PRESS RELEASE
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FDIC Board Issues Proposed Rule on Claims Process Under New Resolution Authority

The Board of Directors of the Federal Deposit Insurance Corporation (FDIC) voted on Friday, October 8, 2010, to approve through notational vote a proposed rule clarifying how the agency would treat certain creditor claims under the new orderly liquidation authority established under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The NPR was the subject of a briefing and board discussion during the FDIC open board meeting on September 27th, 2010.

Title II of the Dodd-Frank Act provides a mechanism for the appointment of the FDIC as receiver for a financial company where the failure of the company and its liquidation under the Bankruptcy Code or other insolvency procedures would pose a significant risk to the financial stability of the United States.

The Notice of Proposed Rulemaking includes a request for comment on a proposed regulation on specific issues related to creditor claims and a request for comment on broader questions to inform a future rulemaking addressing other orderly liquidation issues under the Dodd-Frank Act. The proposed regulation will be open for public comment for 30 days and the broader set of questions for the future rulemaking will be open for public comment for 90 days. As part of the publication, the FDIC has included an overview of the orderly liquidation process to provide further information to the public about the operation of this process under the Dodd-Frank Act.

Among the issues addressed in Notice of Proposed Rulemaking (NPR) is the availability of additional payments to creditors under the authority of the Dodd-Frank Act. These provisions parallel the FDIC's longstanding authority under the Federal Deposit Insurance Act and must be narrowly construed consistent with the Congressional intent. Pursuant to the Dodd-Frank Act, the NPR proposes to absolutely bar any additional payments to holders of long-term senior debt, subordinated debt, or equity interests that would result in those creditors recovering more than other creditors entitled to the same priority of payments under the law. Additional payments to holders of long-term senior debt, subordinated debt, or equity interests do not meet the statutory test that the payments must maximize the value of the assets or recoveries, minimize losses or be essential to implementation of the receivership or any bridge financial company. The NPR also proposes to clarify that all creditors, must expect to absorb losses in any liquidation. Under the NPR, no creditor can receive any additional payment unless the FDIC Board of Directors has determined, by recorded vote, that the payments meet the statutory standards. In addition, such payments are subject to recoupment if ultimate recoveries are insufficient to repay any temporary government liquidity support provided as part of the orderly wind-down. This recoupment must occur before imposition of a general industry assessment to cover any shortfalls. In no event may taxpayer money be used to cover losses associated with the failure of a large financial firm.

The NPR also provides that secured creditors will only be protected to the extent of the fair value of their collateral. To the extent that any portion of the claim is unsecured, it will absorb losses along with other unsecured creditors. Secured obligations collateralized with US government securities will be valued at par. This provision should create additional incentives for market participants to use highly liquid and easy to value collateral such as US government obligations to collateralize short term debt. The use of illiquid collateral to secure short term liabilities was a major contributor to the freezing of credit markets during the financial crisis.

FDIC Chairman Sheila C. Bair said: "The orderly liquidation process established under Title II of the Dodd-Frank Act imposes the losses on shareholders and creditors, while also protecting the economy and taxpayer interests. The proposed rule is the first step in giving market participants greater clarity and certainty about how certain key components of the resolution authority will be implemented. Shareholders and unsecured creditors should understand that they, not taxpayers, are at risk. This NPR represents a significant narrowing of the discretion provided under Dodd-Frank for differentiation among creditors, consistent with the law's overarching public policy objective to maximize market discipline and make clear that all equity and unsecured debt holders are at risk."

The NPR also addresses discrete issues within the following broad areas:

(1) The authority to continue operations by paying for services provided by employees and others (by clarifying the payment for services rendered under personal services contracts);

(2) The treatment of creditors (by clarifying the measure of damages for contingent claims); and

(3) The application of proceeds from the liquidation of subsidiaries (by reiterating the current treatment under corporate and insolvency law that remaining shareholder value is paid to the shareholders of any subsidiary).

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Attachment:

Notice of Proposed Rulemaking on Resolutions - PDF (PDF Help)
Board Memorandum - PDF (PDF Help)