March 9, 2011

MEMORANDUM TO:	The Board of Directors
FROM:	James R. Wigand Director Office of Complex Financial Institutions Michael H. Krimminger General Counsel
SUBJECT:	Notice of Proposed Rulemaking pursuant to section 209 of the Dodd-Frank Wall Street Reform and Consumer Protection Act for the purpose of amending 12 C.F.R. Pt. 380, “Orderly Liquidation Authority”

RECOMMENDATION

Staff recommends that the Board of Directors (“Board”) issue a Notice of Proposed Rulemaking for the purpose of soliciting comments on a proposed regulation (the “Proposed Rule”) that would amend Part 380 of Title 12 of the Code of Federal Regulations, which addresses the FDIC’s rights and powers as receiver of a failing systemic financial company under the orderly liquidation authority provisions of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act” or “Dodd-Frank Act”). The Proposed Rule builds on the initial issues addressed in the Interim Final Rule (“IFR”) approved by the Board in January by establishing a framework for the treatment of creditors under Title II with a comprehensive elaboration of the priority for payment of creditors and of the process for determination of creditor claims by the receiver and through court proceedings. Specifically, the Proposed Rule (i) establishes criteria for determining whether a company is “predominantly engaged in activities that are financial in nature or incidental thereto” and, therefore, a “financial company,” (ii) addresses the recoupment of compensation from senior executives and

directors, (iii) addresses how the receiver will implement its power to avoid fraudulent or preferential transfers, (iv) adds a new Subpart regarding priorities of expenses and unsecured claims, and (v) adds a new Subpart regarding the receivership administrative claims process.

EXECUTIVE SUMMARY

Title II of the Dodd-Frank Act provides for the appointment of the FDIC as receiver for a financial company for which a determination has been made that the company's failure would pose a significant risk to the financial stability of the United States (a "covered financial company"). If approved by the Board, the Proposed Rule would be promulgated under section 209 of the Act, which authorizes the FDIC to prescribe such rules and regulations as the FDIC considers necessary or appropriate to implement the orderly liquidation authority provisions of Title II.

This rulemaking is the second in a series of rulemakings the FDIC will undertake to implement the orderly liquidation authority under Title II. In the first rulemaking, the Board approved the IFR, to be codified at 12 C.F.R. §§ 380.1 – 380.6.to address discrete issues designed to clarify specific provisions of Title II in response to inquiries after the adoption of the Dodd-Frank Act. For example, the IFR clarified the narrow circumstances under which the FDIC would use its discretion to differentiate among similarly situated creditors under Section 210 of Dodd-Frank.

The Proposed Rule is intended to build on the IFR by beginning to establish the broader framework governing the rights of creditors. In particular, the Proposed Rule defines the priority of payment for creditors and specifies the process for creditors to file claims and, if dissatisfied with the receiver's decision on the claim, to pursue the claim

through a court proceeding. For example, while the Interim Final Rule specified the treatment of "similarly situated creditors" in Section 380.2, it did not address the treatment of creditors generally within the overall structure provided by Title II for the payment of creditors. The Proposed Rule takes the next step by defining the priorities in a single subsection (380.21), As a result, the Proposed Rule will provide a 'roadmap' for creditors to better understand their substantive and procedural rights under Title II by defining key elements determining how their claims will be determined and in what priority they will be paid. The discrete issues addressed in the IFR should be viewed as components that fit within this broader framework.

The framework to be established by Subpart A of the Proposed Rule 1) clarifies the meaning of 'administrative expenses' and 'amounts owed to the United States,' 2) details the priority of setoff claims, 3) specifies how post-insolvency interest will be paid, and 4) clarifies the payment of claims for contracts and agreements expressly assumed by a bridge financial company. New Subpart B addresses another key element of creditor rights by specifying the process for initial determination of claims and the steps necessary to seek a judicial decision on any disallowed claims. Other provisions of the Proposed Rule address other foundational elements of Title II. Section 380.8 of the Proposed Rule helps define which companies may be subject to resolution under Title II, by clarifying the meaning of "financial company" in Section 201 of the Dodd-Frank Act. Section 380.7 and the amendments to section 380.1 help define how compensation may be clawed back from senior executives and directors responsible for the failure of the covered financial company under section 210(s) of the Dodd-Frank Act. Section 380.9 of the Proposed Rule will clarify the application of the receiver's powers to avoid fraudulent

and preferential transfers to ensure they conform to the similar powers under the Bankruptcy Code.

A more detailed explanation of the specific provisions of the Proposed Rule follows.

Definition of Financial Companies – "Predominantly Engaged" in Financial Activities. Section 380.8 of the Proposed Rule establishes standards for determining if a company is predominantly engaged in financial activities. If a company is determined to be predominantly engaged in such activities, then it is a "financial company" and may be subject to the orderly liquidation provisions of Title II. Under the Proposed Rule, a company is predominantly engaged in financial activities if the FDIC determines that at least 85 percent of the total consolidated revenues of the company for either of its two most recent fiscal years were derived from such activities ("85% revenue test").

Recoupment of Senior Executive and Director Compensation. The Proposed Rule would amend 12 C.F.R § 380.1 to define the terms "compensation" and "director," and to apply more broadly the definition of "senior executive" that was included in the Interim Final Rule at § 380.3. The Proposed Rule would also add § 380.7, which provides guidance required under section 210(s)(3) of the Act by identifying the circumstances in which the Corporation as receiver will seek to recoup compensation from persons who are substantially responsible for the failed condition of a covered financial company.

