CHAPTER 2 – THE RESOLUTIONS PROCESS

Protecting insured deposits in the event of a bank or thrift failure is one of the Federal Deposit Insurance Corporation's (FDIC) most critical roles. When an insured depository institution is about to fail, the FDIC takes immediate action to resolve it. Any resolution process should be performed quickly and smoothly. In the case of a small bank or thrift, swift resolution minimizes disruption to the local community. In the case of a very large institution, a failure can have national economic implications, and speed in resolving the problem is critical.

There are three basic resolution methods for failing institutions, which are described in more detail in Chapter 3, Purchase and Assumption Transactions, Chapter 4, Deposit Payoffs, and Chapter 5, Open Bank Assistance Transactions.

- A **purchase and assumption (P&A) transaction** is a closed institution[1] transaction in which a healthy institution (generally referred to as either the acquirer or the "assuming" bank or thrift) purchases some or all of the assets of a failed bank or thrift and assumes some or all of the liabilities, including all insured deposits. Occasionally, an acquirer may receive assistance from the FDIC as insurer to complete the transaction. As a part of the P&A transaction, the acquirer usually pays a premium[2] to the FDIC for the assumed deposits, which decreases the total resolution cost.

- In a **deposit payoff,** as soon as the appropriate chartering authority closes the bank or thrift, the FDIC is appointed receiver. The FDIC as insurer pays all of the failed institution's depositors with insured funds the full amount of their insured deposits.[3] Depositors with uninsured funds and other general creditors (such as suppliers and service providers) of the failed institution do not receive either immediate or full reimbursement; instead, the FDIC as receiver issues them receivership certificates. A receivership certificate entitles its holder to a portion of the receiver's collections on the failed institution's assets.

- In an **open bank assistance (OBA) transaction**, the FDIC as insurer provides financial assistance to an operating insured bank or thrift determined to be in danger of failing. The FDIC can make loans to, purchase the assets of, or place deposits in a troubled institution. Where possible, an assisted institution is expected to repay its assistance loan.[4] Due to restrictions imposed under the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991 and under The Resolution Trust Corporation Completion Act of 1993,

[1] A closed financial institution is one whose charter has been revoked by its chartering authority.
[2] The premium is the part of a bid for a failing institution's franchise value.
[3] The FDIC's insurance limit is $100,000. Any amount over that limit, including interest, is uninsured. The FDIC uses the term "insured depositor" to refer to any depositor whose deposits are under the insurance limit. Similarly, the term "uninsured depositor" is used to refer to those depositors whose deposits are over the insurance limit. It is important to note that customers with uninsured deposits are paid up to the insurance limit; and only that portion of their deposits that is over $100,000 is uninsured.
[4] Generally, an OBA agreement includes provisions for the repayment of the assistance in whole or in part.

which amended the Federal Deposit Insurance Act of 1950, OBA is no longer a commonly used resolution method.

During the 1980s, there were a number of adaptations of these basic resolution methods as the nation grappled with a large number of failing banks under challenging economic conditions. Between 1980 and 1994, the FDIC and other financial regulatory agencies developed an array of strategies. Some of these strategies were refined over time, while others were abandoned after they had served their purpose. Although cost considerations determine the ultimate method through which a failed institution is resolved, the FDIC still possesses sufficient latitude to customize particular resolution methods within that framework. Circumstances frequently dictate that the methods be modified considerably.

In every failing institution transaction, the FDIC assumes two roles. First, the FDIC in its corporate capacity as insurer protects all of the failing institution's depositors for the amount of their insured deposits by using one of various resolution techniques. Second, the FDIC acts as the receiver of the failed institution and administers the receivership estate for all creditors. The FDIC as receiver is functionally separate from the FDIC acting in its corporate role as deposit insurer, and the FDIC as receiver has separate rights, duties, and obligations from those of the FDIC as insurer. U.S. courts have long recognized these dual and separate capacities. More information on this subject is provided in Chapter 7, The FDIC's Role as Receiver.

