FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 380

Enforcement of Subsidiary and Affiliate Contracts by the FDIC as Receiver of a Covered Financial Company

RIN

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Notice of proposed rulemaking.

SUMMARY: The FDIC is proposing a rule ("Proposed Rule"), with request for comments, that implements section 210(c)(16) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or the "Act"), codified at 12 U.S.C. section 5390(c)(16), which permits the Corporation, as receiver for a financial company whose failure would pose a significant risk to the financial stability of the United States (a "covered financial company"), to enforce contracts of subsidiaries or affiliates of the covered financial company despite contract clauses that purport to terminate, accelerate, or provide for other remedies based on the insolvency, financial condition or receivership of the covered financial company. The Proposed Rule makes clear that the effect of this enforcement authority is that no party may exercise any remedy under a contract simply as a result of the appointment of the receiver and the exercise of its orderly liquidation authorities as long as the receiver complies with the statutory requirements. As a condition to maintaining these subsidiary contracts in full force and effect, the Corporation as receiver must either: (1) transfer any supporting obligations of the covered financial company that back the obligations of the subsidiary or affiliate under the

contract (along with all assets and liabilities that relate to those supporting obligations) to a bridge financial company or qualified third-party transferee by the statutory one-business-day deadline; or (ii) provide adequate protection to such contract counterparties. The Proposed Rule sets forth the scope and effect of the authority granted under section 210(c)(16), clarifies the conditions and requirements applicable to the receiver, addresses requirements for notice to certain affected counterparties, and defines key terms.

DATES: Written comments on the Rule must be received by the FDIC no later than [INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]

ADDRESSES: You may submit comments by any of the following methods:

- Agency Web Site: http://www.fdic.gov/regulations/laws/federal. Follow instructions for Submitting comments on the Agency Web Site.
- E-mail: Comments@FDIC.gov. Include "RIN 3064-AD89" in the subject line of the message.
- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, DC 20429
- Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m. (EST).
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

Public Inspection: All comments received will be posted without change to http://www.fdic.gov/regulations/laws/federal including any personal information provided. Comments may be inspected and photocopied in the FDIC Public Information Center, 3501 North Fairfax Drive, Room E-I002, Arlington, VA 22226, between 9 a.m. and 5 p.m. (EST) on business days. Paper copies of public comments may be ordered from the Public Information Center by telephone at (877) 275-3342 or (703) 562-2200.

FOR FURTHER INFORMATON CONTACT: R. Penfield Starke, Assistant General Counsel, Legal Division, (703) 562–2422; Elizabeth Falloon, Counsel, Legal Division (703) 562-6148; John W. Popeo, Senior Attorney, Legal Division (972-761-8171);

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SUPPLEMENTARY INFORMATION:

Title II of the Dodd-Frank Act provides for the appointment of the FDIC as receiver of a covered financial company that poses a systemic risk to the nation's economic stability and outlines the process for the orderly resolution of a covered financial company following the FDIC's appointment as receiver. Section 209, codified at 12 U.S.C. section 5389, authorizes the FDIC, in consultation with the Financial Stability Oversight Council, to prescribe rules and regulations as the FDIC considers necessary or appropriate with respect to the rights, interests, and priorities of creditors, counterparties, security entitlement holders, or other persons with respect to any covered financial company and other matters necessary or appropriate to the implementation of the orderly liquidation authority established under Title II of the Act. Pursuant to the authority granted by section 209, the FDIC is issuing the Proposed Rule, with request for comments.

I. Background

Fundamental to the orderly liquidation of a covered financial company is the ability to continue key operations, transactions and services that will maximize the value of the firm's assets and operations and avoid a disorderly collapse in the marketplace. To facilitate this continuity of operations, the Dodd-Frank Act provides several tools to preserve the value of the covered financial company's assets and business lines, including the powers granted in section 210(c)(16), codified at 12 U.S.C. section 5390(c)(16). Specifically, section 210(c)(16) provides that:

> The Corporation, as receiver for a covered financial company or as receiver for a subsidiary of a covered financial company (including an insured

depository institution) shall have the power to enforce contracts of subsidiaries or affiliates of a covered financial company, the obligations under which are guaranteed or otherwise supported by or linked to the covered financial company, notwithstanding any contractual right to cause the termination, liquidation, or acceleration of such contracts based solely on the insolvency, financial condition or receivership of the covered financial company if –

(i) such guaranty or other support and all related assets and liabilities are transferred to and assumed by a bridge financial company or a third party (other than a third party for which a conservator, receiver, trustee in bankruptcy or other legal custodian has been appointed, or which is otherwise the subject of a bankruptcy or insolvency proceeding). . . [by 5:00 p.m. (eastern time) on the business day following the date of appointment]; or

(ii) the Corporation, as receiver, otherwise provides adequate protection with respect to those obligations.

