The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 24936

February 2, 2011

FDIC Adopts Interim Final Rule Implementing Certain Orderly Liquidation Authority Provisions of Dodd-Frank

[24936]

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TO: SEC RULES COMMITTEE No. 11-11
FIXED-INCOME ADVISORY COMMITTEE No. 16-11
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 9-11
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 7-11 RE: FDIC ADOPTS INTERIM FINAL RULE IMPLEMENTING CERTAIN ORDERLY LIQUIDATION AUTHORITY PROVISIONS OF DODD-FRANK

The FDIC has adopted an interim final rule to implement certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to orderly liquidation authority. [1] The rule is intended to provide greater clarity and certainty to the financial industry on certain key issues, and to ensure that the liquidation process reflects the Dodd-Frank Act's mandate of transparency. In addition, the FDIC's notice poses questions for further comment, and invites comments on any aspect of the interim rule that would refine the rule further. [2]

The interim final rule and the FDIC's specific questions for comment are summarized below.

Comments on the interim final rule and questions for further comment are due no later than March 28, 2011. If you have comments for ICI to consider including in a comment letter, please send them to Mara Shreck at mshreck@ici.org or 202/326-5923 by Friday, February 18, 2011.

Treatment of Similarly Situated Claimants (§380.2)

The Dodd-Frank Act permits the FDIC, as receiver for a nonbank financial company to be liquidated under Title II, to pay certain creditors more than similarly situated creditors under certain circumstances. In brief, the FDIC may make such additional payments in order to maximize the value of the company's assets, minimize the loss on the sale or other disposition of assets, or initiate and continue operations that are essential to the implementation of a receivership and any bridge financial company.

The interim final rule clarifies these provisions by identifying certain categories of creditors who will never satisfy these requirements. Specifically, bond holders that hold unsecured debt with a term of more than 360 days will never receive additional payments compared to other general creditors. The attention to long-term unsecured debt is intended to distinguish bondholders from commercial lenders or other providers of financing who have made lines of credit available to the company that are essential for its continuing operation and orderly liquidation. Other types of creditors that are identified as ineligible for additional payments include holders of subordinated debt, shareholders, and other equity holders. Other categories of creditors, i.e., those not identified as being ineligible for additional payments, may receive additional payments, as determined on a case-by-case basis based on the statutory requirements. Any such payments must be approved by the Board of Directors of the FDIC.

The interim final rule also states that, if a secured creditor is under-secured due to a drop in the value of the collateral, the unsecured portion of the claim will be treated as a general creditor claim. Unlike the proposed rule, the interim final rule does not treat US Treasury securities or other government securities differently. This change is consistent with ICI's recommendation. Finally, the interim final rule states that fair market value will be determined as of the date of the appointment of the receiver.

Personal Service Agreements (§380.3)

The interim final rule addresses how personal services agreements, including collective bargaining agreements, may be repudiated if doing so would promote the orderly liquidation of the company. It also addresses the FDIC's use of services of employees who have a personal services agreement with the company, such as if certain of the company's operations are continued by a bridge financial company.

Contingent Obligations (§380.4)

The interim final rule clarifies that the treatment of contingent claims parallels their treatment under the Bankruptcy Code. That is, the FDIC as receiver shall estimate the value of the claim based on the likelihood that the contingent obligation would become fixed and the probable magnitude of the claim. If the receiver repudiates a contingent obligation of a covered financial company consisting of a guarantee, letter of credit, loan commitment, or similar credit obligation, the compensatory damages would be no less than the estimated value of the claim as of the date the FDIC was appointed receiver.

Insurance Company Subsidiaries (§380.5) and Liens on Insurance Company Assets (§380.6)

The interim final rule provides that where the FDIC acts as receiver for an insurance company subsidiary, the value realized from the disposition of the subsidiary will be distributed in accordance with the priority of expenses and unsecured claims set forth in section 210(b)(1) of the Dodd-Frank Act. The interim final rule further limits the ability of the FDIC to take liens on the assets of an insurance company and its covered subsidiaries, as required by the Dodd-Frank Act.

Specific Questions for Comment

In addition to inviting comments on any aspect of the interim rule that would refine the rule further, the notice poses the following questions for comment:

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

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endnotes

[1] See ICI Memorandum No. 24649, dated Oct. 25, 2010, summarizing the proposal, and ICI Memorandum No. 24725, dated November 19, 2010, summarizing ICI’s comments on those aspects of the proposal that are addressed in the interim final rule.

[2] The notice is available at http://www.fdic.gov/regulations/laws/federal/2011/11finalJan25.pdf.