May 29, 2012

Via electronic submission to *www.fdic.gov/regulations/laws/federal*

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Comment on Notice of Proposed Rulemaking Clarifying Enforcement of Subsidiary and Affiliate Contracts by the FDIC as Receiver of a Covered Financial Company under §210(c)(16)

Dear Mr. Feldman:

The Clearing House Association,[1] The Financial Services Roundtable,[2] and the Securities Industry and Financial Markets Association[3] respectfully submit this comment letter

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[1] Established in 1853, The Clearing House is the nation's oldest banking association and payments company. It is owned by the world's largest commercial banks, which collectively employ 1.4 million people in the United States and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the U.S. See The Clearing House's web page at www.theclearinghouse.org.

[2] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

[3] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

in response to an invitation to comment on the FDIC's Notice of Proposed Rulemaking (the "**Proposed Rule**")[4] relating to section 210(c)(16) of the Orderly Liquidation Authority ("**OLA**") provisions of Dodd-Frank.

Section 210(c)(16) is an important tool for mitigating systemic risk during the resolution of a covered financial company ("**CFC**"). By helping the FDIC to preserve subsidiaries and affiliates of the CFC as going concerns, section 210(c)(16) supports a variety of resolution options that provide for continuity of the CFC's operations, such as a recapitalization or an orderly restructuring. In order to effectively preserve the continuity of operations and reduce systemic risk, section 210(c)(16) empowers the FDIC to interfere with the contractual rights of counterparties to subsidiaries and affiliates of the CFC. But the statute tempers this power with protections for creditors whose rights have been affected by requiring that the bargain originally struck with the subsidiary or affiliate be effectively replicated through the transfer of related credit support or other adequate protection. The spirit of section 210(c)(16) is thus to justify the interference with contractual rights by functionally protecting a creditor's bargain.

We applaud the FDIC for providing much-needed clarifications of certain terms used in section 210(c)(16) and embracing the spirit of the statute. Further, we believe that the Proposed Rule largely promotes the resolvability of financial companies and is an important step towards ending "too big to fail." However, we believe that certain aspects of the Proposed Rule unintentionally upset the balance between systemic-risk reduction and creditors' rights by departing from the statute's emphasis on functionally preserving the bargain originally struck between the subsidiaries or affiliates and their counterparties and introducing uncertainty of outcomes. It is only with the confidence that they will be treated predictably and fairly that counterparties will continue to transact with a troubled financial group before, during and after its resolution rather than "run" at the first hint of weakness. Therefore, without adequate protection of creditors' interests, section 210(c)(16) cannot achieve its goal of reducing systemic risk.

We believe that the balance between these two important goals can easily be restored in a way that is consistent with the FDIC's interests. This letter identifies our key areas of concern:

- Clarifying that the FDIC's authority under section 210(c)(16) cannot be exercised to enforce contracts under which the subsidiary or affiliate of the CFC itself has defaulted, because it failed to make a payment or otherwise perform its contractual obligations or is the subject of insolvency proceedings, even if such default arose because of the failure or resolution of the CFC;

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[4] 77 Fed. Reg. 18127 (Mar. 27, 2012).

- Requiring that adequate protection be provided when enforcing contracts "linked to," but not "supported by," the CFC (as required under section 210(c)(16)) and that setoff and netting rights be taken into account when enforcing contracts or determining the adequate protection that must be provided;

- Preserving the rights of counterparties to call for margin based on the credit quality of the relevant affiliate of the other party to the contract, whether such affiliate is a qualified transferee or the CFC; and

- Providing further clarification of the definition of "adequate protection" and, in particular, the meaning of "indubitable equivalent" in the context of section 210(c)(16).