Resolution Strategies

In the United States, a bank or thrift institution must obtain a charter from a recognized chartering authority in order to obtain federal deposit insurance and do business. The chartering authority typically closes an institution when the institution becomes insolvent, critically undercapitalized, or unable to meet requests for deposit withdrawals.[5] The chartering authority, which is the individual state banking agency for state chartered institutions, the Office of the Comptroller of the Currency for national banks, or the Office of Thrift Supervision for federal savings institutions, informs the FDIC when an insured institution will be closed.

Although the FDIC monitors troubled banks, its formal resolution activities begin when a financial institution's chartering authority sends a "failing bank letter" advising the FDIC of the institution's imminent failure.[6] Once the FDIC receives a failing bank letter, a planning team from the FDIC

[5] In 1991, the FDIC was given the authority to close an institution that was considered to be critically undercapitalized (that is, having a ratio of tangible equity to total assets equal to or less than 2 percent) and that did not have an adequate plan to restore capital to the required levels. The FDIC was also given the authority to close an institution that either had a substantial dissipation of assets due to a violation of law, operated in an unsafe or unsound manner, engaged in a willful violation of a cease and desist order, concealed records, or ceased to be insured.

[6] In the past, the FDIC was hesitant to undertake much pre-failure activity regarding a failing institution for fear that such action would cause the institution's customers to panic and withdraw their funds, causing a deposit "run" on the bank or thrift. A deposit run erodes an institution's liquidity and can accelerate its failure. Although bank and thrift customers have confidence in the stability of the banking system, the FDIC still maintains confidentiality regarding a failing institution's status.

contacts the chief executive officer of the failing bank or thrift to discuss logistics, to address senior management's involvement in the resolution activities, and to obtain loan and deposit data from the institution or its data processing servicer. After the FDIC receives the requested data, a team of 5 to 15 FDIC resolution specialists visits the bank or thrift to gather additional information and analyze the institution's condition. The resolution team assigns a value to all the assets of the institution, determines the resolution options the FDIC will offer, prepares an information package for the FDIC to give to potential bidders, and plans for the closing and receivership.

Asset Valuation

Simultaneously, the FDIC begins a review of the failing institution's assets using valuation models to estimate the liquidation value of the assets. This estimate is used in calculating the cost of a deposit payoff. Because the FDIC does not have enough time to assess every asset, it uses a statistical sampling procedure. Loans are divided into categories, such as real estate, commercial, and installment loans, and within each category the loans are identified as either performing or nonperforming. For each subcategory of loans, FDIC specialists identify a sample and carefully review the selected loans to establish an estimated liquidation value for each loan. The liquidation value is driven by the future cash flows and the expenses likely to be incurred during the collection of the loans. Adjustments are made to discount future cash flows and to account for liquidation expenses. The loss factor that results from that estimate is then applied to the subcategory of loans that were not reviewed.

Determining the Resolution Structure

All of the information gathered during the FDIC's review of a failing institution is used to determine the appropriate resolution structures to offer to potential bidders. In developing the marketing strategy, the FDIC considers four factors: 1) the asset and liability composition of the failing institution; 2) the competitive and economic conditions of the institution's market area; 3) any prior resolution experience with similar institutions in the same market; and 4) any other relevant information, such as potential fraud at the institution. Based on this information, the FDIC determines how best to structure the sale of the bank or thrift.

The primary decisions include the following factors:

- How to market the institution; that is, whether to sell it as a whole or in parts. Portions of the bank or thrift, such as its trust business, its credit card division, or its branches may sell best as separate transactions.

- Which types or categories of assets should be offered to prospective purchasers.

- How to package saleable assets; for example, should the acquirer be required to purchase them, should they be sold with loss sharing, or should they be offered as optional asset pools.[7]

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[7] Both loss sharing transactions and optional asset pools are described more fully in Chapter 3, Purchase and Assumption

- At what price the assets should be sold; for example, at book value, at a fixed value estimated by the FDIC, or at the reserve price.

