Miller-Moore Amendment to Limit Secured Creditor Claims

On November 19, 2009, the House Financial Services Committee passed an amendment to the draft legislation known as the Financial Stability Improvement Act of 2009 (FSIA) (to be reported as H.R. 3996) that would limit the claims of certain secured creditors of financial institutions subject to an FDIC receivership. The amendment, proposed by Rep. Brad Miller of North Carolina and Rep. Dennis Moore of Kansas (the "Miller-Moore Amendment"), specifies that if any "covered financial company" (generally expected to include banks and other financial institutions that, if in economic distress, could pose a threat to the financial stability or economic conditions of the United States) is put into receivership by the FDIC and the amounts realized from the resolution of the receivership are insufficient to satisfy in full any amounts owed to the federal government or the systemic-resolution fund created by the FSIA, the secured claims of a creditor of such covered financial company may be subject to a discount (a "Haircut") of up to 20% at the discretion of the FDIC in its receivership capacity. The portion of any claim made subject to the Haircut would be treated as a general unsecured claim. The provisions of the Miller-Moore Amendment would apply prospectively to secured claims that become enforceable after the date of its enactment. It is believed that the Haircut is intended to be used to offset taxpayer losses in connection with the receivership process and the unwinding of the failed institution.

The rationale behind the Miller-Moore Amendment is that a secured creditor will theoretically undertake greater diligence and more closely monitor the risk-taking of the covered financial companies that borrow under secured facilities if such creditor risked up to a 20% Haircut in the event that one of the covered financial companies were to fail. Critics of the Miller-Moore Amendment warn that the measure would increase the cost of raising capital for financial companies and ultimately consumers, and add volatility to an already unstable market. The proposed legislation may have implications for the repo market in particular. If a repurchase agreement—where a creditor buys a security from a covered financial institution and agrees to sell it back a short time later at the same price plus interest—were seen to constitute a secured financing, the transaction might be subject to a Haircut. Participants in the repo market wonder whether the repo market as we now know it might cease to exist if creditors will no longer have the benefit of fully secured claims. Much of the short-term financing of financial institutions is accomplished by means of repurchase agreements.

Since the approval by the House Financial Services Committee of the Miller-Moore Amendment, Rep. Miller has added clarity to the rationale behind certain ambiguities in the Amendment. The Amendment, he states, is targeted at "secured creditors providing short-term lending to systematically important non-banks . . . within a month of the firm's collapse." The Amendment is currently aimed at banks and financial institutions having more than $10 billion in assets and is not intended to apply to depository institutions, such as Federal Home Loan banks, or to Treasury securities. Miller also states it is not intended to cover longer-term credit lending to "systematically significant firms." Sheila Blair, the chairperson of the FDIC, favors excluding Treasury securities from the Miller-Moore Amendment.

Generally, the FSIA is intended to regulate large financial institutions more closely in order to reduce systemic risk in the financial system, including establishing a process for winding down large, financially troubled financial institutions. Whether the Miller-Moore Amendment will be enacted into law or whether the Senate will adopt a similar bill remains to be seen, but this approach could have a significant impact on secured lending. One thing is certain: the Miller-Moore Amendment will be subject to debate this week and could be drastically revised. As noted by House Financial Services Committee Chairman Barney Frank, "an effort to knock it out of the bill" would not be surprising.

If you have questions or would like further information, please contact the Ropes & Gray attorney that usually advises you.

Full text of the Miller-Moore Amendment

Full committee markup of the draft FSIA legislation