The Credit Roundtable
In association with the Fixed Income Forum

January 4, 2013

James Wigand
Director, Office of Complex Financial Institutions
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Re: Living Wills and Title II Orderly Liquidation Authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act")

Dear Mr. Wigand:

The Credit Roundtable[1] appreciates the opportunity to engage the Federal Deposit Insurance Corporation ("FDIC") and other agencies to seek clarity with regard to living wills and Title II Orderly Liquidation Authority ("OLA").

We are suppliers of bank funding at all points in the capital structure, from secured lending to common equity. Our members are also counterparties across a wide range of financial products. We have an obligation to our customers, clients and beneficiaries to make sound investment decisions and cannot invest when the risks are not correctly priced or understood.

The presentations offered by FDIC officials over the last several months have been helpful in illustrating the OLA process; however, the issues covered in these presentations have given rise to a number of questions. We appreciate your clarification on the following topics, as well as an expected implementation timetable. Ambiguity in policy response and its impact to creditors will increase risk aversion during a period of market stress, contribute to financial instability and reduce the franchise value of financial institutions.

[1] Formed in 2007, The Credit Roundtable, organized in association with the Fixed Income Forum, is a group of large institutional fixed income managers including investment advisors, insurance companies, pension funds, and mutual fund firms, responsible for investing more than $3.8 trillion of assets. The Credit Roundtable seeks to enhance investment grade bondholder protection and was formed in response to events such as leveraged buyouts, leveraged recapitalizations and other corporate actions that adversely affected the credit quality and valuations of a significant number of existing investment grade bond issues. Its mission includes education, outreach, and advocacy, and it seeks to benefit all bond market participants through increased transparency and improved market efficiency and liquidity.

A. Living Wills and Title II

Our understanding is that the default mechanism to resolve a failing institution is the United States Bankruptcy Code. However, if a "systemic risk determination" is made under Section 203 of the Dodd-Frank Act, concluding, among other things, that resolution under the Bankruptcy Code is not appropriate, then an institution would be resolved under OLA. Even in that case, the FDIC has indicated that the living will submitted by the institution would be used to inform and help refine the FDIC's planning.[2]

While we support the creation of living wills, we are concerned that the benefit of such plans could be limited, especially under Title II, if public disclosure is insufficient to reduce investor and counterparty uncertainty. While the initial public disclosures of these plans are an important first step in the process, significantly more detail should be disclosed, particularly with regard to intercompany risks. In the absence of more information about the living wills and how the regulators would utilize such plans in exercising their authority to resolve an institution, there is an increased likelihood that a resolution would be disorderly due to creditor flight.

At a minimum, we believe that the FDIC should disclose its "presumptive path" for resolving a particular financial group under Title II. The presumptive path might be a single-point-of-entry recapitalization ("single-entry receivership"), a more traditional purchase and assumption transaction or some other strategy, depending on the group's structure, degree of cross-border operations, funding model and other factors. While the presumptive path need not be the definitive path, the presumption should be strong enough that our members, host country regulators and the rest of the market can reasonably rely on it in order to estimate and manage risk and avoid the need to take value-destroying actions.

We would like clarity around the following:

- *Has the FDIC found living will disclosures made to date adequate for its purposes?*
- *What criteria will be used to determine whether a living will is credible?*
- *When will regulators publicly announce approval or disapproval of a financial institution's living will? What are your expectations regarding future public disclosures?*
- *Will regulators compel a banking group to restructure if they determine that a financial institution's living will is not credible?*

[2] Office of Complex Financial Institutions "Living Wills Overview", January 25, 2012: http://www.fdic.gov/about/srac/2012/2012-01-25_living-wills.pdf

- *Does the FDIC plan to disclose its presumptive path for resolving particular institutions under Title II or the Federal Deposit Insurance Act ("FDIA")?*
- *How will foreign branches and subsidiaries be addressed in living wills?*

B. Title II Implementation Mechanics

In connection with living wills, it is important to understand under what circumstances regulators would invoke OLA. Without clear indications of when it would be invoked and how counterparties and creditors would be treated in an OLA resolution, market participants, particularly short term creditors, would quickly withdraw funding and stop conducting business given a real or perceived concern.