The conditions contained in (i) and (ii) of the quoted statute were included to assure counterparties that any contractual right to guarantees or other support, including claims on collateral or other related assets, would be protected. Thus, section 210(c)(16) requires, as a condition to the authority to enforce subsidiary or affiliate contracts that are "linked to" the financial condition of the covered financial corporation through a default provision, that the Corporation as receiver transfer any guaranty or other support provided by the specified covered financial company for the contractual obligations together with all related collateral to a bridge financial company or other qualified transferee within one business day after its appointment as receiver. In the alternative, if the receiver does not transfer the support and the related assets and liabilities, the receiver must provide "adequate protection" with respect to any support or collateral not transferred in order to preserve its right to enforce the contract of the subsidiary or affiliate.

In providing for the orderly liquidation authority of Title II, Congress recognized the structural complexity of large financial companies that might pose a threat to the

financial stability of the nation. Accordingly, the Dodd-Frank Act provides certain particular authorities with respect to subsidiaries and affiliates of the covered financial company. For instance, section 210(a)(1)(E) of the Dodd-Frank Act provides an expedited procedure to allow the Corporation to appoint itself as the receiver of certain subsidiaries of a covered financial company if the Corporation and the Secretary of the Treasury jointly determine that such subsidiary is in default or in danger of default and that such action would mitigate serious adverse effects on the financial stability of the United States and would facilitate the orderly liquidation of the covered financial company. That section further provides that upon such an appointment, the subsidiary would be treated as a covered financial company, and the Corporation would be able to exercise the full range of special powers available to the receiver.

In certain cases, however, the receiver for the covered financial company may find that the best course of action to maximize the value of the covered financial company and to mitigate systemic risk would be to avoid actions that place subsidiaries in danger of default or that necessitate complex interlocking receiverships. The affiliated legal entities that collectively comprise a complex financial institution typically share and provide intra-group funding, guarantees, administrative support, human resources and other operational and business functions. Some of these operations and activities may be critical to the day-to-day functions and overall operations of the group. In addition, certain significant subsidiaries of a covered financial company may be essential to core business lines or conduct critical operations that, if discontinued, may threaten the stability of the financial markets. In these circumstances, orderly liquidation of a covered financial company may best be accomplished by establishing a single receivership of the

parent holding company and transferring valuable operations and assets to a solvent bridge financial company, including the stock or other equity interests of the company's various subsidiaries. Accordingly, the Dodd-Frank Act provides the FDIC with the tools and flexibility to act effectively as receiver for the covered financial company at the holding company or parent level without placing solvent subsidiaries into receivership. This approach may be the best means of preserving value, minimizing the shock to the financial system, providing additional flexibility to mitigate cross-border resolution issues for global systemically-important financial companies, and allowing for a more expeditious resolution of a covered financial company.

Where such an approach is adopted, the powers granted to the receiver under section 210(c)(16) are essential to preservation of going-concern value of the subsidiaries for the benefit of the parent in receivership. Absent this statutory provision, counterparties to contracts of subsidiaries and affiliates could exercise contractual rights to terminate their agreements based upon the insolvency of the specified covered financial company. As a result, otherwise viable affiliates of the covered financial company could become insolvent, thereby inciting the collapse of interrelated companies and potentially amplifying ripple effects throughout the economy.

As described in more detail below, this Proposed Rule would clarify the scope of the authority granted in section 210(c)(16) as well as conditions and requirements applicable to the receiver. The Proposed Rule would address requirements for notice to affected counterparties and defines key terms. It also would clarify the term "adequate protection" in a manner consistent with its interpretation under the Bankruptcy Code.

II. Proposed Rule

Overview

The Proposed Rule would clarify that the power of the Corporation as receiver to enforce contracts of subsidiaries and affiliates under Dodd-Frank Act section 210(c)(16) effectively preserves contractual relationships of subsidiaries and affiliates of the covered financial company during the orderly liquidation process. The Proposed Rule would identify certain contracts that are "linked to" the covered financial company within the meaning of the statute, as well as contracts that also are "supported by" the covered financial company. Under the statute, a contract is "linked to" a covered financial company if it contains a provision that provides a contractual right to "cause the termination, liquidation or acceleration of such contract based solely on the insolvency, financial condition, or receivership of the covered financial company." That type of provision, called a "specified financial condition clause" in the Proposed Rule, is more fully defined in the Proposed Rule. Although the statute speaks in terms of the power to enforce a contract to which the receiver is not a party, the Proposed Rule would recognize the practical effect of the intent of this authority, which is that the counterparty to such a contract may not exercise remedies in connection with a specified financial condition clause if the statutory conditions are met. No action is required of the receiver to enforce a linked contract; the Proposed Rule would make clear that the contract would remain in full force and effect unless the receiver failed to meet the requirements with respect to any supporting obligations of the covered financial company.

The Proposed Rule would establish that if the subsidiaries' obligations under the linked contract are supported by the covered financial company through, for example,

guarantees or the granting of collateral that supports the obligations, the Corporation as receiver must either (i) transfer such support (along with all related assets and liabilities) to a qualified transferee not later than 5:00 p.m. (eastern time) on the business day following the appointment of the receiver, or (ii) provide "adequate protection" to contract counterparties following notice given to the counterparties in accordance with the guidelines set forth in the Proposed Rule by the one-business-day deadline.

