Resolution Process for Financial Companies that Pose Systemic Risk To the Financial System and Overall Economy

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Under current law, financial regulators do not have the authority to resolve financial holding companies and non-depository financial companies that are in default or serious danger of default as they have with depository institutions. Although the normal bankruptcy process is a very effective process for most non-depository financial companies that default on their obligations, it is not effective for the largest financial companies whose failure pose systemic risks to the financial system and overall economy. This document outlines key components of a "rule of law" based process for resolving financial institutions currently considered "too big to fail" that ensures (1) a continuation of critical services and a stable financial environment, and (2) that a financial company's senior management, shareholders, directors, and creditors account for the costs of their decisions and are held accountable when those decisions lead a company to default on its obligations. Key differences between the proposed resolution process and the process proposed by the Department of Treasury in July 2009 (Treasury proposal) also are discussed.

A. Definitions

1. Alternative Resolution Process – The administrative resolution process described in this document as an alternative to bankruptcy under United States Code for financial companies that meet specific criteria.
2. United States Financial Company – A financial holding company or bank holding company or any other company, including a non regulated subsidiary of a holding company, which is incorporated or organized under the laws of the United States and engaged in financial activities in the United States.
3. Foreign Financial Company – A financial holding company or bank holding company or any other company, including a non-regulated subsidiary of a holding company, which is incorporated or organized in a country other than the United States and engaged in financial activities in the United States.
4. Appropriate Regulatory Agency – The consolidated federal regulatory agency for a bank holding company or financial holding company, the primary federal regulatory agency for a financial company, or state regulatory agency if there is no federal regulatory agency (e.g., insurance company) for a financial company.

   Comment: The intent of this definition of the Appropriate Regulatory Agency is to allow the regulatory authority with the most detailed supervisory knowledge of a company to make the determination that the company is in default or danger of default. In contrast, the definition in the Treasury's proposal is that the appropriate regulatory agency is the Federal Deposit Insurance Corporation (FDIC) unless the holding company's largest subsidiary is a registered broker or dealer, in which case it is the Securities and Exchange Commission (SEC).

5. Covered Financial Company – A United States or Foreign Financial Company (other than an insured depository institution, registered broker or dealer that is a member of the Securities Investor Protection Corporation, or insurance company) that is subject to or may be subject to the alternative resolution process.

Comment: This definition differs from the Treasury's proposal. The Treasury's proposal uses an *ex post* definition in which the Secretary of the Treasury determines that a financial company already in default or in danger of default poses systemic risk and is eligible for emergency assistance and/or an alternative resolution process based on a set of proposed criteria. In contrast, the definition used here is *ex ante* because it is for a predefined group of financial firms based on criteria discussed below. Also, the Treasury's proposal uses the terminology of a covered "bank holding company," which may or may not own a bank or be a holding company because it is defined as (1) a bank holding company as defined in the Bank Holding Company Act, (2) a Tier 1 financial company, or (3) certain nonbank subsidiaries of such companies.

6. Tier 1 Covered Financial Company – A Covered Financial Company that is predetermined to be subject to the alternative resolution process.
7. Tier 2 Covered Financial Company – A Covered Financial Company not designated as Tier 1, which would be subject to the alternative resolution process if, at the time it is in default or danger of default, it is determined to pose a systemic risk to the financial system or overall economy.

B. Designation of Covered Financial Companies and Tier Level

1. Covered United States Financial Company – Any United States Financial Company that has (a) $50 billion or more in assets, (b) $100 billion or more in assets under management, or (c) $2 billion or more in gross annual revenue.
2. Covered Foreign Financial Company – Any Foreign Financial Company that has (a) $50 billion or more in assets in the United States, (b) $100 billion or more in assets under management in the United States, or (c) $2 billion or more in gross annual revenue in the United States.

   Comment on designation as a Covered Financial Company: The criteria for designation as a Covered Financial Company is largely based on the Treasury's criteria for determining whether a financial company would be subject to consideration for designation as a Tier 1 financial company (Title II, Consolidated Supervision and Regulation of Large, Interconnected Financial Firms, Sec. 6, paragraphs a(2)A and a(2)B). The difference from the definition used here is the Treasury used $10 billion for criterion (a). The larger dollar amount is used here because it is unlikely that the failure of an institution with less than $50 billion in assets that does not meet criteria (b) or (c) would have systemic effects on the economy or financial system.