Fraudulent and Preferential Transfers. Section 380.9 of the Proposed Rule addresses the powers granted to the Corporation as receiver in section 210(a)(11) of the Act to avoid certain fraudulent and preferential transfers, and seeks to harmonize the

application of these powers with the analogous provisions of the Bankruptcy Code so that the transferees of assets will have the same treatment in a liquidation under the Dodd-Frank Act as they would in a bankruptcy proceeding.

Priorities of Claims. The Proposed Rule adds a Subpart, consisting of §§ 380.20 – 380.26, regarding the priorities of expenses and unsecured claims in the receivership of the covered financial company. First, Subpart A integrates and harmonizes all of the various provisions of the Dodd-Frank Act that determine the nature and priority of payments. In particular, the Subpart integrates the various statutory references to administrative expenses throughout the Act, including identification of claims for amounts due to the United States, to ensure consistent application of those provisions. Second, the Proposed Rule confirms the preferred statutory treatment of claims arising out of the loss of setoff rights through payments ahead of other general unsecured creditors if the loss of the setoff is due to the receiver's sale or transfer of an asset. Third, the Proposed Rule clarifies the payment of obligations of bridge financial companies and the rights of receivership creditors to any remaining value. Under the Proposed Rule, obligations transferred to and assumed by the bridge financial company will be paid when due by the bridge financial company. Any proceeds remaining upon resolution of a bridge financial company will be made available to the creditors of the covered financial company. Finally, the Proposed Rule provides for the payment of post-insolvency interest on claims and for the determination of the index by which the limit applicable to certain claims for wages and benefits will be increased for inflation.

Claims Procedures. The Proposed Rule includes an additional Subpart, consisting of §§ 380.30 – 380.39 and §§ 380.50-380.55, to clarify how creditors can file

claims against the receivership estate, how the Corporation as receiver will determine those claims, and how disaffected creditors can pursue their claims in federal court. These provisions would implement the statutory claims procedures of sections 210(a)(2) – (5) of the Act. Staff recognizes that many parties with an interest in the conduct of a receivership under Title II may be unfamiliar with an administrative claims process. The Proposed Rule sets out the claims process for a covered financial company receivership in order to clarify certain statutory provisions that might give rise to confusion or uncertainty in that context.

Sections 380.50 – 380.55 of Subpart B would add rules and procedures for secured claims. Under the Dodd-Frank Act (and the Proposed Rule), a secured creditor is entitled to receive the value of its collateral up to the amount of the claim. Any deficiency becomes the basis for an unsecured claim. As required by the Act, the Proposed Rule establishes an expedited process for a secured claimant who alleges that proceeding under the ordinary claims process will irreparably harm its interest. The Proposed Rule also addresses how the receiver may treat property that secures a claim. The receiver may (i) consent to the secured creditor's exercise of its rights against the collateral, (ii) sell the collateral and remit the proceeds to the secured creditor, or permit the secured creditor to purchase the collateral (in doing so the creditor may set off its claim against the purchase price), or (iii) redeem the collateral from the secured creditor's lien by paying its fair market value in cash to the secured creditor.

The Notice of Proposed Rulemaking will solicit public comments on all aspects of the Proposed Rule and in response to certain specific questions.

DISCUSSION

The Dodd-Frank Act was enacted on July 21, 2010. Title II of the Dodd-Frank Act provides for the appointment of the FDIC as receiver of a covered financial company and for the implementation of a process for the orderly liquidation of systemically important financial companies. The Proposed Rule is intended to provide clarity and certainty about how key components of the orderly liquidation authority will be implemented and to ensure that the liquidation process under Title II reflects the Dodd-Frank Act's mandate of transparency in the liquidation of covered financial companies. While it is not expected that the FDIC will be appointed as receiver for a covered financial company in the near future, it is important for the FDIC to have rules in place in a timely manner to allow stakeholders to plan transactions going forward. The Proposed Rule would be promulgated under section 209 of the Act, which authorizes the FDIC, in consultation with the Financial Stability Oversight Council, to prescribe such rules and regulations as the FDIC considers necessary or appropriate to implement Title II. Section 209 also provides that to the extent possible, the FDIC shall seek to harmonize such rules and regulations with the insolvency laws that otherwise would apply to a covered financial company.

The FDIC began rulemaking with respect to Title II on October 19, 2010, when it published in the Federal Register a notice of proposed rulemaking to implement certain orderly liquidation provisions of Title II. This rulemaking culminated in an Interim Final Rule approved by the Board on January 18, 2011, which addressed the payment of similarly situated creditors, the honoring of personal services contracts, the recognition of contingent claims, the treatment of any remaining shareholder value in the case of a covered financial company that is a subsidiary of an insurance company, and limitations

on liens that the FDIC may take on assets of a covered financial company that is an insurance company or covered subsidiary.

The October 19, 2010 notice of proposed rulemaking solicited comments not only on the first proposed rule but also on more general aspects of the orderly liquidation authority of Title II. This comment period ended on January 18, 2011. These comments have been considered with respect to the determination of the scope and subject matter of the Proposed Rule. Many of these comments emphasized the importance of allowing sufficient time in the rulemaking process to fully consider the complex issues raised under the Dodd-Frank Act. This Proposed Rule is a second incremental step in the rulemaking process and will invite input from stakeholders through additional questions posed as part of the Notice of Proposed Rulemaking published in the Federal Register. Additional rulemaking will follow, including certain rules required by the Act, such as rules governing receivership termination, receivership purchaser eligibility requirements, and records retention requirements.