I. Clarifying the Scope of "Indirect" Cross-Defaults

The Proposed Rule should be revised to clarify that authority under section 210(c)(16) cannot be exercised to enforce contracts upon a default by a subsidiary or affiliate of the CFC itself. We do not believe that the FDIC intended the Proposed Rule to apply to such defaults, but the Proposed Rule could be interpreted to yield such a result. The Proposed Rule prohibits the exercise of rights "directly or indirectly based upon or by reason of . . . [a] change in the financial condition or the insolvency of" the CFC. Take, for example, a subsidiary of a financial company that relies on its parent for funds with which to make contractual payments to its counterparties, and the parent financial company is placed into receivership under OLA. If the subsidiary defaults on its contractual payment obligations because the parent CFC is no longer capable of providing it with the necessary funds, it could be argued that the subsidiary's payment default occurred "by reason of . . . [a] change in the financial condition or the insolvency of" the parent CFC and that the FDIC could prohibit the exercise of any default remedies premised on such default. Similarly, if a subsidiary or affiliate of the CFC were to enter insolvency proceedings, and the failure of the subsidiary or affiliate was caused by the failure of the CFC, it could be argued that the Proposed Rule would permit the FDIC to enforce contracts of the subsidiary or affiliate.

We believe that the intention of the Proposed Rule, as stated in the preamble, was to include within the scope of section 210(c)(16) cross-default rights that reference "another company or an affiliate in the corporate structure" and not to address direct defaults. We recommend that the FDIC clarify the scope of "indirect" cross-defaults by specifically exempting from the FDIC's enforcement powers under section 210(c)(16) the exercise of rights premised on payment, performance, insolvency or other contractual defaults of the subsidiary or affiliate of the CFC.

The Proposed Rule also should be revised to clarify that contractual rights of a counterparty to demand performance from a subsidiary or affiliate of the CFC at any time and for any reason cannot be interfered with under section 210(c)(16), without inquiry as to

whether the demand is made as a result of the CFC's default. We do not believe that it was the FDIC's intention to interfere with such rights, as the ability to demand performance is fundamental to the nature of contracts containing such unrestricted demand rights. To eliminate such rights would be to fundamentally alter the bargained-for arrangement, essentially rewriting the contract to extend its original maturity.

Accordingly, we recommend that the following language be added to the end of § 380.12(a) as new subsection (4):

> (4) Nothing in this rule shall affect any right of a counterparty to a contract with a subsidiary or affiliate of a covered financial company (i) to terminate, accelerate, liquidate or exercise any other remedy arising by reason of a default by or in respect of such subsidiary or affiliate itself or (ii) in cases where the counterparty has a right to demand performance at any time and for any or no reason, to demand such performance.

II. Requiring Adequate Protection for Overriding "Naked" Cross-Defaults

The Proposed Rule should be revised to require that adequate protection be provided when enforcing "naked" cross-defaults (contracts that are "linked to," but not "supported by," the CFC).[5] By its terms, the statutory requirement that the FDIC either transfer related credit support or provide adequate protection when enforcing contracts of subsidiaries or affiliates of the CFC apply equally to contracts that are "linked to or supported by" the CFC. Contrary to the statute, the Proposed Rule enforces all contracts of subsidiaries and affiliates of the CFC that are "linked to" the CFC's insolvency or financial condition without any action required by the FDIC as receiver.

This provision of the Proposed Rule is inconsistent with the statute's spirit of providing continuity of contract by replicating bargained-for arrangements. It is common practice in many circumstances to include a cross-default to a parent or affiliate even in the absence of credit support from such entity, and such rights have value to the parties who bargain for them. Under the statute, the rights of such parties must be adequately protected in order for the FDIC to override such cross-defaults.

In many resolution scenarios, the equity in the subsidiaries of the CFC will be transferred to a bridge financial company or to a third-party acquirer. In such cases, adequate protection of naked cross-default rights in contracts of the transferred subsidiaries could be

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[5] Under the Proposed Rule, a contract is ''linked'' to a CFC if it contains a "specified financial condition clause" that gives the "counterparty a right to terminate, accelerate or exercise default rights or remedies as a result of any action or circumstance that results in or arises out of the exercise of the orderly liquidation authority."

provided by replicating the original bargain by providing the counterparty with a cross-default linked to the CFC's transferee. The FDIC could provide such cross-default right by causing the subsidiary to offer to agree to amendments replacing references to the CFC in any naked cross-defaults with references to the CFC's transferee.