The Proposed Rule also would clarify the meaning of the statutory provision regarding a contractual obligation that is "guaranteed or otherwise supported by" the covered financial company. Support includes guarantees that may or may not be collateralized, netting arrangements and other examples of financial support of the obligations of the subsidiary or affiliate under the contract. In circumstances where a contract of a subsidiary or affiliate is linked to the financial condition of the parent company via a "specified financial condition clause," but where the obligations of the subsidiary or affiliate are not "supported by" the covered financial company through guarantees or similar supporting obligations, the requirement to transfer support and related assets or provide adequate protection does not apply. The mere existence of a "specified financial condition clause" does not constitute a "support" obligation by the covered financial company, and the Proposed Rule would make it clear that the subsidiary contract remains enforceable without any requirement to effectively create new support where none originally existed. This is consistent with the effect of sections 210(c)(13), providing that *ipso facto* clauses in contracts of the covered financial company are unenforceable, and 210(c)(8) of the Dodd-Frank Act, providing that "walkaway clauses" in qualified financial contracts of the covered financial company are

unenforceable. In the case of those types of contractual provisions, there is no specified entity required to provide support, hence the concept of alternate support or adequate protection is inapplicable. In the same way, under the Proposed Rule, the concept of adequate protection does not arise in the absence of supporting obligations by the specified entity.

The Proposed Rule similarly apples broadly to all contracts, and not solely to qualified financial contracts. For example, a real estate lease or a credit agreement, neither of which would typically be classified as a qualified financial contract, would be subject to enforcement under section 210(c)(16) and the Proposed Rule notwithstanding a specified financial condition clause that might, for instance, give a lessor the right to terminate a lease based upon a change in financial condition of the parent of the lessee. A swap agreement of a subsidiary or affiliate would be subject to the section 210(c)(16) and the Proposed Rule in the same manner if the agreement contains specified financial condition clause.

The Proposed Rule would not affect other provisions of the Dodd-Frank Act governing qualified financial contracts, such as sections 210(c)(8) ("Certain Qualified Financial Contracts") and 210(c)(9) ("Transfer of Qualified Financial Contracts"). For example, where a covered financial company's support of a subsidiary or affiliate obligation would itself be considered a qualified financial contract, such as a securities contract, the provisions of section 210(c)(9) that prohibit the selective transfer of qualified financial contracts with a common counterparty (or a group of affiliated counterparties) would continue to apply. Likewise, the provisions in section 210(c)(10) of the Dodd-Frank Act applicable to counterparties of qualified financial contracts also

would continue to apply. On the other hand, if the covered financial company's support of a subsidiary or affiliate consists of multiple contracts that are not qualified financial contracts, the Corporation as receiver may transfer all or a portion of such group of contracts as long as it provides adequate protection for the supporting obligations that were not transferred. Similarly, the Corporation may transfer all or a portion of "related assets and liabilities" that are not qualified financial contracts if it provides adequate protection for the portion of the assets and liabilities that was retained by the Corporation as receiver.

Section-by-section analysis.

Paragraph (a) of the Proposed Rule would state the general rule with respect to the authority granted under section 210(c)(16) of the Dodd-Frank Act, i.e., that the contracts of a subsidiary or affiliate of a covered financial company are enforceable notwithstanding the existence of a "specified financial condition clause" that provides a counterparty with the right to terminate or exercise remedies based upon the financial condition of the parent or affiliate covered financial company, provided that the FDIC as receiver for the covered financial company transfers all support and related assets and liabilities that back the obligations of such subsidiary or affiliate. To the extent that the receiver fails to transfer all support and related assets and liabilities, it must provide adequate protection to such counterparty to preserve its right to enforce the contracts of the subsidiary. The effect of this ability to enforce the contract is intended to be broad enough to preclude the counterparties from terminating or exercising other remedies such as requiring additional collateral but is intended to be limited in scope solely to remedies arising out of a specified financial condition clause not other contractual defaults by the

subsidiary or affiliate. The ability either to transfer support or to provide adequate protection can be exercised in the alternative, or in combination. For example, if some, but not all collateral is transferred, appropriate adequate protection may be provided in lieu of the collateral not transferred.

The deadline for the transfer of support is the same as the time limit applicable to the transfer of qualified financial contracts under section 210(c)(10) of the Dodd-Frank Act, i.e., by 5:00 p.m. (eastern time) on the next business day. Although the decision to provide adequate protection in lieu of transferring support must also be made and steps must be taken that are reasonably calculated to provide notice within a business day, the language of the Proposed Rule does not require that the adequate protection be fully in place by that next-day deadline. Although the failure to complete within a business day the documentation or transactions necessary should not be deemed to be a waiver of the right to enforce the contract, once the receiver has provided notice of its intent to transfer support or provide adequate protection, the counterparty would be entitled to the benefit of the adequate protection even before the documentation or transfer of collateral were fully completed, if necessary.