Comments also revealed unfamiliarity with the FDIC's resolution process by many stakeholders outside the banking industry and included many questions regarding the interplay between the Bankruptcy Code and the orderly liquidation authority under the Dodd-Frank Act. By elaborating on the details of the orderly liquidation process, the Proposed Rule provides additional insight with respect to the role of the FDIC as receiver for a covered financial company.

The Proposed Rule establishes criteria to be applied by the FDIC in determining if a company is "predominantly engaged in activities that are financial in nature or

incidental thereto" and is therefore a financial company subject to the Title II orderly liquidation authority.

The Proposed Rule also addresses the recoupment of compensation from senior executives and directors of the covered financial company. Section 210(s) of the Act grants the FDIC as receiver the authority, and requires the FDIC to promulgate regulations to implement its authority, to recover from senior executives and directors who are substantially responsible for the failed condition of a covered financial company any compensation that they received during the two-year period preceding the date on which the FDIC was appointed as receiver. This time period is unlimited in the case of fraud. The Proposed Rule provides guidance by identifying the circumstances in which the FDIC as receiver will seek to recoup compensation from persons who are substantially responsible for the failed condition of a covered financial company.

Finally, the Proposed Rule addresses the interpretation of section 210(a)(11) of the Act regarding preferential and fraudulent transfers. These provisions in the Dodd-Frank Act governing the avoidance of fraudulent and preferential transfers could be interpreted in a manner that would produce a divergent outcome to a transferee under the Dodd-Frank Act and under the Bankruptcy Code. In accordance with the mandate of section 209 of the Act, § 380.9 of the Proposed Rule seeks to harmonize the application of the avoidable transfer provisions of the Dodd-Frank Act with the analogous provisions in the Bankruptcy Code. Staff notes that the Proposed Rule conforms with the interpretation of section 210(a)(11) of the Dodd-Frank Act set forth in the Acting General Counsel's letter dated December 29, 2010 to the Securities Industry and Financial Markets Association and the American Securitization Forum, wherein the Acting General

Counsel undertook to recommend that the Board adopt a regulation to clarify the FDIC's implementation of such subsection.

A number of comments raised issues regarding the priorities of expenses and unsecured claims in a covered financial company receivership. Several comments discussed section 210(a)(12) of the Dodd-Frank Act regarding the priority for creditors who are deprived of setoff rights. Other comments requested that the FDIC clarify the relationship between a bridge financial company and creditors of the covered financial company. Subpart A of the Proposed Rule addresses these and other issues with respect to priorities.

Comments also indicated that many parties are unfamiliar with the administrative process under which the FDIC as receiver would determine claims against the covered financial company. Several comments requested that the FDIC establish an expedited process for the determination of secured claims (such a process is required by the Dodd-Frank Act). Comments also requested guidance on how the FDIC as receiver would treat property that serves as collateral for a secured claim. Several comments suggested that if the FDIC sells collateral, the secured creditor should be permitted to bid and apply the amount of its claim to the purchase price. Subpart B of the Proposed Rule addresses issues with respect to the receivership administrative claims process and the treatment of secured claims.

Section-by-section analysis

Definitions

Section 380.1 of the Proposed Rule would be amended to add definitions of the terms "compensation" and "director," and to make the definition of "senior executive"

included in § 380.3 of the Interim Final Rule apply wherever the phrase "senior executive" is used in the Proposed Rule. The definition of the term "compensation" incorporates the definition mandated in Section 210(s)(3) of the Act. The Proposed Rule's definition for the term "director" includes those persons who are in a position to affect the activities of the covered financial company and that have a material effect on the financial condition of the covered financial company.

Compensation Recoupment

Section 380.7 of the Proposed Rule addresses the authority of the FDIC as receiver to recoup compensation paid to senior executives and directors who are substantially responsible for the failure of the covered financial company. It provides that the FDIC as receiver will consider two factors in assessing how to exercise this authority: (i) whether the senior executive or director performed his or her responsibilities with the requisite degree of skill and care for his or her position; and (ii) whether as a result of his or her performance the senior executive or director individually or collectively caused a loss that materially contributed to the failure of the covered financial company.

Section 210(s) of the Dodd-Frank Act limits the recoupment of compensation to those senior executives and directors who are "substantially responsible for the failed condition of the covered financial company." The Proposed Rule would provide that in assessing whether a senior executive or director is substantially responsible for the failed condition of the covered financial company, the FDIC as receiver will investigate (i) how the senior executive or director performed his or her responsibilities, and (ii) the results of that performance. Senior executives and directors who perform their responsibilities

with the requisite degree of skill and care will not be required to forfeit their compensation. If a senior executive or director fails to meet the requisite standard of skill and care, however, the FDIC as receiver will consider whether the senior executive or director caused a loss to the financial condition of the covered financial company as a result of that performance. The loss to the covered financial company must have materially contributed to the failure of the covered financial company for the FDIC as receiver to consider the senior executive or director substantially responsible for the failed condition of the covered financial company and, as a result, subject to recoupment of compensation.

The Proposed Rule provides for certain circumstances in which the FDIC as receiver will presume substantial responsibility. Substantial responsibility shall be presumed when the senior executive or director is the chairman of the board of directors, chief executive officer, president, chief financial officer, or acts in any other similar role regardless of his or her title if in this role he or she had responsibility for the strategic, policymaking, or company-wide operational decisions of the covered financial company. The FDIC as receiver also will presume that a senior executive or director is substantially responsible for the failed condition of a covered financial company when the senior executive or director has been adjudged to have breached his or her duty of loyalty to the covered financial company. Finally, in order to ensure consistency with the other actions taken by the FDIC as receiver during the liquidation of a covered financial company, this presumption also extends to a senior executive or director who has been removed from his or her position with a covered financial company under sections 206(4) or 206(5) of the Act.