3. Tier Designation – The Board of Governors of the Federal Reserve System (Board), on a nondelegable basis, will designate any Covered Financial Company as a Tier 1 Covered Financial Company if it determines that material financial distress at the company could pose a threat to global or United States financial stability or the global or United States economy during times of economic stress.
   a. Criteria for the determination includes, but is not limited to, factors such as a company's amount and nature of financial assets and liabilities, reliance on short-term funding, off-balance sheet exposures, transactions and relationships with other major financial

companies, and importance as a source of credit to the United States economy and liquidity for the financial system.

b. For foreign companies, the criteria would depend on United States assets, liabilities, and activities.
c. All Covered Financial Companies that are not designated as Tier 1 will be designated as Tier 2.

Comment on Covered Financial Companies: The criteria for designation as a Tier 1 Covered Financial Company is largely the same as the Treasury's criteria (Title II, Consolidated Supervision and Regulation of Large, Interconnected Financial Firms, Sec. 6, paragraphs a(1)A and a(1)B). The Treasury's proposal does not include a Tier 2 designation for a Covered Financial Company.

4. Consultation – If a Covered Financial Company has one or more functionally regulated subsidiaries, the Board shall consult with the Appropriate Regulatory Agency for each subsidiary before making any determination.
5. Reevaluation – The Board shall at least annually reevaluate whether a Covered Financial Company is Tier 1 or Tier 2.
6. Notice and Opportunity to Contest – The Board shall provide a Covered Financial Company notice of its designation as Tier 1 or Tier 2. Within 30 days of its notice of designation, the Company can contest its designation and request a hearing.

C. Resolution Determination

1. Determination of Default or Danger of Default – The Appropriate Regulatory Agency of a Covered Financial Company, in consultation with the consolidated regulator if the company is a subsidiary of a bank holding company or financial holding company, shall determine if the company is in default or danger of default.
2. Default or in Danger of Default – A Covered Financial Company shall be considered to be in default or danger of default if
   a. the company has filed, or likely will promptly file, for bankruptcy under title 11, United States Code,
   b. the company is critically undercapitalized as determined by the Appropriate Regulatory Agency,
   c. the company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion without government assistance,
   d. the company's assets are, or are likely to be, less than its obligations to creditors and others, or
   e. the company is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.
3. Determination of Resolution Process – The resolution method for a Covered Financial Company in default or danger of default will be
   a. the Alternative Resolution Process if the company is a Tier 1 Covered Financial Company, or

b. the bankruptcy process under title 11, United States Code for a Tier 2 Covered Financial Company unless the Board and the Secretary of the Treasury (Secretary), in consultation with the President, jointly determine that the default of the company poses a threat to global or United States financial stability or the global or United States economy, in which case the Alternative Resolution Process would be used.

Comments on Resolution Determination:

- Tier 1 covered companies are those covered companies for which the Board has determined that material financial distress at the company could pose a threat to global or United States financial stability or the global or United States economy during times of economic stress. In the Treasury's proposed resolution process, these companies would be treated like any other company in default or danger of default—i.e., they would be subject to the Alternative Resolution Process only after a recommendation is made to the Secretary that their resolution through bankruptcy poses a systemic threat and the Secretary determines *ex post* to use the Alternative Resolution Process. In the proposal being advanced here, it is recommended that Tier 1 covered companies are predetermined to always be resolved by the alternative resolution process because it already has been determined that their problems could have systemic consequences. In addition, by predetermining the resolution process for Tier 1 companies, creditors would know in advance what their rights will be if the company fails, and the market would have confidence that they will be resolved in a timely and safe manner.
- The Tier 2 covered companies are those whose failure could have systemic consequences, but because they do not meet the criteria necessary for a Tier 1 designation, they would not automatically be resolved by the alternative process. In this proposal, Tier 2 covered companies normally would go through the bankruptcy process if they default, but would be subject to the alternative resolution process if it is determined at the time they are in default or danger of default that it would have systemic consequences. The benefit of this option is that a Tier 2 company's cost of debt may be lower than if it is automatically subject to the alternative process because, if it defaults, creditors have more rights under the normal bankruptcy process than under the alternative resolution process. In addition, creditors know in advance that they might be subject to the alternative resolution process. A potential problem with this approach is that if a Tier 2 company becomes a Tier 1 company, existing creditors lose virtually all of their rights in the resolution process even though they had no influence on the company's decisions that led to its designation as a Tier 1 company.
- An alternative is for Tier 2 companies normally to go through the alternative resolution process unless at the time they are in default or danger of default it is determined that it would not have systemic consequences. The benefit of this option is that potential creditors know in advance they are subject to the worst case scenario of an administrative process if the company defaults, but that they may actually have more rights if instead the company goes through the normal bankruptcy process. In addition, this option would be more equitable to existing creditors if a company changes from a Tier 2 to Tier 1 company because the presumed resolution process would always be the alternative process, in which case creditors would never be moved to a resolution process where their rights are more restricted. A potential cost of this approach is that potential creditors will likely require a higher interest rate to lend to the company.
- As defined in Section A, a financial company may also be a nonbank (nonregulated) subsidiary of a holding company. The resolution designation for these subsidiaries would be

