claim? For example, if a claim is for $100, and the collateral is valued at $98 on the date of appointment of the receiver, and at $102 at the date of payment of the claim, should the claimant receive $98 plus an unsecured claim of $2, should they receive the full value of their secured claim of $100, or should they receive the full value of the collateral, i.e., $102?

Under the Bankruptcy Code, generally speaking, the secured creditor reaps the benefit of any appreciation in value between the filing and the effective date of a plan. So, in the example provided here, if the claim is for $100, the collateral is valued at $98 on the date of the appointment of the receiver, and at $102 at the date of payment of the claim, in bankruptcy, the secured claimant would have a secured claim for $100 plus interest and fees, costs or charges (provided for under the agreement or state statute) up to $2,[7] and a possible unsecured claim for fees, costs or charges in excess of $2.

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[5] 11 U.S.C. § 506(a).

[6] 11 U.S.C. § 1129(b)(2(A)(II) ("With respect to a class of secured claims, the plan provides … that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property.").

[7] 11 U.S.C. § 506(b).

Under the minimum recovery right, the result under Title II should be the same as the result in a liquidation under Chapter 7 of the Bankruptcy Code.

Furthermore, the concept of adequate protection under the Bankruptcy Code is designed to ensure that the secured creditor does not suffer any loss due to any depreciation in value during the bankruptcy case. A bankruptcy court is required to grant a secured creditor relief from the automatic stay to enforce remedies against its collateral if, *inter alia*, the secured creditor's interest in the collateral is not adequately protected (i.e., an oversecured creditor is at risk that the value of the collateral will fall below the amount of the claim or an undersecured creditor is at risk that the value of the collateral will fall at all).[8] Examples of the typical forms of adequate protection include cash payments and additional and replacement liens.[9]

Therefore, if the hypothetical were reversed such that the secured claim is for $100, the collateral is valued at $102 on the date of the appointment of the receiver, and at $98 on the date of the payment of the claim, in bankruptcy, absent adequate protection the secured creditor would suffer this downside risk and receive a secured claim for $98 and a deficiency claim for $2 (possibly plus fees, costs and charges). However, any adequate protection that was provided to the secured creditor is designed to ensure that this creditor would receive payment in full regardless of the aforementioned diminution in value of the collateral (i.e., either through the receipt of adequate protection cash payments or realization on the additional or replacement liens, or to the extent the adequate protection turned out to be insufficient, then through the creditor's deficiency claim, which would have statutory priority over all other administrative expenses).[10]

In sum, the collective design of various provisions of the Bankruptcy Code is that a secured creditor should be protected from any diminution in the value of the collateral and should benefit from any increase in the value of the collateral post-filing. This can be thought of as the cost to the estate of having the benefit of using the collateral during the bankruptcy case.

The resulting protection of secured creditors in bankruptcy should be the result under Title II as well. Otherwise, secured creditors will fear a worse outcome under Title II than in bankruptcy, and will have an incentive to pull their collateral and their credit even earlier if there is a risk that Title II could replace the Bankruptcy Code, thereby having a greater destabilizing effect than the Bankruptcy Code.

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[8] 11 U.S.C. § 362(d).

[9] 11 U.S.C. § 361.

[10] 11 U.S.C. § 507(b).

6. Should the FDIC designate a specific time during the term of the receivership to estimate contingent claims?

The Bankruptcy Code does not provide a time for contingent claims to be estimated, but rather contemplates estimation when the fixing or liquidation of the claim would "unduly delay the administration of the case."[11] We therefore do not support specifying a time to estimate contingent claims. We note that if the FDIC designates a short time period for estimating contingent claims, then the claimant could potentially receive less than it would have under the Bankruptcy Code, thereby violating its minimum recovery right. Also, it is probable that more information regarding the likelihood and magnitude of the contingencies will materialize over time. Conversely, if the FDIC designates a long time period, then the claimant should have the right to petition to have the claim estimated sooner in order to assess its exposure.

In either case, as we noted in our comment letter dated November 18, 2010, the interim final rule should be revised to clarify that if the contingent claim becomes fixed before final distributions are made to creditors generally, the fixed amount should be the relevant amount rather than any estimate. This will discourage the receiver from estimating the contingent claim early at an artificially low value and would be consistent with the rules applicable in bankruptcy, which allow a claimant to petition for a reconsideration of the estimation "for cause … according to the equities of the case." [12]

[11] 11 U.S.C. § 502(c).

[12] 11 U.S.C. § 502(j).