The Proposed Rule would provide that a qualified transferee such as a bridge financial company or solvent third-party acquirer, as well as the Corporation as receiver, would have the authority to enforce linked contracts under the section 210(c)(16) of the Dodd-Frank Act. This is consistent with the intent of the statute that subsidiary and affiliate contracts should remain in effect and enforceable through the entire orderly resolution process. Also, the subsidiary or affiliate continues to have the ability to enforce the terms of such contract as well. In essence, the effect of such authority to

enforce is substantively the same as a prohibition of the counterparty to assert a specified financial condition clause against the subsidiary or affiliate. Effectively, the Proposed Rule would make clear that the practical effect of the operation of section 210(c)(16) is similar to that of section 210(c)(13) (prohibiting counterparties from the exercise of certain rights arising out of *ipso facto* clauses) and section 210(c)(8) (prohibiting counterparties to qualified financial contracts from the exercise of certain rights arising out of walkaway clauses); i.e., that the counterparties are prohibited from exercising remedies under a specified financial condition clause if the statutory conditions are met.

The statute expressly states that the power to enforce contracts of a subsidiary in the circumstances described in section 210(c)(16) is vested in "[t]he Corporation, as receiver for a covered financial company or as receiver for a subsidiary of a covered financial company (including an insured depository institution)." This is captured in subparagraph (a)(3) of the Proposed Rule. This recognizes that the preservation of value through the enforcement of subsidiary and affiliate contracts is important to all of the interconnected entities that are related to the entity in receivership. The effect of the statute is to prohibit the counterparty from terminating or exercising remedies based solely on the condition of the covered financial company. Once the essential link to the covered financial company is established via the specified financial condition clause, all of the subsidiaries of the covered financial company as well as the bridge financial company or qualified transferee share the benefit of the authority to enforce.

Definitions

The Proposed Rule would include eight definitions: "linked," "specified financial condition clause," "support," "related assets and liabilities," "qualified transferee," "subsidiary," "affiliate," and "control."

A contract is "**linked**" to a covered financial company if it contains a specified financial condition clause naming the covered financial company as the specified company.

The term "**specified financial condition clause**" is intended to broadly capture any provision that gives any 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. Each aspect of the definition of the term "specified financial condition clause" should be read expansively to effectuate the statutory intent that counterparties are effectively stayed from exercising rights under such a clause to terminate contracts or exercise other remedies during a Title II resolution process if the requirements of the statute are met. Thus, a specified financial condition clause includes any clause that might be interpreted as giving rise to a termination right or other remedy due to the insolvency of the specified covered financial company that might have precipitated the appointment of the receiver, such as an act of insolvency or a downgrade in a rating from a rating agency. Likewise, the definition is broad enough to include a change in control provision that creates termination rights or other remedies upon the appointment of the FDIC as receiver or other change in control, such as the transfer of stock in the subsidiary to the bridge financial company or the sale, conversion or merger of the bridge financial company or its assets. The intent is to allow the

subsidiary or affiliate contract to remain in effect despite the exercise of any or all of the authorities granted to the FDIC as receiver for a covered financial company throughout the orderly liquidation process.

Although the language of the statute refers to the counterparty's rights as "termination, liquidation or acceleration," that list of remedies is not intended to be exclusive as the overall intent of the statute is to provide the FDIC with the power it needs to preserve going-concern value of the covered financial company as long as the rights of counterparties to receive bargained-for support is respected. Accordingly, the Proposed Rule uses the broader phrase "terminate, liquidate, accelerate or declare a default under" the contract. In effect, the specified financial condition clause is unenforceable if the statutory requirements are met. In addition, by clarifying that the link created by the specified financial condition clause may operate "directly or indirectly," the Proposed Rule clarifies that the scope of the defined term includes contracts where the specified company under the clause may be another company or an affiliate in the corporate structure so long as the ultimate triggering event relates to the financial condition of the covered financial company or the Title II actions take with respect to that covered financial company. The term "specified company" used in the definition is consistent with terminology commonly used in such provisions in derivatives contracts to refer to the company whose financial condition is the basis for the termination right or other remedy.

Language in this definition is borrowed from sections of the Dodd-Frank Act addressing related matters, such as the enforceability of contracts of the covered financial company notwithstanding *ipso facto* clauses (section 210(c)(13)) and walkaway clauses

with respect to qualified financial contracts (section 210(c)(8)(F)). The fact that this language is adapted and expanded upon should not be deemed to reflect any interpretation of the meaning or possible limitations of those sections. The broad language of this definition reflects the intent that it be read to accomplish the purpose of section 210(c)(16) to ensure that the receiver has the power to avoid precipitous terminations by counterparties of the subsidiary resulting in disorderly collapse and a loss of value to the covered financial company.

In the event a counterparty (including its affiliates) has more than one contract with the subsidiary or affiliate of the covered financial company, any contract with a cross-default provision with respect to another contract containing a specified financial condition clause also would be "linked."

The term "**support**" means to guarantee, indemnify, undertake to make any loan, advance or capital contribution, maintain the net worth of the subsidiary or affiliate, or provide other financial assistance. The proposed definition does not include other assistance that is not financial in nature, such as an undertaking to conduct specific performance. Generally, if the obligation of the counterparty to perform is linked to the financial condition of the parent, the support also would likely be financial, and other types of arrangements are beyond the scope of what was intended by the statute. We are requesting comments with respect to whether this definition is sufficiently comprehensive in the Notice of Proposed Rulemaking.