It is possible that the FDIC could attempt to enforce those contracts of subsidiaries of the CFC with naked cross-default rights even in the absence of a transfer of the equity in such subsidiary to a bridge financial company or third-party acquirer. Further, the FDIC could attempt to enforce contracts of affiliates of the CFC with naked cross-default rights. Calculating the value of the loss of such cross-default rights may be difficult in these circumstances, although such difficulty does not absolve the FDIC of its statutory obligation to provide adequate protection. The FDIC may need to make case-by-case determinations of adequate protections in such situations, looking at factors such as the tenor of the particular contracts, the nature of the obligations, whether the obligations are secured or unsecured or benefit from setoff or netting rights, the nature and health of the subsidiary or affiliate, and whether the affiliate that is a party to the contract remains affiliated with the CFC or its transferees (if any).

Accordingly, we recommend the following revisions to § 380.12(a)(2):

> (2) Notwithstanding paragraph (a)(1) of this section, if the obligations under such contract are supported by or linked to the covered financial company then such contract shall be enforceable only if—
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> > (i) In the case of a contract supported by the covered financial company, any ~~Any~~ such support together with all related assets and liabilities are transferred to and assumed by a qualified transferee not later than 5 p.m. (eastern time) on the business day following the date of appointment of the Corporation as receiver for the covered financial company; or
> >
> > (ii) In the case of a contract of a subsidiary of a covered financial company linked to such covered financial company, the Corporation provides notice consistent with the requirements of paragraph (d) of this section not later than 5 p.m. (eastern time) on the business day following the

date of appointment of the Corporation as receiver that (A) the direct or indirect equity or other ownership interest of the covered financial company in the subsidiary has been transferred to a qualified transferee, (B) the Corporation will cause the subsidiary to offer to enter into an amendment to such contract as soon as practicably possible to link such contract to such qualified transferee to the same extent the contract had been linked to the covered financial company, and (C) until the amendments described under (B) above have been made, the Corporation will cause the subsidiary to permit the counterparty to terminate, accelerate, liquidate or exercise any other remedy as if such amendments had been made; or

(iii) ~~(ii)~~If and to the extent neither paragraph (a)(2)(i) nor (a)(2)(ii) of this section is ~~not~~ satisfied, or in the case of a contract of an affiliate of a covered financial company linked to such covered financial company, the Corporation as receiver otherwise provides adequate protection to the counterparties to such contracts with respect to the covered financial company's support of, or linkage to, the obligations or liabilities of the subsidiary or affiliate and provides notice consistent with the requirements of paragraph (d) of this section not later than 5 p.m. (eastern time) on the business day following the date of appointment of the Corporation as receiver.

Further, we recommend that the Proposed Rule be amended to prohibit the exercise of authority under section 210(c)(16) in a way that impairs QFC setoff or netting rights. These rights could be impaired under a number of scenarios involving a counterparty that has

multiple QFCs with, e.g., a subsidiary of the CFC, some of which are "linked to" the CFC while others are "supported by" the CFC.[6] Two such scenarios are illustrated below:

- If the FDIC does not transfer the credit support with respect to the QFCs "supported by" the CFC (perhaps because it has left in the receivership estate the equity in the subsidiary), under the Proposed Rule the counterparty would be entitled to close out the "supported" QFCs but would be prohibited from closing out the "linked" QFCs, which are automatically enforced under the Proposed Rule.[7] If the "supported" QFCs were out of the money and the "linked" QFCs were in the money, the counterparty would be left with the choice of terminating the "supported" QFCs and possibly forfeiting setoff rights, or not terminating the "supported" QFCs and risking adverse market movements.

- Alternately, assuming adoption of the amendments to § 380.12(a)(2) proposed above, if the FDIC transferred the credit support with respect to the "supported" QFCs but failed to provide adequate protection for the "linked" QFCs, the counterparty would be entitled to close out the "linked" QFCs but prohibited from closing out the "supported" QFCs. If the "linked" QFCs were out of the money and the "supported" contracts in the money, the counterparty would again have the choice of terminating and potentially losing setoff rights, or not terminating and facing adverse market movements.

