OVERVIEW:
THE RESOLUTION HANDBOOK AT A GLANCE

The Federal Deposit Insurance Corporation (FDIC) learned many lessons about resolving failing financial institutions as it managed the crisis. The sheer number of failing institutions and their varied businesses and asset sizes afforded the FDIC a wide range of resolution experiences. Finally, because the crisis lasted a relatively long time, the FDIC had to conduct resolutions at all phases of various economic cycles. Following is a brief outline of the material presented in this handbook which is a compilation of the lessons learned by the FDIC during those crisis years.

The Resolution Process

In order to minimize disruption to the local community, the resolution process must be performed as quickly and smoothly as possible. The FDIC employed three basic resolution methods: purchase and assumption (P&A) transactions, deposit payoffs, and open bank assistance transactions.

Resolution Strategy

The FDIC's resolution activities begin with the receipt of the Failing Bank Letter. After a planning team has contacted the chief executive officer of the failing bank or thrift, the FDIC sends in a team of specialists to complete an information package. Part of the information package is an asset valuation review. The appropriate resolution structures are then chosen, and the FDIC conducts an on-site analysis to prepare and plan for the closing.

Marketing a Failing Institution

Once all the possible resolution methods have been selected, the FDIC begins to market the failing bank or thrift as widely as possible to encourage competition among bidders. An information meeting is held to discuss the details of the failing institution with the approved bidders. All bidders performing due diligence are provided the same information, so no one bidder has an advantage.

Bid Submission

Bids are submitted in two parts: the first amount is the premium for the franchise value of the failed institution's deposits, and the second amount is for all or part of the institution's assets.

Least Cost Analysis

In 1991, to comply with legislation, the FDIC amended its failure resolution procedures to decrease the costs to the deposit insurance funds. The new procedures require the FDIC to choose the resolution

alternative that is least costly to the deposit insurance fund of all possible methods for resolving the failed institution. Bids are forwarded to FDIC headquarters where the bids are reviewed and the least cost determination is made.

Calculation of Cash Amount Due to Acquirer

The FDIC in its corporate capacity transfers cash to an acquiring or agent institution in an amount equal to the liabilities assumed, minus the amount of assets purchased, and minus the amount of the premium (if any).

FDIC Board of Directors Approval

The FDIC staff submits a written recommendation to the FDIC Board of Directors requesting approval of the resolution transaction. The FDIC Board of Directors may direct that the winning bid determination be delegated to the appropriate division director. Once the FDIC Board of Directors has approved the transaction, FDIC staff notifies the acquirer(s), all unsuccessful bidders, and their respective regulatory agencies.

Closing the Institution

The final step in the resolution process occurs when the institution is closed and the assets and deposits are passed to the acquirer. The chartering authority closes the institution and appoints the FDIC as receiver.

Resolution Time Line

The entire resolution process is generally carried out in 90 to 100 days, not including the post-closing settlement timeframes.

Purchase and Assumption Transactions

The most common resolution method for failing banks and thrifts is the P&A transaction. In a P&A transaction, a healthy institution assumes certain liabilities of the failed institution in exchange for certain assets of the failed institution plus financial assistance from the FDIC in its corporate capacity. There have been a variety of P&A transactions as the basic agreement is conducive to change. Since each failed bank situation is unique, the terms of the agreements should be flexible enough to obtain the highest value for the receivership. Variations include loan purchase P&As, modified P&As, P&As with put options, P&As with asset pools, and whole bank P&As. Two of the more specialized P&As are loss sharing transactions and bridge banks.

Loss sharing was designed to address the problems associated with marketing large banks with sizeable commercial loan and commercial real estate portfolios by limiting the downside risk of those portfolios to the

acquirers. In a loss sharing transaction, for a specified period of time, the FDIC absorbs a significant portion (typically 80 percent) of credit losses on shared loss assets, usually commercial loans and commercial real estate loans, and acquiring institutions assume the remaining 20 percent of loss. In turn, the FDIC generally receives 80 percent of the recovery on those shared loss assets and the acquirer retains 20 percent. A bridge bank is a full-service national bank chartered by the Office of the Comptroller of the Currency and controlled by the FDIC. It can be operated for two years, with three one-year extensions. A bridge bank provides the FDIC time to arrange a permanent transaction and is especially useful in situations where the failing bank is large or unusually complex.