the same as for their parent holding companies because it would be possible for a subsidiary to be in default or danger of default and to have systemic implications by itself. Moreover, in the case of a limited liability subsidiary, the subsidiary could fail without necessarily putting the parent holding company in default, assuming the reputational and liquidity effects of the subsidiary's failure could be managed. This would be particularly true for subsidiaries that operate outside of the cross guarantee and source of strength provisions that might be imposed on affiliated banks and their parent company. Consequently, it is important to have authority to directly resolve a subsidiary that could threaten financial stability whether or not it is possible to pursue a resolution at the parent company level as well.

D. Resolution

1. Resolution Authority for the Alternative Resolution Process – The FDIC will be the resolution authority for the alternative resolution process.
2. Receivership – If the appropriate regulatory agency for a Covered Financial Company determines that the company is in default or danger of default, and it is determined that the alternative resolution process should be used, the appropriate regulatory agency will appoint the FDIC as receiver.
3. Minimize Overall Cost of Resolution – In taking any actions as receiver of a covered financial firm in default or danger of default, the FDIC must minimize the overall cost of the resolution, taking into consideration the action's effectiveness in mitigating potential adverse effects on the financial system or economic conditions, cost to the general fund of the Treasury, and potential to increase moral hazard on the part of creditors, counterparties, and shareholders of financial companies.

E. Judicial Review

If a receiver is appointed, the Covered Financial Company may, not later than 30 days thereafter, bring an action in the United States district court for an order requiring that the receiver be removed. The court shall, upon the merits, dismiss such action or direct the receiver to be removed.

F. Powers and Duties of the Receiver

1. Successor to the Covered Financial Company – The FDIC as receiver for a Covered Financial Company will succeed to all rights, titles, powers, and privileges of the Covered Financial Company and any of its stockholders, members, officers, or directors with respect to the company and its assets. At a minimum, the FDIC must replace the directors and members of senior management responsible for the company's condition.
2. Operate the Covered Financial Company – The FDIC as receiver for a Covered Financial Company may
   a. take over the assets of and operate the company with all the powers of the members or shareholders, the directors, and the officers and conduct all business,
   b. collect all obligations and money due the company,
   c. perform all functions of the company in the name of the company,
   d. preserve and conserve the assets and property of the company, and

   e. provide by contract for assistance in fulfilling any function, activity, action, or duty of the FDIC as receiver.
3. Actions Taken by the Receiver – Upon its appointment as receiver of a Covered Financial Company, and subject to the minimum overall cost of resolution requirement in Section D, paragraph 4, the FDIC may
   a. make loans to, or purchase any debt obligation of, the Covered Financial Company or any covered subsidiary,
   b. purchase assets of the Covered Financial Company or any covered subsidiary directly or through an entity established by the FDIC for such purpose,
   c. assume or guarantee the obligations of the Covered Financial Company or any covered subsidiary to one or more third parties,
   d. acquire any type of equity interest or security of the Covered Financial Company or any covered subsidiary,
   e. take a lien on any or all assets of the Covered Financial Company or any covered subsidiary, including a first priority lien on all unencumbered assets of the company or any covered subsidiary to secure repayment of any financial assistance provided under this subsection, or
   f. sell or transfer all, or any part thereof, of such acquired assets, liabilities, obligations, equity interests or securities of the Covered Financial Company or any covered subsidiary.
4. Functions of Covered Financial Company's Officers, Directors, and Shareholders – The FDIC as receiver may provide for the exercise of any function by any member or stockholder, director, or officer.
5. Additional Powers as Receiver – The FDIC as receiver of the Covered Financial Company may place the company in liquidation and proceed to realize upon its assets in such manner as the FDIC deems appropriate, including through the sale of assets, the transfer of assets to a bridge financial company established under this Act, or the exercise of any other rights or privileges granted to the receiver.
6. Organization of New Companies – The FDIC as receiver may organize a bridge financial company. (The definitions and rules governing the organization of a bridge financial company would be defined as part of the legislation and likely modeled after the legislation that allows the FDIC to organize a bridge national bank.)
7. Debt-for-Equity Exchange – As part of its powers as receiver of a Covered Financial Company under paragraphs F(5) and F(6), the FDIC may offer creditors the opportunity to exchange their debt for equity as a means for raising new equity capital and a prelude for the timely reprivatization of the company.

