PRESS RELEASE

Federal Deposit Insurance Corporation

May 19, 1995

FDIC ISSUES POLICY STATEMENT ON COLLATERALIZED LETTERS OF CREDIT

FOR IMMEDIATE RELEASE

The FDIC announced today a policy statement assuring the financial markets that certain collateralized letters of credit issued by insured banks and thrifts prior to August 9, 1989, will continue to be treated substantially the same by the agency as they now are being treated by the Resolution Trust Corporation (RTC). The policy statement, adopted yesterday by the FDIC's Board of Directors, is intended to remove doubts the financial markets may have about the FDIC's treatment of these instruments when the agency assumes responsibility for thrift receiverships from the RTC on July 1, 1995.

These letters of credit include those issued by banks and thrifts as collateral for state or municipal bonds that finance low- and moderate-income housing developments and similar projects. The policy statement explains the limited circumstances when the FDIC would seek to repudiate a collateralized letter of credit issued by an insured institution that fails.

The policy statement is effective immediately. A copy of the policy statement is attached.

[6714-01]

FEDERAL DEPOSIT INSURANCE CORPORATION

Statement of Policy Regarding Treatment of Collateralized Letters of Credit After Appointment of the Federal Deposit Insurance Corporation as Conservator or Receiver

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Statement of Policy.

SUMMARY: The FDIC has adopted a statement of policy that sets forth how the FDIC, as conservator or receiver for an insured depository institution, proposes to treat letters of credit backed by a pledge of collateral by the insured depository institution. Only those collateralized letters of credit (CLOCs) that were initially issued prior to the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) are covered by this policy.

DATE: May 19, 1995

FOR FURTHER INFORMATION CONTACT: Sharon Powers Sivertsen, Assistant General Counsel (202-736-0112), or Michael H. Krimminger, Senior Counsel (202-736-0336), Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429.

STATEMENT OF POLICY REGARDING
TREATMENT OF COLLATERALIZED LETTERS OF CREDIT
AFTER APPOINTMENT OF THE FEDERAL DEPOSIT INSURANCE CORPORATION
AS CONSERVATOR OR RECEIVER

This Statement of Policy sets forth the treatment that the Federal Deposit Insurance Corporation (FDIC) as the conservator or receiver of an insured depository institution will give certain collateralized letters of credit issued by insured depository institutions prior to August 9, 1989.

Background

On August 9, 1989, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was signed into law. This statute amended the Federal Deposit Insurance Act (FDI Act) to clarify the FDIC's rights as conservator or receiver to repudiate contracts and to limit claims for damages upon repudiation to those actual, direct compensatory damages determined as of the date of the appointment of the conservator or receiver. 12 U.S.C. . 1821(e)(3)(A). With regard to secured contracts, the FDI Act provides that the repudiation provisions contained in 12 U.S.C. . 1821(e) are not to be construed as permitting the avoidance of any legally enforceable or perfected security interest in any assets of the institution, except where such interest is taken in

contemplation of the institution's insolvency or with the intent to hinder, delay, or defraud the institution or the institution's creditors. 12 U.S.C. . 1821(e)(11).

Generally, contingent obligations do not give rise to provable claims against a receivership or conservatorship, and any claims based upon such obligations have no provable damages because the damages are not fixed and certain as of the date of the appointment of the receiver or conservator. Accordingly, no provable claims in a receivership or conservatorship can be based on contingent obligations unless the default by the account party conferring a right to draw under the obligations occurred prior to the appointment of the receiver or conservator.

Reading section 11(e) of the FDI Act, 12 U.S.C. . 1821(e), as a whole, it is clear that even secured contracts may be repudiated; that damages are limited to the extent set forth in the statute; and that legally enforceable or perfected security agreements will be honored to the extent of such damages but no further or otherwise. In other words, if there is a repudiation, the collateral securing the contract may be liquidated and the proceeds paid to or retained by the creditor up to the damages allowed by the statute. The remaining collateral or proceeds will be remitted or returned to the conservator or receiver as property of the institution or its estate, or to a bona fide junior lienholder to the extent applicable.