Deposit Payoffs

A deposit payoff is only executed if the FDIC does not receive a bid for a P&A transaction that meets the least cost test. There are two types of deposit payoffs. The first type is a straight deposit payoff, in which the FDIC in its corporate capacity ensures that each depositor is paid the amount due, up to the insured limit. Depositors may come to the failed bank premises to collect their checks, or the FDIC may mail the checks to the depositors. The second type is an insured deposit transfer, in which insured deposits and secured liabilities of a failed bank or thrift are transferred to a healthy institution, and service to insured depositors is uninterrupted.

Open Bank Assistance Transactions

The FDIC may provide open bank assistance to prevent an insured depository institution from closing; however, such proposals face significant policy, cost, and administrative obstacles when compared to alternative types of transactions. As a result, open bank assistance has not been used since 1992.

Other Resolution Alternatives

Net Worth Certificate Program

Net worth certificates were used to provide noncash assistance to troubled institutions. The purpose of this program was to buy time for banks, thrifts, and savings banks to correct temporary problems caused by interest rate imbalances.

Income Maintenance Agreements

Income maintenance agreements were used to adjust for the effect that deregulation of interest rates was having on some of the larger savings banks. The FDIC used income maintenance agreements to facilitate mergers of troubled savings banks with healthy institutions.

Capital Forbearance Program and Loan Loss Amortization Program

The FDIC implemented these two programs to assist well-managed, economically sound institutions that were suffering because of the agricultural or energy crises.

Resolution of Savings and Loan Associations Prior to FIRREA

Mergers were a common method of resolution for the Federal Savings and Loan Insurance Corporation (FSLIC). Assistance in mergers included yield maintenance, which guaranteed a market rate of return on nonperforming assets; capital loss coverage on certain assets, which reimbursed the acquirer for losses that occurred when the assets were sold; negative net worth payments, which made the assets and liabilities of a failed thrift balance for the acquirer; and indemnifications, which protected the acquirer for legal expenses.

Control of Management

In 1985, a new FSLIC program called the Management Consignment Program placed troubled thrifts under new management in an attempt to strengthen the financial positions of the institutions for future sales or mergers.

The FDIC's Role as Receiver

The federal statutory framework governing the resolution of failed depository institutions promotes the sound and effective operation of receiverships, with the goal of reducing losses to depositors and creditors. The FDIC plays a predominant role as principal administrator of the resolutions of insured institutions.

Comparison with Bankruptcy Law

See special receivership powers.

Why the FDIC Acts as Receiver

Prior to the creation of the FDIC, the Office of the Comptroller of the Currency supervised national bank liquidations. Liquidations of state banks varied considerably from state to state, but most were handled under the provisions for general banking insolvencies. The U.S. Congress created the FDIC in an effort to simplify the procedures; to eliminate duplication of records; and to vest responsibility for liquidation in the largest creditor, whose interest was to obtain the maximum possible recovery.

How the FDIC Becomes a Receiver

The FDIC must be appointed as receiver for insured federal savings associations and national banks. For state chartered and Federal Reserve member banks, the chartering authority has the option of appointing the FDIC as receiver, although rarely has another entity been appointed. In certain instances, the FDIC may appoint itself as receiver for a depository institution. Courts have long recognized the dual and separate functions of the FDIC in its corporate capacity as insurer and as receiver.

The FDIC's Functions as Receiver

The FDIC is expected to maximize the return on the assets of the failed bank or thrift and to minimize any loss to the insurance fund that may result from closing the institution. A receivership is designed to market the institution's assets, liquidate them, and distribute the proceeds to the institution's creditors. The FDIC as receiver succeeds to the rights, powers, and privileges of the institution and its stockholders, officers, and directors. A receiver also has the power to merge a failed institution with another depository institution or to form a new nationally chartered institution, known as a bridge bank. The receiver is not subject to the direction or supervision of any other regulatory authority.