Comment: The existing resolution process for insured depository institutions has a least cost requirement for the FDIC to use the resolution method that is least costly for the deposit insurance fund, but it includes a systemic risk exception to the least cost requirement. There is little need for a systemic risk exception to the requirement proposed in Section D, paragraph 4 to minimize the overall cost of resolution because the FDIC can carry on critical financial functions through a bridge holding company and take other steps to mitigate systemic risk, although if deemed necessary, an exception could be added with restrictions that allow it to be used only in very limited circumstances.

8. Merger and Transfer of Assets and Liabilities – The FDIC as receiver of the Covered Financial Company may (a) merge the company with another company, or (b) transfer any of its assets or liabilities.
9. Payment of Valid Obligations – The FDIC as receiver of the Covered Financial Company shall, to the extent funds are available, pay all valid obligations of the company that are due and payable at the time of the appointment of the FDIC as the resolution authority.
10. Disposition of Assets – In exercising any right, power, privilege, or authority as receiver, the FDIC should conduct its operations so as to
    a. maximize the net present value return from the sale or disposition of assets,
    b. minimize the amount of any loss realized in the resolution of cases,
    c. minimize the cost to the general fund of the Treasury,
    d. mitigate the potential for serious adverse effects to the financial system and the United States economy,
    e. ensure timely and adequate competition and fair and consistent treatment of offerors, and
    f. prohibit discrimination on the basis of race, sex, or ethnic groups in the solicitation and consideration of offers.
11. Shareholders and Creditors of the Covered Financial Company – Notwithstanding any other provision of law, the FDIC as receiver for a Covered Financial Company shall terminate all rights and claims that the stockholders and creditors of the company may have against the company's assets or the FDIC arising out of their status as stockholders or creditors, except for their right to payment, resolution, or other satisfaction of their claims as permitted under this section.
12. Coordination with Foreign Financial Authorities – The FDIC as receiver for a Covered Financial Company shall coordinate with the appropriate foreign financial authorities regarding the resolution of subsidiaries of the company that are established in a country other than the United States.

G. Authority of the FDIC to Determine Claims

1. The FDIC as receiver may
    a. determine claims,
    b. determine rules and regulations for the determination of claims, including the use of the regulations used by the FDIC for insured depository institutions.
2. Priority of Expenses and Unsecured Claims – In general, unsecured claims against a Covered Financial Company or the FDIC as receiver for the company shall have priority in the following order:
    a. Administrative expenses of the FDIC.
    b. Any amounts owed to the United States.
    c. Any other general or senior liability of the Covered Financial Company that is not a liability described under clauses (d) or (e).
    d. Any obligation subordinated to general creditors that is not an obligation described under clause (e).
    e. Any obligation to shareholders, members, general partners, limited partners or other persons with interests in the equity of the Covered Financial Company arising as a result of their status as shareholders, members, general partners, limited partners or other persons with interests in the equity of the company.