The term "**related assets and liabilities**" includes assets of the covered financial company serving as collateral securing the covered financial company's support obligation, and setoff rights or netting arrangements to which the covered financial

company is subject if they are related to the covered financial company's support. It should be noted, however, that if the "support" were in the nature of a non-recourse guarantee, or an unsecured limited recourse guarantee, the related assets and liabilities would not consist of all of the assets of the covered financial company. The transfer of an unsecured guarantee or obligation to a qualified transferee would meet the requirements of the Proposed Rule in this regard, without the transfer of any particular assets. The definition also broadly includes any liabilities of the covered financial company that directly arise out of or relate to its support of the obligations or liabilities of the subsidiary or affiliate. In some instances, this definition may be redundant with the definition of support, as a guaranty could be both a related liability or a supporting obligation. The broader definition is intended to make clear that the full range of supporting obligations and related assets and liabilities must be transferred to ensure that the counterparties are in substantially the same position as they were prior to the transfer to the qualified transferee.

It is important to note that in some situations "support" and "related assets and liabilities" are themselves qualified financial contracts. Section 210(c)(8)(D)(ii)(XII) of the Act includes "securities contracts" as qualified financial contracts, and defines securities contracts to include "any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in this clause, including any guarantee or reimbursement obligation in connection with any agreement or transaction referred to in this clause." To the extent such support and related assets and liabilities are securities contracts or other forms of qualified financial contracts, they are

subject to the rules applicable to the treatment of qualified financial contracts, including the so-called all-or-none rule under section 210(c)(9).

The term "**qualified transferee**" specifically includes a bridge financial company as well as any other unrelated third parties that assume the support of the covered financial company (and all related assets and liabilities). A qualified transferee can include both the bridge financial company and a subsequent transferee; for instance, if assets and liabilities, including the support and related assets and liabilities are transferred first to a bridge financial company and then to another acquirer either prior to or upon the termination of the bridge financial company pursuant to the orderly liquidation authorities granted under Title II of the Dodd-Frank Act.

The definition of the terms "**subsidiary**" and "**affiliate**" are consistent with the definitions given to such terms in the Dodd-Frank Act. Section 2(18) of the Act, codified at 12 U.S.C. 5301(18), provides that these terms will have the same meanings as in section 3 of the FDI Act (12 U.S.C. 1813). Under the FDI Act, the term "subsidiary" is broadly defined as "any company which is owned or controlled directly or indirectly by another company...." "Affiliate is defined by reference to the Bank Holding Company Act, 12 U.S.C. 1841(k) as "any company that controls, is controlled by, or is under common control with another company."

The statute refers to the definition of "**control**" provided in the FDI Act, which in turn, refers to the definition provided in the Bank Holding Company Act, 12 U.S.C. 1841(a). The Proposed Rule streamlines these cross references, clarifies that certain provisions of the Bank Holding Company Act definition are inapplicable in this context, and adopts the flexible approach of conforming to the relevant provisions of the Bank

Holding Company Act and regulations promulgated thereunder at the time of appointment of the receiver.

In effect, the Proposed Rule would define "control" to include a company that directly or indirectly or acting through one or more persons owns, controls, or has the power to vote 25 percent or more of any class of voting securities of the company. Under the Proposed Rule, a company may also exercise "control" if that company controls in any manner the election of a majority of the directors or trustees of the company. This definition is consistent with the Bank Holding Company Act definition as it has been reflected in regulations promulgated under that section, including Regulation W (12 C.F.R. 223.3(g)) and Regulation Y (12 C.F.R. 225.2(e)).

Section 2 of the Dodd-Frank Act expressly adopts the FDI Act definitions that incorporate the Bank Holding Company Act definitions "except to the extent the context otherwise requires." Parts of the Bank Holding Company Act definition of "control" are inapposite to the context of section 210(c)(16). Provisions that provide for a determination of "control" made by the Federal Reserve Board of Governors pursuant to a notice and hearing are inconsistent with the expedited decision-making expressly required by section 210(c)(16) and would undermine the statutory goal of providing prompt certainty to counterparties with respect to their contractual rights and remedies.

Adequate Protection

Paragraph (c) of the Proposed Rule describes the different ways that the Corporation may provide adequate protection in the event that it does not transfer a covered financial company's support to a qualified transferee. The definition of adequate protection is consistent with the definition in section 361 of the Bankruptcy Code, which

also formed the basis of the definition of adequate protection in the context of treatment of certain secured creditors under 12 C.F.R. 380.52. Adequate protection may include any of the following: (1) making a cash payment or periodic cash payments to the counterparties of the contract to the extent that the failure to cause the assignment and assumption of the covered financial company's support and related assets and liabilities causes a loss to the counterparties; (2) providing to the counterparties a guaranty, issued by the Corporation as receiver for the covered financial company, of the obligations of the subsidiary or affiliate of the covered financial company under the contract; or (3) providing relief that will result in the realization by the claimant of the indubitable equivalent of the covered financial company's support. The phrase "indubitable equivalent," which appears in section 361 of the Bankruptcy Code, is intended to have a meaning consistent with its meaning in bankruptcy, in conformance with section 209 of the Dodd-Frank Act that requires rules promulgated under Title II of the Act to be "harmonized" with the Bankruptcy Code where possible.