The FDIC's Closing Function

After failure, the first task of the receiver is to take custody of the failed institution's premises and all its records. The next step is to inform the public of the institution's closing. The FDIC closing staff works to bring the general ledger in balance as of the closing date and, when there is an assuming institution, creates two sets of books: one for the assuming institution and one for the receivership.

Resolution of Claims Against the Failed Institution

All claimants must file proof of their claims with the receiver by a specified deadline. Once a claim has been filed, the receiver has 180 days to determine if the claim should be allowed. If the claim is allowed, the claim will be paid on a pro rata basis with other allowed claims of the same class. If the claim is denied, the claimant may file suit or continue pending litigation.

Payment of Claims

The National Depositor Preference Amendment and related statutory provisions provide that claims are to be paid in the following order:

1. Administrative expenses of the receiver,
2. Deposit liability claims (the FDIC claim takes the position of the insured deposits),
3. Other general or senior liabilities of the institution,
4. Subordinated obligations, and
5. Shareholder claims.

Claimants are sometimes issued an advance dividend based on the projected recovery value of the failed institution's assets. Advance dividends usually range between 50 cents and 80 cents on the dollar of receivership claims.

Special Receivership Powers

The FDIC as receiver has a number of special powers that have been granted by federal law.

- A receiver may repudiate contracts of the depository institution that it deems are burdensome.

- The receiver is substituted as a party in litigation pending against the bank or thrift. However, a court must stay the litigation at the request of the receiver; this allows the receiver to evaluate the facts to decide how to proceed. The receiver also has the right to remove litigation from state court to federal court.

- The receiver has the power to avoid certain fraudulent transfers made by an institution's obligors within the period beginning five years before and ending five years after the receiver's appointment if there was an intent to hinder, delay, or defraud the institution.

- Federal statutes provide certain "special defenses" to the FDIC in its role as receiver to allow for the efficient resolution of a failed institution's affairs. Both statutes and court decisions recognize that, unless an agreement is properly documented in the institution's records, it cannot be enforced against the receiver, either to make a claim or to defend against a claim by the receiver. The U.S. Congress also provided the FDIC as receiver with additional protection by prohibiting courts from issuing injunctions or similar equitable relief to restrain the receiver from completing its resolution or liquidation activities.

Settlement with the Assuming Institution

A settlement date may be from 180 days to 360 days after the bank or thrift closing, depending on the institution's size.

Disposal of Assets and Termination of Receivership

In order to have funds to disburse, the FDIC works to dispose of the remaining assets of a failed institution in a timely manner through a variety of methods. Receivership termination represents the final process of winding up the affairs of the failed institution.

Other Significant Issues

The FDIC discovered many significant issues that arose while it resolved failing institutions during the bank and thrift crisis that began in 1980. Some of these issues include the following:

Maintaining Public Confidence in the Banking System

One of the FDIC's primary missions is to maintain public confidence in the U.S. financial system. When a bank fails, the FDIC accomplishes this mission through prompt and efficient payment of insured deposits and by minimizing the impact of an institution's failure on the local economy.

Adequacy of Insurance Funds

Ideally, adequate insurance funds should be available for resolving failing financial institutions. When such funds are not available, officials should focus on alternatives that minimize delay in resolutions.

Other Resolution Concerns

Failing financial institutions should be resolved as quickly as possible to preserve franchise values. Bidders' due diligence should be monitored to ensure equitable treatment among all bidders. A resolution process that most closely resembles a free market will yield the best economic results for all involved. Resolution structures that provide assistance over a period of time must be carefully crafted to provide appropriate incentives.

Receivership Issues

Assistance can be gained and goodwill can be created by sharing information with the local media about how a resolution will be conducted. When planning for any closing, whether there is to be an acquiring

institution or not, it is important to make arrangements for direct deposits coming into the failing bank or thrift and to coordinate with the on-line debit servicers concerning ATM transactions. Arrangements must be made to take care of the failed institution's customers who have concerns about uninsured deposits and loans retained by the receiver. Consideration must be given to ongoing business concerns and the availability of other credit sources in the local area.
The creation of policies for dealing with borrowers of failed institutions is critical to maximizing recovery on their loans.