3. Creditors Similarly Situated – All claimants of a Covered Financial Company that are similarly situated under paragraph G(2) shall be treated in a similar manner, except that the FDIC may take any action (including making payments) that does not comply with this section if
   a. the FDIC determines that such action is necessary to maximize the value of the assets of the company, maximize the present value return from the sale or other disposition of the assets of the company, minimize the amount of any loss realized upon the sale or other disposition of the assets of the company, or to contain or address serious adverse effects on financial stability or the United States economy, and
   b. all claimants that are similarly situated under paragraph G(2) receive at least the amount they would have received if
      i. the alternative resolution process had not been used to resolve the Covered Financial Company, and
      ii. the company had been liquidated under title 11, United States Code, any case related to title 11, United States Code, or any State insolvency law.
4. Secured Claims Unaffected – The claims priority in this section shall not affect secured claims, except to the extent that the security is insufficient to satisfy the claim and then only with regard to the difference between the claim and the amount realized from the security.
5. Additional Priorities in a Financial Crisis – The FDIC as receiver of a Covered Financial Company may place a higher claims priority on short-term (maturity 180 days or less) unsecured general or senior liabilities than on other general or senior liabilities in the creditor class described in clause G(2)c
   a. if the FDIC, Board, and Secretary (in consultation with the President) jointly determine that such action is the best course of action to mitigate potential adverse effects on the financial system or economic conditions, taking into consideration the cost to the general fund of the Treasury and potential to increase moral hazard on the part of creditors, counterparties, and shareholders of financial companies, and
   b. subject to the other conditions of this section.

   Note: The additional priority for short-term liabilities does not apply to repurchase agreements because they are qualified financial contracts (as described in section H) and not a liability.

Comments on allowing a higher claims priority for some unsecured short-term liabilities:

- The rationale for the proposed exception to the normal claims priority for unsecured liabilities with maturities of 180 days or less is that many short-term liabilities of financial companies have become an important component of the daily financial flows required for the smooth functioning of the financial system and the economy. For example, many short-term instruments, such as commercial paper and repurchase agreements, are used by financial and nonfinancial firms as cash management instruments, or serve as backing for cash management instruments such as money market mutual fund shares. As a result, if a covered financial company were to go into receivership, the inability of customers and counterparties to access their short-term funds, or the potential loss of a portion of those funds, could intensify market disruptions and contribute to systemic risk.
- The systemic risks and market disruptions that arise from excessive reliance on short-term funding, and therefore the likelihood of needing to use this claims priority exception, can be

significantly reduced by strengthening liquidity and/or capital requirements as part of the prudential supervisory process. Specifically, legislation providing for a systemic risk regulator and/or increased authority for consolidated supervisors of financial holding companies should mandate regulations that covered financial firms meet specific minimum liquidity requirements, supplemented by a required capital surcharge if liquidity is insufficient, explicitly tied to short-term funding.

- The rationale for requiring a capital surcharge only after assessing a firm's liquidity condition is that the underlying systemic problem with short-term funding is an asset-liability maturity mismatch that prevents firms from meeting short-term obligations in a crisis, i.e., the firm either cannot access short-term funding or has to sell illiquid assets to meet the withdrawal of funds. For example, firms whose asset and liability maturities are perfectly matched would not need to hold additional capital because they would be able to meet all short-term obligations. A perfect match is not realistic since all financial intermediaries fund assets with longer maturities than the liabilities to some extent, so the liquidity requirement established by regulators would allow for a "reasonable" mismatch in asset-liability maturities, including liquidity risk management measures. For firms that do not meet the liquidity requirement, i.e., they have an excessive asset-liability maturity mismatch, a capital surcharge requirement would increase the cushion available to meet short-term obligations through the sale of longer-term or illiquid assets at the discounted values that may occur in a crisis.
- Listed below are suggestions for liquidity and capital surcharge regulatory requirements that legislation could require supervisory authorities to impose on covered financial firms.
  - Minimum liquidity—Covered firms must hold high-quality assets of comparable maturities that are at least equal to a specified percentage (e.g., 25 percent) of its liabilities with a maturity of 180 days or less. High-quality assets for purposes of this liquidity requirement are U.S. Treasury and government agency securities, claims on or unconditionally guaranteed by Organisation for Economic Co-operation and Development (OECD) central governments, deposits in United States depository institutions or banks in OECD countries, and claims collateralized by cash on deposit or securities issued or guaranteed by OECD central governments or United States government agencies.
  - Capital surcharge—Covered firms that fail to meet or only marginally exceed the minimum liquidity requirement must maintain <u>additional</u> Tier 1 capital based on (1) the shortfall that they have in matching short-term liabilities and assets, and (2) a specified percentage (e.g., 100 percent) of the minimum Tier 1 tangible capital ratio requirement. For example, if the minimum Tier 1 tangible capital requirement is 5 percent of tangible assets and the capital surcharge is 100 percent of the minimum Tier 1 tangible capital requirement, a firm would have to hold an extra amount of Tier 1 tangible capital equal to 5 percent of the shortfall of short-term liabilities. Tier 1 tangible capital (as currently defined) is common stock, noncumulative perpetual preferred stock, and minority interests in the equity accounts of consolidated subsidiaries less goodwill and other intangible assets.
- An additional benefit of tying specific liquidity and capital surcharge requirements to short-term funding (maturity of 180 days or less for the remainder of this comment) is that it could mitigate pricing distortions from changing the normal claims priority.