In the early to mid-1980s, the FDIC was able to select the resolution method it preferred as long as the cost of the chosen method was less than the estimated cost of paying off the depositors and liquidating the failed institution's assets.[8] As the banking crisis became more acute toward the end of the 1980s, the FDIC tended to choose resolution transactions that passed a large portion of a failing institution's assets to the acquirer. This type of transaction was chosen for a variety of reasons that are described more fully in Chapter 3, Purchase and Assumption Transactions.

Since 1991, the FDIC has been subject to a new provision of the law that requires it to use the resolution type that is the least costly of all possible options. As a result, bidders of failed institutions have been offered a number of options, which tends to increase the number of bids the FDIC receives.

The Information Package

As part of its resolution process, the FDIC develops detailed data for the information package on the amounts and types of assets and liabilities that the failing institution holds. The information varies depending on each institution's business strategy, as reflected in its asset and liability structure. For example, if a failing bank or thrift is involved primarily in residential mortgage lending, the FDIC will develop information on the basis of that bank's asset characteristics, such as the interest rates and the terms of the loans, as well as the performance status of the portfolio (that is, performing versus nonperforming).

Planning for the Closing

Finally, the FDIC conducts an on-site analysis to prepare and plan for the closing. The FDIC estimates the number and dollar amount of uninsured deposits at the institution, determines and analyzes the extent of any contingent liabilities, and investigates whether any potential fraud is present.

Transactions.

[8] The FDIC developed a cost test in 1951 to determine the cost of a proposed resolution. The cost test was used to determine whether a purchase and assumption (or other) transaction would cost less than a deposit payoff. Purchase and assumption transactions resulted in *de facto* deposit insurance for all depositors, whereas deposit payoffs protected only customers with insured deposits.

Marketing a Failing Institution

Once the information has been gathered and the resolution options to be offered have been selected, the FDIC, while still cognizant of confidentiality concerns, begins to market the failing bank or thrift as widely as possible to encourage competition among bidders. The FDIC's bank examination force compiles a list of potential acquirers consisting of approved financial institutions and private investors.[9] In compiling the list, the FDIC takes into account the failed institution's geographic location, competitive environment, minority-owned status, overall financial condition, asset size, capital level, and regulatory ratings. Private investors wishing to bid on a failing institution must have adequate funds and be engaged in the process of obtaining a charter to create a new institution.

The Information Meeting

The FDIC invites all approved bidders to an information meeting. After signing confidentiality agreements, bidders receive copies of the information package, which includes financial data on the institution, legal documents, and descriptions of the resolution options being offered. At the meeting, the FDIC provides details on the failing institution, the resolution methods being offered, the legal documents, the due diligence process,[10] and the bidding procedures. Typically, the terms of the transaction focus on the treatment of the deposits and assets held by the failing bank or thrift. The FDIC also advises the bidders about the types and amounts of assets that will pass to an acquirer as part of each of the various transactions terms; which assets the FDIC plans to retain; the terms of the asset sale, such as loss sharing arrangements and optional asset pools; and other significant conditions that are part of each proposed resolution method. Chartering authority officials describe the regulatory requirements for bidding, as well as the application process for branches or new charters.[11]

Revealing the FDIC's Reserve Price for Assets

For many years, the FDIC sold assets of failing institutions revealing only the book value of the assets, which is the principal amount shown on the failing institution's books or records. When only the book value was disclosed, bidding institutions were unaware of the FDIC's estimated value for the asset pool. The FDIC establishes the reserve price by estimating the fair market value of the assets in each pool and then deducting any estimated costs of disposition and direct marketing, arriving at a net figure that is known as the liquidation value of the assets. The reserve price is the liquidation value of the assets expressed as a percentage of the book value. For example, a reserve price for a mortgage loan pool might be listed as 94 percent.

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[9] The bid list is reviewed by the financial regulatory authorities concerned, including the Office of the Comptroller of the Currency, the Federal Reserve Board, the Office of Thrift Supervision, and the appropriate state banking authority to determine which bidders will be approved to acquire the failing institution.

[10] Due diligence is a potential purchaser's on-site inspection of the books and records of a failing institution.