In both of these scenarios, therefore, the counterparty's QFC setoff and netting rights would be impaired, which is not a result that we believe the FDIC intends. Moreover, OLA expresses a strong policy interest in favor of protecting QFC setoff and netting rights, and any exercise of authority under section 210(c)(16) that impairs these rights would be contrary to the spirit of the statute.

Accordingly, we recommend that the following be added to § 380.12(a) as a new subsection (5):

> (5) Notwithstanding any other provision of this section, a qualified financial contract of a

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[6] For non-QFCs, as discussed above, we believe that the FDIC's determination as to the form and value of adequate protection should take into account setoff and netting rights and their impairment. For QFCs, however, as discussed below, we believed additional protections are necessary.

[7] There are good arguments that, like credit support of a QFC provided by a CFC, the "linkage" of a QFC to the CFC may itself be a QFC and thus subject to the all-or-none QFC-transfer requirements. Such arguments are, however, untested, and thus we believe that the Proposed Rule should be amended as set forth above.

> subsidiary or affiliate of a covered financial company shall only be enforceable to the extent that such enforcement does not impair any setoff or netting rights of the counterparty to such contract with respect to other qualified financial contracts between the counterparty and such subsidiary or affiliate.

III. Preserving Rights To Call for Additional Margin

The Proposed Rule should be revised to preserve the right of a counterparty to call for margin based on the changed credit quality of affiliates of the other party to the contract. As drafted, the Proposed Rule would prevent a margin call against a subsidiary or affiliate of a CFC premised on a post-receivership change in the rating of the CFC.[8] Prohibiting such margin calls goes beyond the statutory scope of section 210(c)(16), which only permits the FDIC to override contractual provisions to "terminate, liquidate or accelerate." More significantly, we believe that prohibiting such margin calls is contrary to the spirit of section 210(c)(16), which is to provide for the continued performance of contracts of subsidiaries and affiliates of the CFC and to preserve the arrangements bargained for among the parties.

Further, it is unclear how margin should be calculated under the Proposed Rule. It would appear that margin levels would be frozen based on the rating of the CFC immediately before its entry into receivership under OLA (since any subsequent changes in margin levels would be prohibited under the rule). This approach would produce anomalous results when credit support is transferred to a rated third party or to a bridge that subsequently becomes rated. For example, even if the bridge is rated higher than the CFC, under the Proposed Rule the counterparty could apparently continue to call for margin based on the CFC's last rating.

We believe that the right approach is to reproduce the original bargain by providing that rights to margin under contracts "supported" by the CFC and enforced by the FDIC be based on the rating of the bridge or third-party acquirer to which such credit support is transferred. Similarly, where naked cross-default rights are "transferred" to a successor parent, as described above, margin levels should be based on the rating of the transferee. In the absence of any such transferee, we believe that margin levels should be based on the changed status of the CFC.

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[8] The definition of "specified financial condition clause" includes any provision of a contract that "permits a contract counterparty to . . . obtain possession or exercise control over any property of the subsidiary or affiliate." Furthermore, the preamble to the Proposed Rule states that the "effect of [the FDIC's] ability to enforce the contract is intended to be broad enough to preclude the counterparties from . . . requiring additional collateral."

It is possible that a bridge transferee may not have a rating at the time of such transfers. We understand that margin calls based on the unrated status of a bridge transferee could affect the liquidity available during resolution. We recommend that the FDIC and industry work together to develop approaches to address any possible negative liquidity effects that such margin calls may have on the CFC, its subsidiaries and affiliates or any related bridge transferee. One approach could be the development of methods for quickly establishing a credit rating for bridge entities chartered under OLA, which could reduce or eliminate the period of time when a bridge is unrated. Working with rating agencies, it may be possible to develop a prospective or pro forma rating for bridge entities based on the provisions of OLA relating to a bridge's ability to pay, such as: the requirement that assets transferred to a bridge equal or exceed the liabilities transferred to the bridge; the role of the Orderly Liquidation Fund in financing a resolution; and the ability of the FDIC to assess industry for any shortfalls. Another approach to addressing liquidity concerns might be for the FDIC to provide a temporary "credit substitution" guarantee of the obligations of the bridge until such time as the bridge can be rated on its own. We believe that working together we can develop approaches that are consistent with the statutory limitations of section 210(c)(16) and promote effective resolution strategies.