It is important to note that although a guaranty of the Corporation as receiver is expressly included among the enumerated examples of "adequate protection" in paragraph (c) of the Proposed Rule, the omission of such specific reference in 12 C.F.R. 380.52 is not intended to suggest that such a guaranty would not constitute adequate protection to secured creditors under to 12 C.F.R. 380.52. The guaranty of the receiver is, in any event, the indubitable equivalent of any guaranty or support that it may replace, and the express mention of the guaranty is added only for the avoidance of any doubt. Any such guaranty issued in accordance with the Act would be backed by the assets of the covered financial company, and also would be supported by the orderly liquidation

fund and the authority of the Corporation as manager of the orderly liquidation fund to assess the financial industry pursuant to section 210(o) of the Act. Such a guaranty would in all events qualify as the indubitable equivalent of any guaranty or support that it may replace. The express mention of the guarantee is added merely for the avoidance of any doubt. The NPR will request comment on whether the interpretation of "adequate protection" under Section 380.52 should be consistent with the interpretation under the Proposed Rule, and whether Section 380.52 should be amended to include the express reference to the receiver's guarantee for the sake of consistency and clarity.

Notice of Transfer or Provision of Adequate Protection

Paragraph (d) of the Proposed Rule provides that if the Corporation as receiver transfers any support and related assets and liabilities of the covered financial company or decides to provide adequate protection in accordance with subparagraphs (a)(1) and 2, it will promptly take steps to notify contract counterparties of such transfer or provision of adequate protection. Although the statute does not contain a notice requirement, the Proposed Rule would require that these reasonable steps be taken to provide notice in recognition of the practical reality that contract counterparties will need to know whether they may exercise remedies under a specified financial condition clause. In acknowledgement of the public's growing reliance on communication using the internet as well as the prevalence of online commerce, the Proposed Rule provides that the Corporation may post such notice on its public website, the website of the covered financial company or the subsidiary or affiliate, or provide notice via other electronic media. While the Corporation will endeavor to provide notice in a manner reasonably calculated to provide notification to the parties in a timely manner, the provision of actual

notice is not a condition precedent to enforcing such contracts. Any action by a counterparty in contravention of section 210(c)(16) will be ineffective, whether or not such counterparty had actual notice of the transfer of support or provision of adequate protection. Further, where the contract of the subsidiary or affiliate is linked to the covered financial company but not otherwise supported by the covered financial company, actual notice of by the Corporation of its appointment as receiver or its intent to exercise the authority under section 210(c)(16) is not required.

III. Request for Comments

The FDIC seeks comments on all aspects of the Proposed Rule. Comments will be considered by the FDIC and appropriate revisions will be made to the Proposed Rule, if necessary, before a final rule is issued. Comments are specifically requested on the following:

1. What terms defined by the Proposed Rule require further clarification, and how should they be defined?

2. Are there other terms used in the Proposed Rule that should be defined? Should the term "Business Day" be defined in the regulation consistent with the definition found in section 210(c)(10)(D) of the Dodd-Frank Act?

3. Are the scopes of the definitions of "support" and "related assets and liabilities" sufficiently broad so as to cover substantially all of the forms of financial assistance and related assets and liabilities that a company may provide in support of the obligations of the subsidiary or affiliate? If the scope is not sufficiently broad, please provide specific examples if possible.

4. Is the definition of "control" used for purposes of determining whether an entity is a subsidiary or affiliate of the covered financial company sufficient? Is it sufficiently clear?

5. Is the definition of "adequate protection" appropriately consistent with the definition found elsewhere in Part 380, in particular with the definition found at 12 C.F.R. 380.52? Is the specific mention of guarantees of the receiver as a form of adequate protection necessary to clearly signal that this is one of the options available to the receiver? If so, should 12 C.F.R. 380.52 be amended to specifically reference guarantees of the receiver as a form of adequate protection to assure that these provisions will be interpreted in harmony?

6. Under the Proposed Rule, the Corporation is required to promptly take steps to notify contract counterparties when the covered financial company's support and related assets and liabilities have been transferred to a qualified transferee, or when the Corporation provides adequate protection with respect to the obligations of a subsidiary or affiliate of the covered financial company. Are the steps described reasonably calculated to provide notice? Is the scope of circumstances in which notice is provided appropriate?

7. Is the Proposed Rule sufficiently clear that no action is required of the receiver to preserve the enforceability of a contract as long as the conditions with respect to the transfer of support or provision of adequate protection are met?

