

## **FEDERAL DEPOSIT INSURANCE CORPORATION ISSUES INTERIM FINAL RULE UNDER ORDERLY LIQUIDATION AUTHORITY**

January 21, 2011

To Our Clients and Friends:

The Board of Directors of the Federal Deposit Insurance Corporation (the “FDIC”) at a meeting on January 18, 2011 adopted an interim final rule implementing certain select provisions of the Orderly Liquidation Authority in Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (to be codified at §12 C.F.R. Part 380). The FDIC had issued a notice of proposed rulemaking in October 2010 to implement these provisions as the first step in a larger rulemaking process relating to Title II.<sup>1</sup> The interim final rule adopts the approach taken in the proposed rule with several changes.

### **TREATMENT OF SIMILARLY SITUATED CLAIMANTS**

The FDIC has decided to retain the language of section 380.2(a) and (b) relating to the treatment of similarly situated creditors exactly as it was proposed in October 2010. Thus, section 380.2(b) continues to provide that the FDIC will not exercise any authority under Title II to make “additional” payments to holders of long-term senior debt, subordinated debt or shareholders. A number of commenters on the proposed rule had requested that the FDIC not limit its ability to make additional payments to long-term debt holders. The FDIC declined to adopt this suggestion or otherwise change the provisions of section 380.2(a) and (b). The FDIC observed that many of the comments requesting this change appear to be based on the misapprehension that section 380.2 as proposed would make it more likely that short-term debt holders would receive additional payments. The FDIC stated that short-term debt holders (including holders of commercial paper or derivative counterparties) are highly unlikely to meet the statutory criteria for additional payments in any event. Thus, “[i]n virtually all cases,” short-term debt holders will receive the same pro rata share on their claims as long-term debt holders. Acting Comptroller of the Currency John Walsh nonetheless expressed concerns about limiting the ability of the FDIC to deal with long-term debt holders in the next financial crisis. While Chairman Sheila Bair stated that she was in favor of the approach taken in section 380.2, she noted that the notice accompanying the interim final rule specifically asks for further comment on the approach taken in section 380.2 and suggested that the FDIC might arrange a roundtable to provide market participants a further opportunity to share their views on this issue.

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<sup>1</sup> 75 Fed. Reg. 64173 (Oct. 19, 2010).

## VALUATION OF COLLATERAL

Section 380.2(c) of the proposed rule provided that the portion of any secured claim exceeding the fair market value of the collateral would be treated as an unsecured claim and paid in accordance with the priority established in 12 U.S.C. 5390(b). The proposed rule, however, made an exception for claims secured by U.S. government or agency obligations where the collateral instead would be valued at par. The FDIC has decided to revise section 380.2(c) in the interim final rule to provide that all collateral, including U.S. government securities, will be valued at fair market value. The FDIC has also revised section 380.2(c) in the interim final rule to provide that the fair market value of collateral will be determined *as of* the date the FDIC is appointed as receiver. But in the preamble to the interim final rule, the FDIC specifically asks for comment on whether it would be more appropriate to determine the value of collateral based on fair market values existing on the day *before* the appointment of the FDIC as receiver.

## CONTINGENT OBLIGATIONS

The FDIC has revised section 380.4 relating to contingent claims to broaden and clarify its application. Section 380.4 of the proposed rule dealt only with contingent obligations consisting of a guarantee letter of credit, loan commitment or similar credit obligation. Section 380.4 as revised in the interim final rule now provides more broadly that the FDIC as receiver will not disallow a claim based on an obligation solely because the obligation is contingent. Section 380.4 has also been revised in the interim final rule to provide that the receiver will estimate the value of a contingent claim based on the likelihood that the contingent obligation would become fixed and the probable magnitude thereof. In the preamble to the interim final rule, the FDIC states that these changes are intended to clarify that the treatment of contingent claims under Title II parallels their treatment under the Bankruptcy Code. The FDIC also asks for comment on whether the rule should provide a specific time during the term of the receivership to estimate contingent claims.

## INSURANCE COMPANY ISSUES

Section 380.5 relating to the distribution of value realized from the liquidation or sale of subsidiaries of insurance companies in accordance with the order of priorities set forth in Title II is unchanged from the proposed rule. Section 380.6 relating to the potential taking of liens by the FDIC on insurance company (or affiliate) assets has been revised to clarify that the power to take a lien on a company's assets is limited to the assets of the company receiving an advance of funds from the FDIC. The determination under section 380.6 of whether taking a lien is necessary for the orderly liquidation and will not unduly impede or delay the liquidation or rehabilitation of the insurance company or the recoveries by its policyholders would remain committed to the discretion of the FDIC. The FDIC has also omitted from the preamble to the interim final rule a sentence contained in the preamble to

the proposed rule that could have been read to suggest that a liquidation or rehabilitation of an insurance company could be conducted (as opposed to initiated) under state law by the FDIC if the appropriate state regulatory authority had not filed the appropriate state judicial action.

### **ADDITIONAL QUESTIONS**

In addition to the questions noted above, the notice accompanying the interim final rule asks for comments on the following questions:

- Are there additional ways to reduce moral hazard, increase market discipline and clarify that all creditors should assume that they will receive no additional payments under Title II?
- What additional guidelines would be useful for establishing the fair market value of various types of collateral for secured claims?
- Who should receive the benefit or burden of market fluctuations on collateral between the date of appointment of the receiver and the date of payment of the claim?

The comments on the interim final rule are due not later than 60 days after the date of publication of the interim final rule in the Federal Register.

The FDIC has indicated that it will be engaging in the near future in a more extensive rulemaking process to delineate the other provisions of Title II that are not covered by the limited rulemaking reflected in the interim final rule.

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Please feel free to contact any of the undersigned with any questions that you might have on the FDIC interim final rule or any other questions relating to the Orderly Liquidation Authority.

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