- *What are the triggering events for invoking Title II?*
- *Please address how the regulators are coordinating the policy framework for invocation of Title II. For example, would an institution's designation by the Financial Stability Oversight Council as a "grave threat" or the inability to complete a capital raise post a Federal Reserve stress test be the precursor to a Title II resolution?*

The FDIC has indicated that under the single-entry receivership model, only a holding company would be placed in a Title II receivership, while operations at equity solvent subsidiaries would continue with capital from the bridge holding company and liquidity from the Orderly Liquidation Fund ("OLF"). This seems to imply that the single entry receivership is limited to circumstances in which the institution is in danger of default, subsidiaries are solvent and immediate liquidity needs are less than 10% of pre-failure consolidated assets. The Credit Roundtable requests that the FDIC please confirm these limitations and address the following questions:

- *How will subsidiary solvency be determined?*
- *How will financial institutions be resolved if their primary (or non primary) subsidiaries are not solvent?*
- *How will financial institutions be resolved if immediate liquidity needs exceed the OLF's maximum limitation of 10% of pre-failure consolidated assets?*

C. Creditor Outcomes under Title II

1. Short-Term vs. Long-Term Debt

Given the FDIC's plan to favor short-term debt over long-term debt in an OLA proceeding, it would be helpful to receive clarity on what qualifies as short-term debt. Investors generally define short-term debt as any debt obligation with a remaining maturity of less than one year. It is important that investor and regulator views are in sync in order to avoid investor flight and enterprise value destruction.

- *What is the distinction between long- and short-term debt and is it based on original or remaining maturity?*
- *Would this definition of short-term debt apply only to debt held at the top holding company or also include debt at intermediate holding companies and operating entities?*
- *How will long-term senior unsecured and short-term subordinated debt be treated?*

2. <u>Priority of Debt Capital</u>

In recent FDIC presentations of the single-entry receivership, it appears that holding company assets, including intercompany loans from the bank holding company to a subsidiary, would be the primary assets used to increase the capital of an "equity solvent" subsidiary. However, it is our understanding that in almost all cases intercompany lending is pari passu as a contractual matter with all non-deposit senior unsecured liabilities at the subsidiary level. It is important that we understand where each type of debt stands in terms of its availability to be converted into equity in an OLA process.

- *As there would be no subsidiary insolvency proceedings, please confirm that subordinated subsidiary debt held by investors would have a priority of claim over senior intercompany lending to a holding company from an operating bank.*
- *What is the priority of debt issued by intermediate holding companies versus operating entities or top holding companies under OLA?*
- *Please confirm that equity will be apportioned to creditors that have a principal reduction and that principal reductions will occur by original issue class and original or remaining maturity.*
- *What are the risk differences and required disclosures between the existing senior and subordinated debt stock versus debt issued after the passage of the Dodd-Frank Act?*

Section 212(c) of the Dodd-Frank Act requires the FDIC to avoid any conflict of interest that may arise in connection with being appointed receiver for multiple receiverships. However, such conflicts of interest appear difficult to avoid under OLA. Specifically, when the FDIC acts as a Title II receiver for a bank holding company, it will also have an incentive to minimize losses for insured depository institution subsidiaries due to its role as deposit insurer and FDIA receiver. Additionally, under the single-entry receivership model, the enterprise value of a bank holding company would be impaired for the sake of supporting its undercapitalized subsidiaries where not only depositors, the deposit insurance fund, and senior creditors would benefit, but also liabilities that count as regulatory capital.