8. Is the Proposed Rule definition of specified financial condition clear? Is the definition broad enough to cover all orderly liquidation events from the point at which the covered financial company is insolvent or in danger of default to the final liquidation

and transfer of assets of the covered financial company? Is it sufficiently limited to make clear that the ability to enforce contracts is limited to events arising out of the specified financial condition clause and is not intended to affect rights or remedies arising out of defaults unrelated to the financial condition of the covered financial company or the related exercise of orderly liquidation authority?

IV. Regulatory Analysis and Procedure

A. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act (44 U.S.C. § 3501, *et seq.*) ("PRA"), the FDIC may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid Office of Management and Budget (OMB) control number. The Proposed Rule would not involve any new collections of information pursuant to the Paperwork Reduction Act (44 U.S.C. § 3501, *et seq.*). Consequently, no information will be submitted to the Office of Management and Budget for review.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act 5 U.S.C. § 601, *et seq.* (RFA) requires each federal agency to prepare a final regulatory flexibility analysis in connection with the promulgation of a final rule, or certify that the final rule will not have a significant economic impact on a substantial number of small entities.[1] Pursuant to Section 605(b)

[1] *See* 5 U.S.C. 603, 604 and 605.

of the Regulatory Flexibility Act, the FDIC certifies that the Proposed Rule will not have a significant economic impact on a substantial number of small entities.

Under regulations issued by the Small Business Administration ("SBA"), a "small entity" includes those firms within the "Finance and Insurance" sector with asset sizes that vary from $7 million or less in assets to $175 million or less in assets.[2]

The Proposed Rule will clarify rules and procedures for the liquidation of a nonviable systemically important financial company, to provide internal guidance to FDIC personnel performing the liquidation of such a company and to address any uncertainty in the financial system as to how the orderly liquidation of such a company would be conducted. As such, the Proposed Rule will not have a significant economic impact on small entities.

C. The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The FDIC has determined that the Proposed Rule will not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, enacted as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (Pub. L. 105–277, 112 Stat. 2681).

D. Plain Language

Section 722 of the Gramm-Leach-Bliley Act (Pub. L. 106–102, 113 Stat.1338, 1471), requires the Federal banking agencies to use plain language in all proposed and

[2] 13 CFR § 121.201.

final rules published after January 1, 2000. The FDIC has sought to present the Proposed Rule in a simple and straightforward manner.

List of Subjects in 12 CFR Part 380

Banks, banking, Financial companies, Holding companies, Insurance companies, Mutual insurance holding companies.

For the reasons stated above, the Board of Directors of the Federal Deposit Insurance Corporation amends part 380 of title 12 of the Code of Federal Regulations as follows:

PART 380—ORDERLY LIQUIDATION AUTHORITY

■ 1. The authority citation for part 380 is revised to read as follows:

Authority: 12 U.S.C. 5383(e); 12 U.S.C. 5389; 12 U.S.C. 5390(c)(16); 12 U.S.C. 5390(s)(3); 12 U.S.C. 5390(b)(1)(C); 12 U.S.C. 5390(a)(7)(D).

■ 2. The heading for subpart A is revised to read as follows:

Subpart A—General and Miscellaneous Provisions

Sec.

380.1 Definitions.

380.2 [Reserved]

380.3 Treatment of personal service agreements.

380.4 [Reserved]

380.5 Treatment of covered financial companies that are subsidiaries of insurance companies.

380.6 Limitation on liens on assets of covered financial companies that are insurance companies or covered subsidiaries of insurance companies.

380.7 Recoupment of compensation from senior executives and directors.

380.8 [Reserved]

380.9 Treatment of fraudulent and preferential transfers.

380.10 Calculation of maximum obligation limitation.

380.11 Treatment of mutual insurance holding companies.

380.12 Enforcement of subsidiary and affiliate contracts by the FDIC as receiver of a covered financial company.

380.13–380.19 [Reserved]

■ 3. Revise § 380.12 to read as follows:

§ 380.12 **Enforcement of certain contracts of a subsidiary or affiliate of the covered financial company**.

(a) *General.*

(1) Contracts of subsidiaries or affiliates of a covered financial company that are linked to or supported by the covered financial company shall remain in full force and effect notwithstanding any specified financial condition clause contained in such contract and no counterparty shall be entitled to terminate, accelerate, liquidate or exercise any other remedy arising solely by reason of such specified financial condition clause. The Corporation as receiver for the covered financial company and

any qualified transferee shall have the power to enforce such contracts according to their terms.

(2) Notwithstanding subparagraph (1) above, if the obligations under such contract are supported by the covered financial company then such contract shall be enforceable only if –

(i) any such support together with all related assets and liabilities are transferred to and assumed by a qualified transferee not later than 5:00 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) if and to the extent condition subparagraph (i) is not satisfied, the Corporation as receiver otherwise provides adequate protection to the counterparties to such contracts with respect to the covered financial company's support of 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 5:00 p.m. (eastern time) on the business day following the date of appointment of the Corporation as receiver.

(3) The Corporation as receiver of a subsidiary of a covered financial company (including a failed insured depository institution that is a subsidiary of a covered financial company) may enforce any contract that is enforceable by the Corporation as receiver for a covered financial company under subparagraphs (1) and (2) above.