A senior executive or director who falls within the presumption in the Proposed Rule may rebut the presumption. An individual presumed to be substantially responsible for the failed condition of a covered financial company based on his or her position or role in the covered financial company may rebut the presumption of substantial responsibility for the condition of the covered financial company by proving that he or she performed his or her duties with the requisite degree of skill and care required by the position. A senior executive or director presumed to be substantially responsible for the failed condition of a covered financial company based on his or her removal from his or her position under sections 206(4) or 206(5) of the Act, or based on an adjudication that he or she breached his or her duty of loyalty to the covered financial company may rebut the presumption by proving that he or she did not cause a loss to the covered financial company that materially contributed to the failure of the covered financial company.

Senior executives or directors who join a covered financial company specifically for the purpose of improving its financial condition are exempted from this presumption if they were hired by the covered financial company for this purpose within the two years preceding the appointment of the FDIC as receiver. However, although they are not subject to the presumption, the FDIC as receiver may still seek recoupment of their compensation if their actions nevertheless establish that they are substantially responsible for the failed condition of the covered financial company.

The use of a rebuttable presumption of substantial responsibility under certain circumstances is consistent with its use in other regulatory and common law areas. The Office of the Comptroller of the Currency uses rebuttable presumptions to determine when an individual's acquisition of bank stock will result in the acquisition by that

individual of the power to direct the bank's management or policies. See 12 C.F.R. § 5.50. The Social Security Administration uses presumptions to establish total disability. See 20 C.F.R. § 410. At common law, the existence of certain facts, such as exclusive control in negligence cases or disparate impact in discrimination cases, is viewed as sufficient to require some form of rebuttal evidence.

The authority of the FDIC as receiver to recoup compensation from senior executives and directors is separate from the authority granted to the FDIC as receiver in other sections of Title II to pursue recovery from senior executives and directors for losses suffered by a failed covered financial company. Section 204(a)(3) of the Act provides that the FDIC "will take all steps necessary and appropriate to assure that all parties, including management, directors and third parties having responsibility for the failed condition of the financial company bear losses consistent with their responsibilities." Section 210(f)(1) provides that the FDIC as receiver is authorized to seek damages from officers and directors for losses incurred by a covered financial company. The FDIC as receiver is not precluded from pursuing recovery based on other grants of authority in Title II of the Act because it recoups compensation from senior executives and directors under section 210(s) and may seek to hold senior executives and directors responsible under other sections in appropriate cases.

Predominantly Engaged In Financial Activities

Section 380.8 of the Proposed Rule implements section 201(b) of the Act, which requires the FDIC, in consultation with the Secretary of Treasury, to establish by regulation standards for determining, for the purposes of Title II, if a company is predominantly engaged in activities that are financial in nature or incidental thereto as

determined by the Board of Governors of the Federal Reserve System (FRB) under section 4(k) of the Bank Holding Company Act ("BHC Act"). A company that is predominantly engaged in such activities is a "financial company" under Title II and may be subject to the orderly liquidation provisions of the Dodd-Frank Act. Section 380.8 establishes the scope of the FDIC's orderly liquidation authority over financial companies that are neither nonbank financial companies supervised by the FRB under Title I nor bank holding companies.

Under § 380.8, a company is predominantly engaged in financial activities or activities that are incidental to financial activities for purposes of section 4(k) of the BHC Act, if at least 85 percent of the total consolidated revenues of the company for either of its two most recent fiscal years were derived from such activities ("85% consolidated revenue test"). See 12 U.S.C. 1843(k). The Proposed Rule expressly provides that revenues derived from the ownership or control of a depository institution would be included as revenues derived from financial activities. The Proposed Rule also permits the FDIC to determine, based on all the relevant facts and circumstances, that a company satisfies the 85% consolidated revenue test.

Additionally, § 380.8 uses the company's own accounting standards in determining whether the 85% consolidated revenue test is met. The Proposed Rule limits the permissible accounting standards to U.S. Generally Accepted Accounting Principles, International Financial Reporting Standards, or such other accounting standards that the FDIC determines are appropriate, provided the company uses such standards in the ordinary course of business in preparing its consolidated financial statements.

Section 380.8 also provides that in determining whether an activity is financial or incidental thereto, it is irrelevant (i) whether a bank holding company ("BHC") would be authorized to engage in the activity under any other provisions of Federal law or regulation, and (ii) whether other provisions of Federal or state law or regulations prohibit, restrict, or otherwise place conditions on the conduct of the activity by a BHC, financial holding company, or foreign bank.

Section 380.8 also includes two rules of construction governing the application of the 85% consolidated revenue test to revenues derived from a company's minority, non-controlling equity investments in unconsolidated entities. Under the first rule of construction, all of the revenues derived from a company's equity investment in another company ("investee company"), the financial statements of which are not consolidated with those of the company under applicable accounting standards, would be considered as revenues derived from a financial activity if the investee company itself is predominantly engaged in financial activities under the revenue test set forth in § 380.8.