Statement of Policy

The FDIC has considered a number of relevant policy factors with respect to the treatment of certain collateralized letters of credit after its appointment as conservator or receiver of insured depository institutions. Specifically, it has considered its legal rights and powers under FIRREA; the assurances provided by the Federal Home Loan Bank Board prior to the enactment of FIRREA; the assurances provided by the Resolution Trust Corporation in its September 15, 1990 statement of policy on the treatment of collateralized letters of credit; market reliance on these assurances; the need for market certainty and stability; and the potential long-term cost to the FDIC of the repudiation of certain collateralized letters of credit. Based on its consideration and balancing of such factors, the FDIC has determined to adopt and implement the following Policy on the treatment of certain collateralized letters of credit after its appointment as conservator or receiver of insured depository institutions. This Policy is substantively the same as the RTC's September 25, 1990 policy statement on collateralized letters of credit and conforms to the RTC and FDIC policy statements on collateralized put obligations. As a consequence, adoption of the proposed policy statement will promote market certainty and stability upon the transition of receivership responsibilities from the RTC to the FDIC on July 1, 1995. 12 U.S.C. . 1441a(b)(3)(A)(ii).

This Policy will apply only to collateralized letters of credit utilized in capital markets financing transactions originally issued by insured depository institutions prior to August 9, 1989, and any subsequent renewal, replacement or extension of such letters of credit. In addition, this Policy will apply only in such transactions where the underlying security interest is in collateral owned and pledged by the insured depository institution

to secure its obligations and the security interest is both perfected and legally enforceable under applicable law. These financing transactions include transactions involving publicly-offered obligations rated by one or more nationally- recognized credit rating agencies and transactions involving non-rated privately placed obligations structured in a manner substantially similar to such rated obligations. The policy does not apply to trade letters of credit or letters of credit issued for any other purpose.

After its appointment as conservator or receiver of any insured depository institution, the FDIC may either (1) continue any collateralized letters of credit as enforceable under the terms of the contract during the pendency of the conservatorship or receivership or (2) call, redeem or prepay any collateralized letters of credit by repudiation or disaffirmance.

If the FDIC as conservator or receiver exercises its right to call, redeem or prepay any collateralized letters of credit by repudiation or disaffirmance, it may do so either directly by cash payment in exchange for the release of the collateral or by repudiation of the contract followed by liquidation of the collateral by a trustee or other secured party. If the FDIC in its capacity as conservator or receiver accelerates the collateralized letters of credit by repudiation or disaffirmance, payment will be made to the extent of available collateral up to an amount equal to the outstanding principal amount or accreted value of the secured obligations, together with interest at the contract rate up to and including the date of payment and expenses of liquidation, if provided in the contract. If any collateral or proceeds remain after payment of such amounts, such collateral or proceeds then must be remitted or returned to the conservator or receiver as property of the institution or its estate, or to a bona fide junior lienholder to the extent applicable. If, however, the collateral securing the contract is insufficient to pay in full the amounts owing under the contract, the holder will receive a receivership certificate for any balance remaining due under the contract.

The FDIC shall have a reasonable time, generally no more than 180 days from the date of the appointment of the FDIC as conservator or receiver, to elect whether to disaffirm, repudiate, or accelerate a collateralized letter of credit. In the case of institutions for which the FDIC already has been so appointed, the period in which to make such an election shall begin to run as of the date of the adoption of this Policy and continue for 180 days.

This Policy Statement does not change or amend the FDIC's longstanding position that standby letters of credit are contingent obligations. Based on its consideration and balancing of the policy issues presented, however, the FDIC has adopted this statement of policy for collateralized letters of credit initially issued prior to August 9, 1989, and any subsequent renewal, replacement or extension of such letters of credit. It is understood that the persons involved in such secured transactions with insured depository institutions may reasonably rely upon this Policy Statement.

By order of the Board of Directors. Dated at Washington, D.C., this 18th day of May, 1995.

FEDERAL DEPOSIT INSURANCE CORPORATION

Robert E. Feldman
Acting Executive Secretary

Last Updated 07/14/1999

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