(b) *Definitions*. For purposes of this Part, the following terms shall have the meanings set forth below:

(1) A contract is "linked" to a covered financial company if it contains a specified financial condition clause that specifies the covered financial company.

(2) (A) A "specified financial condition clause" means any provision of any contract (whether expressly stated in the contract or incorporated by reference to any other contract, agreement or document) that permits a contract counterparty to terminate, accelerate, liquidate or exercise any other remedy under any contract to which the subsidiary or affiliate is a party or to obtain possession or exercise control over any property of the subsidiary or affiliate or affect any contractual rights of the subsidiary or affiliate directly or indirectly based upon or by reason of (i) a change in the financial condition or the insolvency of a specified company that is a covered financial company; (ii) the appointment of the FDIC as receiver for the specified company or any actions incidental thereto including, without limitation, the filing of a petition seeking judicial action with respect to the appointment of the Corporation as receiver for the specified company and the issuance of recommendations or determinations of systemic risk; (iii) the exercise of rights or powers by the Corporation as receiver for the specified company, including, without limitation, the appointment of the Securities Investor Protection Corporation (SIPC) as trustee in the case of a specified company that is a covered broker-dealer and the exercise by SIPC of all of its rights and powers as trustee; (iv) the transfer of assets or liabilities to a bridge financial company or other qualified transferee; (v) any actions taken by the FDIC as receiver for the specified company to effectuate the liquidation of the specified company; or (vi) any actions taken by or on behalf of the bridge financial company to operate and terminate the bridge financial company including the

dissolution, conversion, merger or termination of a bridge financial company or actions incidental or related thereto.

(B) Without limiting the foregoing general language, a specified financial condition clause includes a "walkaway clause" as defined in 12 U.S.C. 5390(c)(8)(F)(iii) or any regulations promulgated thereunder.

(3) The term "support" means undertaking any of the following for the purpose of supporting the contractual obligations of a subsidiary or affiliate of a covered financial company for the benefit of a counterparty to a linked contract --

(i) to guarantee, indemnify, undertake to make any loan or advance to or on behalf of the subsidiary or affiliate;

(ii) to undertake to make capital contributions to the subsidiary or affiliate; or

(iii) to be contractually obligated to provide any other financial assistance to the subsidiary or affiliate.

(4) The term "related assets and liabilities" means—

(A) any assets of the covered financial company that directly serve as collateral for the covered financial company's support (including a perfected security interest therein or equivalent under applicable law);

(B) any rights of offset or setoff or netting arrangements that directly arise out of or directly relate to the covered financial company's support of the obligations or liabilities of its subsidiary or affiliate; and

(C) any liabilities of the covered financial company that directly arise out of or directly relate to its support of the obligations or liabilities of the subsidiary or affiliate.

(5) A "qualified transferee" means any bridge financial company or any third party (other than a third party for which a conservator, receiver, trustee in bankruptcy, or other legal custodian has been appointed, or which is otherwise the subject of a bankruptcy or insolvency proceeding).

(6) A "subsidiary" means any company which is controlled by another company at the time of, or immediately prior to, the appointment of receiver of the covered financial company.

(7) An "affiliate" means any company that controls, is controlled by, or is under common control with another company at the time of, or immediately prior to, the appointment of receiver of the covered financial company.

(8) The term "control" has the meaning given to such term under 12 U.S.C. 1841(a)(2)(A) and (B) as such law, or any successor, may be in effect at the date of the appointment of the receiver, together with any regulations promulgated thereunder then in effect.

(c) Adequate Protection.

The Corporation as receiver for a covered financial company may provide adequate protection with respect to a covered financial company's support of the obligations and liabilities of a subsidiary or an affiliate pursuant to subparagraph (a)(2)(ii) by any of the following means:

(1) making a cash payment or periodic cash payments to the counterparties of the contract to the extent that the failure to cause the assignment and assumption of the covered financial company's support and related assets and liabilities causes a loss to the counterparties;

(2) providing to the counterparties a guaranty, issued by the Corporation as receiver for the covered financial company, of the obligations of the subsidiary or affiliate of the covered financial company under the contract; or

(3) providing relief that will result in the realization by the counterparty of the indubitable equivalent of the covered financial company's support of such obligations or liabilities.

(d) Notice of Transfer of Support or Provision of Adequate Protection.

If the Corporation as receiver for a covered financial company transfers any support and related assets and liabilities of the covered financial company in accordance with subparagraph (a)(2)(i) or provides adequate protection in accordance with subparagraph (a)(2)(ii) it shall promptly take steps to notify contract counterparties of such transfer or provision of adequate protection. Notice shall be given in a manner reasonably calculated to provide notification in a timely manner, including, but not limited to, notice posted on the website of the Corporation, the covered financial company or the subsidiary or affiliate, notice via electronic media, or notice by publication. Neither the failure to provide actual notice to any party nor the lack of actual knowledge on the part of any party shall affect the authority of the Corporation or a qualified transferee to enforce any contract or exercise any rights or powers under this section.

Dated at Washington, D.C., this [Date].

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman,
Executive Secretary