The second rule of construction would permit (but not require) a company to treat revenues derived from certain de minimis equity investments in investee companies as not derived from financial activities without having to separately determine whether the investee company is itself predominantly engaged in financial activities ("de minimis rule"), subject to several conditions designed to limit the potential for such investments to substantially alter the character of the company's activities.

The FRB has issued a Notice of Proposed Rulemaking ("FRB's NPR") addressing a similar provision in Title I of DFA. See 76 FR 7731 (February 11, 2001. While the provisions of Title I addressing "predominantly engaged" differ from the provisions in

Title II, the Proposed Rule is similar to the FRB's NPR, to the extent permitted under the statute.

Avoidable Transfers

Section 380.9 of the Proposed Rule addresses two areas in which there is a potential for inconsistent treatment of transferees under a Dodd-Frank orderly liquidation as compared to a Chapter 7 bankruptcy liquidation. The first issue relates to the standard used in determining whether the FDIC as receiver can avoid a transfer as fraudulent or preferential under Title II. For purposes of this determination, section 210(a)(11)(H)(i)(II) of the Act provides that a transfer is made (a) when the transfer is so perfected that a *bona fide* purchaser cannot acquire a superior interest or (b) if the transfer has not been so perfected before the FDIC is appointed as receiver, immediately before the date of appointment. Title II could be read to apply the *bona fide* purchaser construct to all fraudulent transfers and to all preferential transfers (section 210(a)(11)(B) of the Dodd-Frank Act). By contrast, the Bankruptcy Code uses the *bona fide* purchaser construct only for fraudulent transfers and for preferential transfers of real property other than fixtures. Section 547(e)(1)(B) of the Bankruptcy Code provides that in the case of preferential transfers of personal property and fixtures, a transfer occurs at the time the transferee's interest in the transferred property is so perfected that a creditor on a simple contract[1] cannot acquire a judicial lien that is superior to the interest of the transferee. The proposed regulation would make clear that under section 210(a)(11)(H) of the Dodd-Frank Act, the FDIC could not, in a proceeding under Title II, avoid as preferential the grant of a security interest perfected by the filing of a financing statement in accordance

[1] The term "judicial lien" is defined in section 101(36) of the Bankruptcy Code as a lien obtained by judgment, levy, sequestration or other legal or equitable process or proceeding.

with the provisions of the Uniform Commercial Code where a security interest so perfected could not be avoided in a case under the Bankruptcy Code.

The second issue relates to the 30-day grace period, provided in section 547(e)(2) of the Bankruptcy Code, in which a security interest in transferred property may be perfected after such transfer has taken effect between the parties. Section 547(e)(2) generally states that a transfer of property is made (i) when the transfer takes effect between the transferor and the transferee, if the transfer is perfected at or within 30 days after that time (or within 30 days of the transferor receiving possession of the property, in the case of certain purchase money security interests), (ii) when the transfer is perfected, if the transfer is perfected after the 30-day period, or (iii) if such transfer is not perfected before the later of the commencement of the bankruptcy case or 30 days after the transfer takes effect, immediately before the date when the bankruptcy petition is filed. Section 210(a)(11)(H) of the Dodd-Frank Act does not contain any express grace period. Consistent with the direction provided in section 209 of the Act to harmonize the regulations with otherwise applicable insolvency law to the extent possible, and to facilitate implementation of the avoidable transfer provisions of sections 210(a)(11)(A) and (B) of the Act, § 380.9 of the Proposed Rule includes provisions that would result in the following:

- the avoidance provisions in section 210(a)(11) would apply the *bona fide* purchaser construct only in the case of fraudulent transfers under subparagraph (A) thereof and preferential transfers of real property (other than fixtures) under subparagraph (B) thereof;

- the avoidance provisions in section 210(a)(11)(B) would apply the "hypothetical lien creditor" construct as applied under section 547(e)(1)(B) of the Bankruptcy Code to any preferential transfers of personal property and fixtures; and
- the avoidance provisions in section 210(a)(11)(B) would apply the 30-day grace period as provided in section 547(e)(2) of the Bankruptcy Code, including any exceptions or qualifications contained therein.

Subpart A – Priorities

The following sections would appear under Subpart A of the Proposed Rule.

Section 380.20 of the Proposed Rule contains a definition of the term "allowed claim" which is used throughout Subpart A to mean a claim in the amount allowed by the Corporation as receiver in accordance with the procedures established in Subpart B of the Rule, or as determined by the final order of a court of competent jurisdiction.

Section 380.21 lists each of the eleven priority classes of claims established under the Dodd-Frank Act in the order of its relative priority. In addition to the specified priorities listed in section 210(b), the Proposed Rule integrates additional levels of priority established under section 210(c)(13)(d) (certain post-receivership debt); section 210(a)(13) (claims for loss of setoff rights); and section 210(a)(7)(D) (post insolvency interest). In order, the eleven priorities are as follows:

(1) claims with respect to post-receivership debt extended to the covered financial company where such credit is not otherwise available;

(2) other administrative costs and expenses;

(3) amounts owed to the United States;

(4) wages, salaries and commissions earned by an individual within 6 months prior to the appointment of the receiver up to the amount of $11,725 (as adjusted for inflation);

(5) contributions to employee benefit plans due with respect to such employees up to the amount of $11,725 (as adjusted for inflation) times the number of employees;

(6) claims by creditors who have lost setoff rights by action of the receiver;

(7) other general unsecured creditor claims;

(8) subordinated debt obligations;

(9) wages, salaries and commissions owed to senior executives and directors;

(10) post-insolvency interest, which shall be distributed in accordance with the priority of the underlying claims; and

(11) distributions on account of equity to shareholders and other equity participants in the covered financial company.