[11] Private investors who do not already hold a financial institution charter must be approved for a new charter, known as a *de novo* charter, by the appropriate chartering authority, before they can purchase a failing institution. They cannot purchase a failed institution without the chartering authority's approval.

The estimated liquidation value of the assets is a part of the FDIC's cost test for the resolution of the institution. Therefore, if a potential acquirer offers an amount at least equal to the FDIC's estimated liquidation value of the assets, that bid will be evaluated as less expensive than the cost of the FDIC's conducting a payoff of the failed institution's insured deposits and a liquidation of the assets. If no investor bids an amount at least equal to the FDIC's estimated liquidation value, then the asset pool remains with the receivership.

In the early 1990s, the FDIC attempted to increase the volume of assets sold at resolution by revealing the FDIC's reserve price for the asset pools. There are advantages and disadvantages to this practice. One advantage is that it promotes the sale of the loans. Revealing the reserve price encourages potential acquirers to have confidence that the FDIC's estimates are reasonable and that the time they invest in due diligence will be well spent.

The principle disadvantage to revealing the reserve prices of the asset pools occurs in transactions with few bidders. When bidders know there is little competition, revealing the reserve price may bias the bidding toward the reserve prices. For example, if an asset pool has a book value of $1 million and if the FDIC estimates the fair market value to be only $900,000 and the collection expenses to be another $50,000, the FDIC's reserve price will be 85 percent of the book value of the assets. A potential acquirer, having completed its own due diligence, may have estimated the fair market value of the assets to be $950,000 and its own collection costs as $30,000. That potential acquirer might ordinarily have bid up to 92 percent. However, if the FDIC discloses its 85 percent reserve price, the potential acquirer facing little competition might bid closer to 85 percent than to 92 percent. Although the FDIC's acceptance of the bid at 85 percent is less expensive for the FDIC than the cost of liquidating the assets, the reduced bid results in a loss of income for the receivership estate.

Even though the FDIC requires separate bids for the deposits (franchise value) and for the assets, many potential bidders frequently view a failing institution as a whole and will formulate the total amount they are willing to bid. They submit bids that link their franchise and asset bids into one "all-or-nothing" bid. If the FDIC's reserve price for the asset pools is higher than what a bidder had wanted to pay, a potential acquirer may offer the reserve price of the assets and correspondingly lower the amount it offers for the deposit franchise.

For example, a bidder may have valued a hypothetical failing institution at $1 million by estimating the value of the asset pools (net of collection costs) at $800,000 and the value of the deposit franchise at $200,000. In this example, the FDIC is offering two asset pools: one has a book value of $500,000 with a reserve price of 85 percent ($425,000), and the second has a book value of $800,000 with a reserve price of 50 percent ($400,000). The bidder must offer at least $825,000 to acquire the two asset pools. The bidder may offer the same $1 million bid for the entire institution by lowering its bid for the franchise to $175,000. Exhibit 2-1 illustrates this example. Such a situation can occur only if competition among the bidders is minimal, because a bidder has a greater risk of losing the deposit franchise if it submits a low bid in a more competitive setting.

Exhibit 2-1

How Revealing the Reserve Price for Asset Pools May Affect Deposit Franchise Bidding

Bidder's calculations after due diligence		**Bidder's calculations to meet reserve price on assets**	
Estimate of asset value	$800,000	Bid for asset pools	$825,000
Estimate of franchise value	200,000	Bid for franchise	175,000
Total bid	$1,000,000	Total bid	$1,000,000

Historically, bankers have been reluctant to purchase assets of failing banks or thrifts unless they received the corresponding deposit base to fund the acquisition of the loans. In transactions completed between 1992 and 1994, virtually all of the assets passed to acquirers were part of asset pool bids that were contingent on the bidding bank winning the franchise. On the other hand, the Resolution Trust Corporation (RTC) experienced little difficulty in marketing the deposit franchise separately from the assets. Both methods should be offered to determine what the market will bear in a particular area. Exhibit 2-2 shows the benefits and other considerations of disclosing the reserve price on optional asset pools.

