

**MEMO# 25041**

March 23, 2011

# **ICI Comment Letter on FDIC Interim Final Rule Implementing Orderly Liquidation Authority**

[25041]

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TO: SEC RULES COMMITTEE No. 23-11  
FIXED-INCOME ADVISORY COMMITTEE No. 27-11  
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 16-11  
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 16-11 RE: ICI COMMENT LETTER ON  
FDIC INTERIM FINAL RULE IMPLEMENTING ORDERLY LIQUIDATION AUTHORITY

As we previously informed you, [\[1\]](#) the FDIC has adopted an interim final rule to implement certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) relating to orderly liquidation authority. [\[2\]](#) 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 additional questions for comment, and invites comments on any aspect of the interim rule that would refine the rule further.

The ICI has filed a comment letter, which is attached and summarized below.

## **Summary of ICI Comment Letter**

The letter begins by noting that ICI members are major investors in the U.S. bond and money markets, as well as in qualified financial contracts (“QFCs”) such as repurchase agreements and over-the-counter derivatives transactions. They therefore have a strong interest in ensuring that any liquidation of a covered financial company minimizes risk to the financial system, maximizes the value of the liquidated company, and treats creditors fairly in doing so. As in ICI’s previous letters to the FDIC on orderly liquidation, [\[3\]](#) the letter asserts that clarity and certainty must be critical elements of the orderly liquidation process. As explained below, consistent with these principles, the letter requests clarification on two aspects of the resolution of collateralized QFCs. It also addresses certain special considerations that may arise in the context of a covered financial company that is

a major participant in OTC derivatives contracts and/or repurchase agreements. Finally, the letter recommends that, when QFCs are not transferred to a bridge financial company, the FDIC allow for additional flexibility with respect to the valuation and disposition of collateral for QFCs when market circumstances so require.

## **Recommended Clarifications Regarding the Resolution of Collateralized Qualified Financial Contracts**

The letter requests that the FDIC clarify that the provisions in the interim final rule relating to the valuation of collateral are only intended to apply in the event a QFC is not transferred to a bridge financial company. While the rule text is ambiguous on this issue, several provisions of the Dodd-Frank Act, as well as a more recent FDIC notice of proposed rulemaking, [\[4\]](#) indicate that when a QFC is transferred to a bridge entity, both parties are expected to meet their obligations under the contract. In these circumstances, it would seem unnecessary to assign value to collateral at the time a receiver is appointed.

The letter also recommends the FDIC clarify that no provisions of the interim final rule are intended to foreclose the rights of a creditor in a collateralized QFC to take possession of the collateral following the one-business-day stay provided for under the Dodd-Frank Act. Again, this is consistent with provisions in the Dodd-Frank Act, but the rule text suggests that the FDIC might itself liquidate collateral and pay its established value to the creditor under a QFC.

## **Special Considerations Regarding Transfer of Repurchase Agreements and other QFCs to a Bridge**

The letter next outlines ICI members' concerns regarding the resolution of derivatives contracts and repurchase agreements. It notes that because these agreements are typically collateralized by more than 100 percent of the value of the contract, we expect that, consistent with the FDIC's goal of maximizing value in a liquidation, they would be transferred to a bridge financial company and would terminate upon their expiration or for other contractually permitted reasons.

The letter explains that in connection with the demise of a covered financial company (which, by definition, could have serious adverse effects on U.S. financial stability), the value of collateral accepted under these contracts could experience a sudden, significant, and likely temporary drop. This drop could be further compounded if the contracts secured by these assets, which may be undersecured as a result of the drop in value, were left in the receivership, forcing counterparties to take control of and sell the collateral. This could create a "fire sale" environment.

The letter notes that the stated purposes of a bridge financial company are both to maximize the value in a liquidation and to "prevent the immediate and disorderly liquidation of collateral during a period of market distress." It expresses our belief that the latter directive dictates that, in a circumstance where a sudden drop in the market value of collateral renders a portfolio of QFCs undersecured, particularly where the rapid liquidation of that collateral could further destabilize the market, such contracts should be transferred to the bridge financial company for orderly resolution.

## **The Appropriate Timing for Valuation of Collateral**

In response to questions posed in the Notice, the letter offers recommendations for the timing of valuation of collateral. While the interim final rule establishes that collateral will be valued as of the date of the appointment of a receiver, the Notice asks whether other

dates should be considered. The letter states that, for QFCs, the earliest that such collateral should be valued is the time at which a creditor is entitled to take control of – and therefore dispose of – the collateral. The letter notes that this approach would be consistent with certain provisions in the Dodd-Frank Act as well as the Bankruptcy Code.

The letter then explains that in some instances, a creditor under a QFC may not reasonably be able to dispose of collateral immediately upon taking control of it, such as where the covered financial company is a substantial participant in the OTC derivatives and/or repurchase agreement market, such that the termination of even a portion of its QFCs (i.e., those not transferred to a bridge financial company) could result in a large amount of collateral being disposed of by counterparties simultaneously. The letter recommends that in these circumstances, the FDIC should require the creditor to dispose of the collateral by commercially reasonable methods taking into account existing market conditions, and should value the collateral – and any residual claim – in accordance with the actual price received for such collateral. The letter notes that the FDIC recently proposed a similar approach for the disposition of property of a covered financial company that serves as collateral under a secured agreement other than a QFC.

## **Adjustments for Market Fluctuations**

The Notice posed a question as to who should bear the benefit or burden of market fluctuation between the date of appointment of the receiver and the date of payment of a claim. The letter explains that if the FDIC values collateral no earlier than the date a creditor is entitled to take control of (and therefore dispose of) it, this question does not arise.

The letter states that, if the FDIC does not take our recommendation, and instead uses the date of appointment of the FDIC as receiver or, as suggested in the Notice, the day prior to the appointment of the receiver in some circumstances, such differences would need to be resolved. It recommends that secured creditors be made whole to the greatest extent possible, while any overage should accrue to the receivership. It explains that the creditor should not be penalized by the existence of the one-business-day stay required by the statute, which prevents it from exercising its contractual rights to take control of the collateral immediately.

Mara Shreck  
Associate Counsel

## [Attachment](#)

### **endnotes**

[1] See ICI Memorandum No. [24936](#), dated Feb. 2, 2011, summarizing the interim final rule and additional questions.

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

[3] See Letters from Karrie McMillan, General Counsel, Investment Company Institute, to Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation, dated [November 18, 2010](#) and [January 18, 2011](#).

[4] See Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, (March 15, 2011), available at <http://www.fdic.gov/news/board/10MarNo6.pdf>.

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