Paragraph (b) of section 380.21 conforms the method of adjusting certain payments for inflation to the similar provisions of the Bankruptcy Code. Paragraph (c) provides that each class will be paid in full before payment of the next priority, and that if funds are insufficient to pay any class of creditors, the funds will be allocated among creditors in that class, *pro rata*.

Section 380.22 of the Proposed Rule expands and clarifies the statutory definition of "administrative expenses of the receiver" by consolidating all statutory references to administrative expenses in a single rule, and by making clear that administrative expenses can include costs and expenses incurred by the FDIC prior to the appointment of the

receiver, as well as post-appointment expenses if the expenses are necessary and appropriate to facilitate the smooth and orderly liquidation of the covered financial company. This is consistent with 12 C.F.R. § 360.4 with respect to determination of administrative expenses under the FDI Act. In a bankruptcy case, the prepetition expenses of preparing and filing the petition must be paid prior to filing or await confirmation.

Section 380.23 of the Proposed Rule would establish a definition of "amounts owed to the United States" that are entitled to be paid at the level of priority following administrative expenses. It makes clear that "amounts owed to the United States" include amounts advanced by the Department of Treasury, or by any other department, instrumentality or agency of the United States, whether such sums are advanced before or after the appointment of the receiver. It expressly includes advances by the FDIC for funding of the orderly liquidation of the covered financial company pursuant to section 204(d)(4) of the Act but also includes other sums advanced by departments, agencies and instrumentalities of the United States such as payments on FDIC corporate guarantees, including the Temporary Liquidity Guarantee Program and unsecured accrued and unpaid taxes owed to the United States. Unsecured claims for net realized losses by a Federal Reserve Bank also are included, consistent with the mandate under section 1101 of the Act that requires such advances to have the same priority as amounts due to the United States Treasury. The Proposed Rule would not give the same level of priority to amounts advanced by government-sponsored entities such as FNMA, FHMLC or Federal Home Loan Banks.

The Proposed Rule would expressly acknowledge that amounts advanced by the FDIC for the orderly liquidation of the covered financial company will be repaid after other administrative expenses of the receiver regardless of whether such advance is secured by a lien under section 210(4)(d) of the Act or not, in recognition that the claw-back and additional assessments authority under section 210(o) effectively guarantees repayment of these advances in any event. Although the statute permits a distinction between advances for the purpose of administrative expenses that are repayable at the administrative expense priority, and other advances that are repaid after the payment of administrative expenses, there is little practical difference in that all amounts advanced under section 204(d)(4) will be repaid, so that the burden of tracking the actual uses of various amounts advanced is unwarranted. As a practical matter, the only potential difference in the payment of a claim at the administrative expense priority under § 380.21(a)(2) and a claim at the priority class for amounts owed to the United States under § 380.21(a)(3) would be the timing of the payment, and that potential differential would be mitigated by the payment of interest at the post-insolvency interest rate as described in § 380.25.

Paragraph (b) of § 380.23 acknowledges that the United States may subordinate its right to repayment behind any class of creditors by express written consent, provided that in any event all amounts due to the United States must be paid prior to any payment to equity holders of the covered financial company. Absent such express written subordination, all amounts owed to the United States will be paid at the priority under § 380.21(a)(3), regardless of whether they are characterized as debt or equity on the books of the covered financial company.

Section 380.24 of the Proposed Rule addresses the claims of creditors who have lost a right of setoff due to the exercise of the receiver's right to sell or transfer assets of the covered financial company free and clear of any setoff right. This transfer would destroy the mutuality that is the pre-requisite of any setoff, and therefore would cause the creditor to lose the ability to offset its claim directly against an asset of the covered financial company. Several commenters addressed this issue. Under the Dodd-Frank Act, the receiver is expressly authorized to sell assets free and clear of setoff claims and the resulting claim for loss of those rights is expressly given a priority above other general unsecured creditors – but below administrative claims, amounts owed to the United States and several other classes of unsecured claims. The Proposed Rule clearly establishes that the Corporation as receiver will pay claimants for their loss of setoff rights in accordance with the express provisions of the Dodd-Frank Act.

Section 380.25 of the Proposed Rule would establish a post-insolvency interest rate, as required by section 210(a)(7)(D) of the Dodd-Frank Act. That rate is established based upon the coupon equivalent yield of the average discount rate set on the three-month T-bill. Post-insolvency interest is computed quarterly and is not compounded. The Bankruptcy Code provides in section 726(a)(5) for interest at the "legal rate," however, in interpreting this provision, the Bankruptcy Courts have not established a uniform post-petition interest rate. As the two approaches are functionally equivalent, the Proposed Rule provides for post-insolvency interest in the same manner as provided for under the FDI Act pursuant to 12 C.F.R. § 360.7, as that familiar rule will be easier to administer.

Section 380.26 of the Proposed Rule provides that any obligation transferred to and assumed by the bridge financial company will be paid by the bridge financial company in accordance with its terms. Several comments requested that a rule be promulgated to provide clarity about the relationship between the bridge financial company and the creditors of the covered financial company. Section 380.26 clarifies that relationship. That section provides that any obligation that is finally and unconditionally transferred to the bridge financial company is assumed and will be paid by the bridge financial company in accordance with its terms rather than being subject to the claims process.