Exhibit 2-2
Disclosing the Reserve Price on Optional Asset Pools

Benefits

- *Ensures that at least the minimum is bid for each asset pool.*
- *Encourages bidders to invest in due diligence.*
- *Eliminates unrealistic bids and provides serious bidders with information necessary to formulate their bids.*

Other Considerations

- *May potentially recoup less money for the receivership estate in less competitive situations.*

Branch Breakups

Some financial institutions may be worth more if sold in pieces. In certain failing institution situations, there may be few, if any, acquirers willing to assume the deposits of all branches of a multi-branch bank or thrift. A solution to this problem is to offer individual branches along with their deposits as a resolution option. The RTC used this strategy frequently in resolving multi-branch institutions, and the FDIC subsequently adopted this method.

Offering failing institutions on both a whole franchise and a branch breakup basis expands the universe of potential bidders. It allows smaller institutions to participate along with larger institutions

that may be interested only in certain branches or markets. The RTC/FDIC experience shows that this process results in more bidders and higher premiums than if failing institutions are only marketed on a whole franchise basis.

Branch breakup transactions have certain disadvantages. Electronic data processing and conversion costs to facilitate the acquisition are generally higher than in whole franchise deals, and it is more difficult to complete transactions quickly and smoothly in branch breakup transactions. Further, branch breakups require one of the acquiring institutions to be the "lead" acquirer and to provide backroom operations (accounting, payment posting, and check processing) for all the other acquirers during the transition period. Failing institutions with little franchise value or with geographically concentrated branches are considered poor candidates for branch breakup resolutions, because there is little marketability for extra buildings and there is not ample opportunity for acquirers to generate new account activity. Exhibit 2-3 shows the benefits and other considerations of branch breakups.

Exhibit 2-3

Branch Breakups

Benefits

- *Expands universe of potential bidders by allowing smaller institutions to participate in the bidding, which may increase the premiums received.*
- *Increases the resolution options available to the bidders.*

Other Considerations

- *Electronic data processing and conversion costs are generally higher.*
- *It is more difficult to complete transactions quickly and smoothly.*
- *Requires one of the acquiring institutions to be "lead" acquirer.*
- *Some branches may be undesirable, and a payoff of their insured deposits may have to be completed.*

Bidder Due Diligence

Approved bidders who have signed confidentiality agreements are invited to conduct due diligence at the failing institution. Due diligence is the bidder's on-site inspection of the books and records of the institution and the bidder's assessment of the value of the franchise, and is performed so the bidder can submit an educated bid. The failing institution's board of directors must pass a board resolution authorizing the FDIC to conduct on-site due diligence before bidders visit the institution, because the institution is still an ongoing entity under private ownership. All bidders performing due diligence are provided the same information so no one bidder has an advantage.

Occasionally, the reality of the due diligence process spurs the failing bank into action to find sources of capital on their own. When this happens, the resolution process is put on hold. If the failing bank's plan for an unassisted merger or capital injection pans out, the resolution process is

terminated; if the plan falls through, the resolution process resumes and all information is updated if there was a significant time lapse.

Bid Submission

After all bidders have completed their due diligence, bidders submit their proposals to the FDIC. This generally occurs 12 to 15 days before the scheduled closing, but it is often as few as 6 or 7 days before closing. To determine the least cost resolution, all bids, including those that do not conform to the FDIC's previously identified resolution methods (referred to as nonconforming bids) are evaluated and compared with each other and with the FDIC's estimated cost of liquidation.