- The potential that creditors holding a covered financial firm's short-term unsecured liabilities could receive a higher claims priority in receivership reduces their risk relative to longer-term creditors, which could lower the firm's cost of short-term funding relative to longer-term funding. This distortion could lead to a greater asset-liability maturity mismatch for covered firms and, therefore, an increase in the systemic risks associated with excessive short-term funding.
- In addition, short-term unsecured creditors of covered firms would have additional protection not available to creditors of other (i.e., smaller) firms. This distortion perpetuates the view that investments in the short-term debt of financial firms is safer at the largest financial firms than at smaller firms, which gives the largest firms a competitive advantage in the short-term funds markets, particularly in times of financial stress.
- However, these cost distortions would be mitigated by the additional costs incurred by covered firms in meeting the proposed minimum liquidity and/or capital surcharge requirements.

H. Provisions Relating to Contracts Entered into Before Appointment of Receiver

1. Authority to Repudiate Contract – In addition to any other rights it may have, the FDIC as receiver for any Covered Financial Company may disaffirm or repudiate any contract or lease
   a. to which the company is a party,
   b. the performance of which the FDIC determines to be burdensome, and
   c. the disaffirmance or repudiation will promote the orderly administration of the company's affairs.
2. Timing of Repudiation – The FDIC as receiver appointed for any Covered Financial Company shall determine whether or not to exercise the rights of repudiation within a reasonable period following appointment as the resolution authority.
3. Claims for Damages for Repudiation – In general, the liability of the FDIC as receiver for the disaffirmance or repudiation of any contract shall be
   a. limited to actual direct compensatory damages, and
   b. determined as of the date of the appointment of the receiver, or for qualified financial contracts, the date of the disaffirmance or repudiation of the contract.
4. Qualified Financial Contract – A qualified financial contract is any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement that the FDIC determines by regulation, resolution, or order to be a qualified financial contract.
5. Certain Qualified Financial Contracts – Subject to paragraph H(6), no person shall be stayed or prohibited from exercising any right
   a. they have to cause the termination, liquidation, or acceleration of any qualified financial contract with a Covered Financial Company which arises upon the appointment of the FDIC as receiver for the company at any time after the appointment,
   b. under any security agreement or arrangement or other credit enhancement related to one or more qualified financial contracts described in clause (a), or

c. to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with one or more contracts and agreements described in clause (a), including any master agreement for such contracts or agreements.

6. Transfer of Qualified Financial Contracts – In making any transfer of assets or liabilities of a Covered Financial Company in default that includes any qualified financial contract, the FDIC as receiver for such covered bank holding company shall either
   a. transfer to one financial institution all qualified financial contracts between any person and the company in default, all claims under the contract (other than claims subordinated to general unsecured creditors) of the person against the holding company, all claims of the company against the person, and all property securing or any other credit enhancement for these contracts and claims, or
   b. transfer none of the qualified financial contracts, claims, property or other credit enhancements.
7. Certain Transfers Not Avoidable – The FDIC as receiver of a Covered Financial Company may not avoid any transfer of money or other property in connection with any qualified financial contract with a Covered Financial Company except for transfers in which the intent is to hinder, delay, or defraud the FDIC, company, or creditors.