- *How will the FDIC avoid conflicts when concurrently acting as Title II receiver, FDIA receiver and/or deposit insurer or when deciding between a single-entry and multi-entry receivership path?*
- *How will the FDIC treat subsidiary liabilities that count as regulatory capital (for which nonpayment is not an event of default) under a single-entry receivership?*
- *Is there any after-the-fact review of the FDIC's decisions as receiver? Will there be any remedy available to creditors?*

3. Holding Company Capitalization

Recently the Federal Reserve joined the FDIC in suggesting that bank holding companies will need to hold unsecured debt relative to consolidated assets in order to facilitate OLA.

- *Please clarify if bank holding or bank operating companies will be required to maintain a specific percentage of unsecured senior or subordinated debt. What will drive the potential unsecured debt level or issuance need: total assets, risk-weighted assets, the notional value of tangible common equity, commercial or investment banking focus, domestic or international assets or targeted long-term credit rating post resolution?*
- *If required, over what period of time will new minimum levels of unsecured debt be phased in, and would there be limits on the type of assets purchased with the proceeds?*

4. Counterparty Credit

FDIC presentations have indicated that certain other senior unsecured debt and contingent liabilities may or may not pass to a bridge holding company in an OLA receivership. Combined with the liquidity guarantees offered by the U.S. Treasury, clarity on how the FDIC plans to treat counterparty agreements would insure that the goal of maintaining "business as usual" would be achieved. Although some of the following is addressed in Section 210(c)(16) rulemaking, we would appreciate clarification regarding the following:

- *Which contingent liabilities would be left behind?*
- *When we act as counterparties in unsecured transactions conducted at the subsidiary level, counterparty risk is mitigated with parental guarantees. In an OLA, would all counterparty agreements, including parental guarantees, pass to the Newco and be honored in full?*
- *The FDIC has stated that there would be a one-day stay on derivatives netting when an OLA exercise is made public. Once the stay is lifted, would collateral posting proceed normally as stipulated in each counterparty agreement? If not, what form would the collateral postings take?*

- *If sufficient collateral is not available at the subsidiary with which a counterparty is doing business (for example, a broker-dealer subsidiary), would intercompany lending be available to satisfy this collateral posting requirement? If not, would the U.S. Treasury make collateral available?*

5. Use of the Orderly Liquidation Fund

Under the proposed single-entry receivership model, the FDIC has indicated that it would use the OLF to provide liquidity for a bridge financial company and its subsidiaries. However, the ability to use the OLF in this manner is unclear.

Section 212(b) of the Dodd-Frank Act requires that claims of the United States have, at a minimum, a higher priority than liabilities of a covered financial company that count as regulatory capital. Yet, under the proposed single-entry receivership model, the OLF would provide a bridge financial company with funds that would subsequently be transferred to its subsidiaries. At the same time, our understanding is that intercompany balances would be subordinated to all subsidiary liabilities, including those that count as regulatory capital. This voluntary subordination of intercompany balances would seem to structurally elevate regulatory capital liabilities above claims of the United States (via the OLF). Such subordination may also be inconsistent with the stated purpose of OLA within Section 204(a), that creditors and shareholders of a covered financial company bear the losses.

- *Would existing and future intercompany balances, specifically those created by way of the OLF, be subordinated to existing subsidiary liabilities?*

Additionally, Section 210(n) appears to limit the use of the OLF to support only covered financial companies, the definition of which excludes insured depository institutions, and places an explicit prohibition on using the OLF to assist the deposit insurance fund. However the proposed use of the OLF to support insured depository institutions, and potentially other subsidiaries, seems to be inconsistent with these requirements.

- *What restrictions will the FDIC place on proceeds of the OLF regarding bank and non bank subsidiaries and or foreign or domestic entities?*

We hope that, through clarification of the discussion topics noted above, we will have the ability to work with the regulators during a period of financial system stress. We welcome the opportunity to meet with the respective staffs to discuss our concerns in greater detail, and are

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more than happy to answer any questions regarding this letter.

Sincerely,

Lyn Perlmuth

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