The Dodd-Frank Act contemplates several means of disposing of the assets and liabilities a bridge financial company and terminating its existence. It can be sold by merger or consolidation or a sale of stock, following which the bridge financial company's federal charter is would be terminated and any remaining assets liquidated. A bridge financial company also can be liquidated by a sale of assets and assignment of liabilities. If, however, it is not liquidated and terminated within two years of the date it is chartered (subject to not more than three one-year extensions of such 2-year period), then the FDIC, as receiver for the bridge financial company, will wind up the affairs and dissolve the bridge financial company in the same manner as provided for the liquidation of a covered financial company. The Proposed Rule makes clear that in any event, the any proceeds that remain following the sale, liquidation and of the bridge financial company, whether by stock sale, asset sale, merger or consolidation or otherwise, will be made available to the creditors of the covered financial company once all administrative expenses and other creditor claims of the bridge financial company have been satisfied.

Subpart B – Receivership Administrative Claims Process

The following sections appear under Subpart B of the Proposed Rule.

Section 380.30 of the Proposed Rule reflects the express authorization under the Dodd-Frank Act that the FDIC as receiver shall determine all claims in accordance with the statutory procedures as well as in accordance with the specific regulations promulgated by the FDIC. This section also clarifies that the administrative claims process will not apply to claims transferred to a bridge financial company or to third parties to whom such claims are transferred.

Section 380.31 of the Proposed Rule defines the term "claim" to have the same meaning as in the Dodd-Frank Act, essentially a "right of payment" from the covered financial company. This definition is generally consistent with the definition of the term in the Bankruptcy Code. The Proposed Rule modifies the definition slightly to clarify that a "claim" means a right to payment not only from the covered financial company but also from the FDIC as receiver. This modification is necessary to make the administrative claims process consistent with the limitation on court jurisdiction of section 209(d)(9) of the Act, which absent compliance with the claims process, divests jurisdiction over claims seeking payment from the assets of the covered financial company and claims based on errors and omissions of the receiver. The terms "Corporation," "Corporation as receiver," and "receiver" are used interchangeably in the statute and the Proposed Rule clarifies that such terms refer to the FDIC in its capacity as receiver of a covered financial company.

Section 380.32 of the Proposed Rule confirms the statutory requirement that the FDIC as receiver establish a "claims bar date" by which creditors of the covered financial

company must file their claims with the receiver. The claims bar date would be included in both the published notice and the mailed notice required by the statutory procedures. The Proposed Rule also clarifies that that the claims bar date will be not less than 90 days after the date of the *first* published notice to creditors.

Section 380.33 of the Proposed Rule reiterates the statutory procedures for notice to creditors. As required by the statute, upon its appointment as receiver of a covered financial company, the FDIC will cause to be published a first notice to creditors to present their claims, and subsequently will publish a second and third notice one month and two months, respectively, after the first notice is published. The Proposed Rule provides that the notice will be published in one or more newspapers of general circulation in the market where the covered financial company had its principal place of business. In recognition of the prevalence of and common reliance on communication via the internet, the Proposed Rule also provides that in addition to the published and mailed notices, the FDIC may post the notice on its public website. Similarly, the Proposed Rule provides that the FDIC may communicate by electronic media (such as email) with any claimant who agrees to such means of communication.

Paragraph (d) of § 380.33 clarifies the treatment of claimants that are discovered after the initial publication and mailing. If the receiver discovers before the claims bar date the existence of a creditor not appearing on the books and records, the receiver will have 30 days to mail to such claimant a notice to file claims by the claims bar date. If the receiver discovers a claimant after the claims bar date, however, the claims bar date is clearly inapplicable. In this case, the claimant will be given 90 days to file its claim. The

failure to file a claim before the end of the 90-day period will result in disallowance of the claim.

Section 380.34 of the Proposed Rule provides that the receiver shall utilize reasonably practicable means to provide creditors with instructions on how to file a claim. These include providing contact information in the publication notice; providing a proof of claim form with filing instructions with the mailed notice; and posting a link to filing instructions on the FDIC's public website. A claim would be deemed to be filed as of the date of postmark if the claim is mailed and as of the date of transmission if the claim is submitted by facsimile or electronically. This section also confirms existing law that each individual claimant must submit its own claim and that no single party may assert a claim on behalf of a class of litigants. On the other hand, a trustee named or appointed in connection with a structured financial transaction or securitization is permitted to file a claim on behalf of the investors as a group because in such a case the trustee legally owns the claim. The Proposed Rule also reiterates the statutory provisions that the filing of a claim constitutes the commencement of an action for purposes of any applicable statute of limitations and does not prejudice a claimant's right, after the receiver determines the claim, to continue any legal action filed prior to the date of the receiver's appointment.

Section 380.35 of the Proposed Rule recognizes that under the statute, the FDIC as receiver may disallow all or any portion of a claim, including a claim based on security, preference, setoff or priority, which is not proved to the receiver's satisfaction. Pursuant to the statutory procedures, the receiver is required to disallow any claim that is filed after the claims bar date, subject to the statutory exception for late-filed claims.

Under this exception, a late-filed claim will not be disallowed if the claimant did not have notice of the appointment of the receiver in time to file by the claims bar date and the claim is filed in time to permit payment by the receiver. The Proposed Rule establishes that the claims process applies to claims that do not accrue until after the claims bar date and that such claims satisfy the statutory late-filed claim exception. Claims of this type may include claims that arise if the receiver repudiates a contract after the claims bar date, or claims that arise from acts or omissions of the FDIC as receiver that occur after the claims bar date. The Proposed Rule also provides a necessary definition of the phrase "filed in time to permit payment" to refer to a claim that is filed at any time before the FDIC as receiver makes a final distribution from the receivership of the covered financial company.