Accordingly, we recommend that the following be added to § 380.12(a) as a new subsection (6):

> (6) Notwithstanding any other provision of this section—
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> > (i) The enforcement by the Corporation of a contract pursuant to paragraph (a)(1) of this section shall not affect (A) any right of the counterparty to the contract to demand additional collateral, margin or security pursuant to the terms of the contract or (B) any obligation of the subsidiary or affiliate of the covered financial company party to the contract to satisfy any such demand made pursuant to the terms of the contract.
> >
> > (ii) If the Corporation satisfies either paragraph (a)(2)(i) or (a)(2)(ii) of this section with respect to a contract enforced pursuant to paragraph (a)(1) of this section, the Corporation will cause the subsidiary party to the contract to—
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> > > (A) Offer to enter into an amendment to the contract as soon as practicably possible

to replace any references to the covered financial company for purposes of calculating the amount of margin, collateral or security that must be provided by the subsidiary with references to the relevant qualified transferee, and

(B) Until the amendments described under (A) above have been made, provide margin, collateral or security as if such amendments had been made.

IV. <u>Further Clarification of Adequate Protection</u>

We ask that the FDIC further clarify the definition of “adequate protection” and in particular the meaning of “indubitable equivalent” under the Proposed Rule. The preamble explains that the definition of adequate protection should be consistent with the definition of “adequate protection” under section 361 of the Bankruptcy Code and notes in particular that it and “indubitable equivalent” should be read as having meanings consistent with their respective uses and applications under the Bankruptcy Code. However, under the Bankruptcy Code, these terms are applied in the context of secured obligations, whereas, under section 210(c)(16), they are applied in the context of potentially unsecured credit-support obligations or naked cross-defaults. In addition, treatment of these terms under the Bankruptcy Code varies among different jurisdictions and cases. The application of these concepts therefore remains somewhat uncertain under the Proposed Rule. While we believe that the FDIC means for “adequate protection” to protect counterparties from any incremental loss sustained due to actions taken by the FDIC as receiver for a covered financial company, clarifying this view could help provide much-needed certainty with respect to the application of this term.

We also ask for further clarity on the application of the first prong of the definition of adequate protection, providing for one-time or periodic cash payments, and the circumstances under which it might be applicable. In particular, it would be helpful to better understand the difference between this form of adequate protection and the guarantees provided for under the second prong of the definition.

Finally, we ask the FDIC to clarify the procedures by which counterparties to enforced contracts may challenge the FDIC’s determination that it has provided adequate protection. Consistent with previous recommendations that we have made to the FDIC regarding rules implementing OLA, we recommend that similarly situated creditors be able to collectively challenge determinations of the FDIC to reduce the burden on creditors and the FDIC in resolving such issues and to ensure consistent outcomes for such similarly situated parties.

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We appreciate this opportunity to comment on the FDIC's Proposed Rule and your consideration of the views expressed in this letter. Many of these matters are complex, and we would welcome the opportunity to meet with you to discuss the Proposed Rule and our comments in this letter. If you have any questions or need further information, please contact Mark Zingale (Mark.Zingale@TheClearingHouse.org / (212) 613-9812), Richard Foster (Richard.foster@fsround.org / (202) 589-2424) and Kenneth E. Bentsen, Jr. (kbentsen@sifma.org / (202) 962-7400).

Very truly yours,

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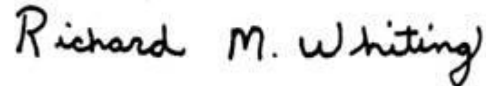

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