I. Funding

1. Establishment of Fund – The Treasury will establish a separate fund called the Financial Company Resolution Fund (Fund), which shall be available without further appropriation for the cost of actions authorized by this legislation to the FDIC as receiver to carry out its authorities for resolving a covered financial company, including the payment of administrative expenses and principal and interest on debt obligations issued to carry out its authorities.
2. Proceeds – Amounts received by the FDIC to carry out its authorities under paragraph (3) and assessments received under paragraph I(4) shall be deposited into the Fund, subject to apportionment.
3. Capitalization of the Fund – When assigned as the resolution authority for a Covered Financial Company, the FDIC may issue obligations to the Secretary to capitalize the Fund.
   a. The Secretary may purchase any obligations issued by the FDIC and may use the proceeds from the sale of any securities to fund the purchase.
   b. Each purchase of obligations by the Secretary shall be upon such terms and conditions as to yield a return at a rate not less than a rate determined by the Secretary, taking into consideration the current average yield on outstanding marketable obligations of the United States of comparable maturity.
   c. The Secretary may sell any of the obligations acquired from the FDIC.

Note: The following paragraphs provide 3 options for funding the costs of resolving a Covered Financial Company.

4. **Option 1 (ex-post assessment funding):** Funding the Costs of Resolving a Covered Financial Company – The FDIC shall take steps to recover the amount of funds expended out of the Fund that have not been recouped.

a. Such steps shall include one or more risk-based assessments on Tier 1 Covered Financial Companies based on their total liabilities not already assessed for deposit insurance purposes.
b. The FDIC will determine the terms and conditions for the assessment, which by regulation, are necessary to pay in full its obligations to the Secretary within 60 months from the date it was assigned as the resolution authority of a Covered Financial Company.
c. Risk-Based Assessment Considerations – In imposing assessments, the FDIC may differentiate among Tier 1 covered companies by taking into consideration
   i. different categories and concentrations of assets,
   ii. different categories and concentrations of liabilities, both insured and uninsured, contingent and noncontingent,
   iii. leverage,
   iv. size, complexity, risk profile, and interconnectedness to the financial system,
   v. the threat each poses to the stability of the financial system, and
   vi. any other considerations that the FDIC deems appropriate.
d. Assessment Deduction – A Tier 1 Covered Financial Company may deduct from its assessment an amount equal to what it or any subsidiary paid to any State insurance guarantee fund association due to conservation, rehabilitation, or liquidation of a covered company or any subsidiary of the covered company.

4. **Option 2 (ex-ante assessment funding)**: Funding the Costs of Resolving a Covered Financial Company – The FDIC shall assess a risk-based fee on all Covered Financial Companies (Tier 1 and Tier 2) to capitalize the Fund prior to the placement of a Covered Financial Company in receivership.
   a. The assessments will be based on a Covered Financial Company's total liabilities not already assessed for deposit insurance purposes.
   b. Risk-Based Assessment Considerations – In imposing assessments, the FDIC may differentiate among covered companies by taking into consideration
      i. different categories and concentrations of assets,
      ii. different categories and concentrations of liabilities, both insured and uninsured, contingent and noncontingent,
      iii. leverage,
      iv. size, complexity, risk profile, and interconnectedness to the financial system,
      v. the threat each poses to the stability of the financial system, and
      vi. any other considerations that the FDIC deems appropriate.
   c. Assessment Deduction – A covered financial company may deduct from its assessment an amount equal to what it or any subsidiary paid to any State insurance guarantee fund association due to conservation, rehabilitation, or liquidation of a covered company or any subsidiary of the covered company.
4. **Option 3 (no assessment)**: Funding the Costs of Resolving a Covered Financial Company – The Fund will be capitalized entirely by the Treasury's general fund.

Comment on Funding: Funding may be less of an issue if the proposed resolution process were to be adopted because the resolution costs are likely to be much lower than the costs of rescuing the "too big to fail" firms in the current financial crisis. In the proposed resolution

process, no institution is too big to fail because all "systemic" institutions that are in default or danger of default are required to be put in receivership, with directors and senior management being replaced, shareholders losing their entire investment, and unsecured creditors losing principal on their securities based on the losses and costs of resolving failed or troubled companies. Because the largest companies typically have large amounts of unsecured debt, the creditors are likely to absorb all or most of the costs of resolving these institutions. As a result, while option 3 would not be considered in today's crisis because it imposes all of the high resolution costs on taxpayers, it is a more viable option under the current proposal because no large financial institutions are being rescued. In addition, to the extent there are some residual costs borne by taxpayers under option 3, all taxpayers and financial and nonfinancial firms benefit from the resolution process' prevention of economic and financial instability.