Section 380.36 of the Proposed Rule reiterates that under the statute the FDIC as receiver has up to 180 days to review a claim after the claim is filed. The Proposed Rule also reflects that under the statute the claimant and the receiver may extend the claims determination period by agreement in writing.

Section 380.37 of the Proposed Rule reflects the statutory requirement that the receiver notify the claimant of the determination of the claim and that the notification may be mailed to the claimant as specified in the statutory procedure. If the receiver has disallowed the claim, the notification shall explain each reason for the disallowance and advise the claimant of the procedures to be followed for the claimant to seek judicial review of the claim. Consistent with the statute, the Proposed Rule provides that for purposes of triggering the procedures for seeking judicial review of the claim, a claim shall be deemed to be disallowed if the receiver does not notify the claimant prior to the

end of the 180-day determination period or any extended claims determination period agreed to by the claimant.

Section 380.38 of the Proposed Rule reflects the statutory procedures for a claimant to seek a judicial determination of its claim when it has been disallowed by the FDIC. As provided by the statute, the Proposed Rule states in clear terms that a claimant may either file suit on its disallowed claim in the district court where the covered financial company's principal place of business is located, or continue in the original court a suit that the claimant had commenced before the FDIC was appointed as receiver of the covered financial company. (In the latter case, the FDIC would have the authority to remove the action to federal court if it chose to do so.) The Proposed Rule also confirms that under the statute, the claimant would have 60 days to commence or continue an action. This time period is calculated from the date of the notification of disallowance; otherwise, from the end of the 180-day claims determination date, or the end of the extended determination date, if any. If a claimant fails to file suit on a claim (or continue a pre-receivership suit) within the 60-day period, the claimant will have no further rights or remedies with respect to the claim. This time period would not be subject to a tolling agreement between the FDIC and the claimant. Because the FDIC can neither confer nor divest the jurisdiction of a federal court, the Proposed Rule merely reiterates the statutory provision that the jurisdiction of any court to hear a claim against the covered financial company or the receiver is conditioned on the claimant first exhausting its administrative remedies by filing a claim with the FDIC as receiver and receiving a determination on that claim.

The remaining sections of proposed Subpart B address secured claims.

Section 380.50 of the Proposed Rule reflects the statutory provision that a secured claim may be separated into a secured component, the amount of which is equal to the value of the property serving as collateral for the claim, and an unsecured component, which may be paid *pari passu* with other unsecured claims.

Section 380.51 of the Proposed Rule provides that the FDIC as receiver may grant the consent contemplated under sections 210(c)(13)(C) and 210(q)(1)(B) of the Act. Section 210(c)(13)(C) provides that during the 90-day period after the FDIC is appointed receiver of a covered financial company, no person may exercise any right to terminate, accelerate, or declare a default under any contract to which the covered financial company is a party, or obtain possession of or exercise control over any property of the covered financial company, or affect any contractual rights of the covered financial company, without the consent of the FDIC as receiver. Section 210(q)(1)(B) provides that no property of the FDIC as receiver shall be subject to levy, attachment, garnishment, foreclosure, or sale without the consent of the receiver. The Proposed Rule establishes that the FDIC may grant consent to a secured creditor to obtain possession of or exercise control over property of the covered financial company that serves as collateral for a secured claim, or to foreclose upon or sell such property. It is most likely that the receiver would grant consent in a situation in which the collateral is worth less than the claim it secures.

Section 380.52 of the Proposed Rule reflects the statutory provision that the authority to repudiate a contract of the covered financial company will not have the effect of avoiding any legally enforceable and perfected security interests in the property. The Proposed Rule reflects existing law under the FDI Act by providing that in the event of

repudiation, the security interest would go from securing the contract to securing a claim for repudiation damages. The FDIC may consent to the liquidation of the collateral by the creditor and application of the proceeds to the claim for repudiation damages in accordance with the procedures for consents set forth in § 380.51.

Section 380.53 of the Proposed Rule would implement the requirement of section 210(a)(5) of the Act that the FDIC establish an expedited claims determination procedure for secured creditors who allege that they will suffer irreparable injury if they are compelled to follow the ordinary claims process. The expedited claims procedure established by the Proposed Rule tracks the statutory procedures and time frames set forth in section 210(a)(5). Under such procedures, the receiver has 90 days to review the secured claim, and the secured creditor has 30 days to file or continue an action for judicial review of the claim.

Section 380.54 of the Proposed Rule further addresses how the receiver may treat property that serves as collateral for a secured claim. A number of comments were received on the topic of the receiver's valuation and disposition of collateral, and this section of the Proposed Rule attempts to address this issue. As discussed, § 380.51 of the Proposed Rule provides that the receiver may consent to the secured creditor's exercise of rights against the collateral, including its liquidation. Section 380.54 provides an alternative that the receiver may sell the collateral, but the security interest will attach to the proceeds. The receiver may want to sell the collateral if its value exceeds the amount of the claim that it secures. In the event of a sale by the receiver, the secured creditor will be permitted to purchase the collateral and may "credit bid" the amount of its claim against the purchase price.

Section 380.55 of the Proposed Rule provides that the FDIC as receiver may redeem the property of the covered financial company from a lien held by a secured creditor by paying the fair market value of the collateral in cash to the secured creditor. The ability to exercise this power may be important to the receiver in a situation in which use or possession of the property would be necessary to the orderly liquidation of the covered financial company.

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