MEMO# 25042

March 23, 2011

FDIC Proposes to Implement Additional Orderly Liquidation Authority Provisions of Dodd-Frank Act

[25042]

March 23, 2011

TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 17-11
FIXED-INCOME ADVISORY COMMITTEE No. 28-11
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 17-11
SEC RULES COMMITTEE No. 24-11 RE: FDIC PROPOSES TO IMPLEMENT ADDITIONAL ORDERLY LIQUIDATION AUTHORITY PROVISIONS OF DODD-FRANK ACT

The FDIC has proposed a rule to implement additional provisions of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to orderly liquidation authority. [1] According to the Notice, the proposed rule builds on the interim final rule the FDIC published on January 25, 2011, which addressed certain discrete issues under Title II. [2] The proposed rule addresses the following topics: (1) the definition of a "financial company" subject to resolution under Title II by establishing criteria for determining whether a company is "predominantly engaged in activities that are financial in nature or incidental thereto"; (2) recoupment of compensation from senior executives and directors, as provided in Section 210(s) of the Dodd-Frank Act; (3) application of the power to avoid fraudulent or preferential transfers; (4) the priorities of expenses and unsecured claims; and (5) the administrative process for initial determination of claims and the process for judicial determination of claims disallowed by the receiver. In addition to describing the proposed rule and inviting comment on all aspects of it, the Notice poses several specific questions for comment.

The Notice is briefly summarized below.

Comments on the proposed rule are due to the FDIC not later than May 23, 2011. If you have comments for ICI to consider including in a comment letter, please send them to Frances Stadler (frances@ici.org) by April 11th.

Companies Predominantly Engaged in Financial Activities (Section 380.8)

The proposed rule establishes standards for determining whether a company is "predominantly engaged in financial activities" for purposes of the definition of "financial company" in Section 201(a)(11) of the Dodd-Frank Act. [3] In this context, the definition of "financial company" is important because only those companies meeting the definition are potentially subject to resolution under Title II. Section 201(a)(11) defines "financial company" to include, among others, "any company that is predominantly engaged in activities that the [Federal Reserve Board] has determined are financial in nature or incidental thereto for purposes of section 4(k) of the [Bank Holding Company] Act." Section 201(b) provides that no company shall be deemed to be predominantly engaged in the above-mentioned activities for this purpose "if the consolidated revenues of such company from such activities constitute less than 85 percent of the total consolidated revenues of such company," as the FDIC shall establish by regulation, in consultation with the Treasury Secretary.

The proposed rule addresses this 85 percent threshold. Under the proposed rule, a company is predominantly engaged in activities that the Federal Reserve Board has determined are financial in nature or incidental thereto for purposes of section 4(k) of the Bank Holding Company Act if: (1) at least 85 percent of the total consolidated revenues of the company for either of its two most recent fiscal years were derived, directly or indirectly, from financial activities ("two-year test") or (2) based upon all the relevant facts and circumstances, the FDIC determines that the consolidated revenues of the company from financial activities constitute 85 percent or more of the total consolidated revenues of the company. The proposed rule defines the terms "total consolidated revenues" and "financial activity." It also includes two rules of construction governing the application of the two-year test to revenues derived from a company's minority, non-controlling equity investments in unconsolidated entities.

The Notice requests comment on, among other things, whether Section 380.8 should be limited to companies that are eligible under Section 102 of the Dodd-Frank Act for designation as nonbank financial companies supervised by the Federal Reserve Board, or to companies that are designated as systemically important under the Dodd-Frank Act (in each case, either individually or on a consolidated basis).

Recoupment of Compensation (Section 380.7)

Under Section 210(s) of the Dodd-Frank Act, the FDIC as receiver for a failed "covered financial company" is authorized to recover from senior executives and directors who were substantially responsible for the failed condition of the company any compensation they received during the two-year period preceding the date on which the FDIC was appointed as receiver (or during an unlimited time period in the case of fraud). The FDIC is required to promulgate rules to implement the compensation recoupment provisions. [4] The proposed rule addresses how the FDIC will assess whether a senior executive or director is substantially responsible for the failed condition of the company. It enumerates certain presumptions that will apply and provides certain exceptions to those presumptions.

Priorities of Expenses and Unsecured Claims (Sections 380.20-26)

The proposed rule lists in order of their relative priority eleven classes of unsecured claims. The list includes “administrative expenses of the receiver” and any “amounts owed to the United States.” The proposed rule defines these terms.

The Notice states that the proposed rule establishes the general rule for the priority of claims. It notes that the Dodd-Frank Act provides for limited exceptions to this general rule of similar treatment for similarly-situated creditors, and that any exception must meet the statutory grounds for such an exception and the related regulations, including Section 380.2.

Section 380.26 of the proposed rule seeks to clarify the treatment of assets and liabilities that the FDIC as receiver for a covered financial company transfers to a bridge financial company and that the bridge financial company expressly purchases or assumes, and the treatment of contracts or agreements expressly entered into by the bridge financial company. It also addresses issues related to the dissolution or termination of the bridge financial company.

Receivership Administrative Claims Process (Sections 380.30-39 and 380.50-55)

These proposed provisions clarify how creditors can file claims against the receivership estate, how the FDIC as receiver will determine those claims, and how creditors can pursue their claims in federal court. The Notice refers to the “exclusive, separate set of procedures for the determination of claims” that Congress established under the Dodd-Frank Act. It states that while the FDIC cannot promulgate rules that materially diverge from or are inconsistent with those in the statute, “the FDIC believes it is appropriate to look to the Bankruptcy Code to fill gaps in the Act . . . .” The Notice indicates that the proposed rule seeks to explain certain important aspects of the claims process and also organizes the statutory claims procedures in a “step-by-step manner.” Where necessary (in the FDIC’s view), the proposed rule interprets or supplements the statutory procedures. The proposed rule also addresses the treatment of secured claims under certain provisions of the Dodd-Frank Act that do not apply to qualified financial contracts (and thus should not affect the interests of funds as secured creditors).

Frances M. Stadler
Senior Counsel - Securities Regulation

endnotes

[1] See FDIC Notice of Proposed Rulemaking, Orderly Liquidation Authority, 76 Fed. Reg. 16324 (March 23, 2011) (“Notice”), available at http://edocket.access.gpo.gov/2011/pdf/2011-6705.pdf.

[2] See ICI Memorandum No. 24936, dated February 2, 2011, for a description of the interim final rule.

[3] As noted in the Notice, the Federal Reserve Board has issued a notice of proposed rulemaking addressing the definition of “predominantly engaged in financial activities” for purposes of determining if an entity is a “nonbank financial company” under Title I of the Dodd-Frank Act. See 76 Fed. Reg. 7731 (February 11, 2011). The two proposals are similar in many respects.

[4] The rules are required to define “compensation” to mean any financial remuneration, including salary, bonuses, incentives, benefits, severance, deferred compensation, or golden parachute benefits, and any profits realized from the sale of the securities of the covered financial company.