A bid has two parts: one amount, called the premium, is for the franchise value of the failing institution's deposits; and the second amount is what the bidder is willing to pay to acquire the institution's assets. The first figure generally represents the bidder's perception of the value of the customer base; and the second amount reflects the bidder's perception of the imbedded losses and the level of risk associated with the assets.[12]

Least Cost Analysis

When selecting a resolution method, the FDIC has changed procedures over the years. Before the passage of FDICIA in 1991, the FDIC could effect any resolution transaction that was less costly than a deposit payoff. While the estimated cost of the resolution method has always been important, the FDIC at times considered other factors before making its final selection. Deposit payoffs were sometimes discouraged because they reduced the availability of local banking services in smaller communities. The FDIC also looked at broad issues such as the effect certain resolution methods may have had on banking stability and on discouraging shareholders and creditors of insured institutions from excessive risk-taking actions. The FDIC also considered the effect the selected method might have on increasing the inventory level of loans being serviced by the FDIC. After FDICIA, the FDIC amended its failure resolution procedures to accept the "least cost" bid.

The new procedures require the FDIC to choose the alternative in which the total amount of the FDIC's expected expenditures (including any immediate or long-term obligation and any direct or contingent liability for future payment) is the least costly to the deposit insurance fund of all possible methods for resolving the failed institution.

The FDIC determines the least costly resolution transaction by evaluating all possible resolution alternatives and computing costs on a net present value basis, using a realistic discount rate. The overall cost to the FDIC of a failed institution depends on a number of factors, including the following:

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[12] The latter figure results in a net payment from the FDIC to the acquirer. For example, if the acquirer assumes responsibility for $100 in deposits and views the assets with a book value of $100 as being worth $80, then the acquirer will expect a $20 payment from the FDIC to make up the difference.

- The difference between total book value of assets and liabilities of the bank;
- The levels of uninsured and insured liabilities;
- The premium paid by the acquirer;
- Losses on contingent claims;
- The realized value of assets placed in liquidation by the FDIC; and
- Cross guarantee provisions against affiliated institutions.[13]

In most cases, the FDIC will receive at least one bid that is less costly than the estimated cost of liquidation. If the bid includes assumption of all deposits, including uninsured deposits, the premium paid must be at least as large as the losses that would have been incurred by customers with uninsured deposits in a payoff in order for the bid to be considered less costly than liquidation.

The cost to the FDIC of a liquidation and payoff is generally calculated by the formula is shown in exhibit 2-4.

Exhibit 2-4

FDIC's Least Cost Test Calculation

FDIC's cost = (loss to depositors) x (the loss factor)

Or more appropriately shown as

(loss on all assets - equity capital - unsecured creditors' loss) x (insured deposits/total deposits)

The first term in parentheses in the equation (loss to depositors) defines the total expected loss on all receivership assets to be absorbed by the depositors. It includes all loan loss reserves as well as an estimate of the FDIC's receivership expenses. This loss is reduced by the amount of equity remaining and by the amounts owed to unsecured creditors (since they now absorb all losses first before the depositors.)

The second term in parentheses in the equation (the loss factor) accounts for the portion of losses absorbed by customers with uninsured deposits in a payoff. It is important to note that the FDIC shares pro rata with customers who had uninsured deposits. For example, if customers who had

[13] The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 included a cross guarantee provision that allows the FDIC to recover part of its resolution cost by seeking reimbursement from affiliated institutions. That provision was designed to prevent affiliated banks or thrifts from shifting assets and liabilities among themselves in anticipation of the failure of one or more of the institutions.

uninsured deposits constitute 30 percent of the total deposits, then the FDIC as subrogee[14] has the other 70 percent and will absorb 70 percent of any loss to the depositors.

Savings to the FDIC may come from several sources, such as the premium paid by the acquirer, cross guarantee provisions against affiliated institutions, assets sold to the assuming bank at a smaller discount than that estimated by FDIC staff, and future losses absorbed by the FDIC as a result of loss sharing agreements that are expected to be less than losses incurred through liquidation of assets.

Calculation of Cash Amount Due to Acquirer

When an open financial institution acquires or assumes the liability for a failing institution's deposits, the FDIC as insurer reimburses it for the amount of insured deposits.[15] This occurs in two types of transactions: a purchase and assumption transaction and an insured deposit transfer (IDT).[16]

In a P&A, the institution acquiring the deposits of the failed institution is called the acquiring institution; in an IDT, the institution assuming the liabilities is called the agent institution. The amount of cash to be transferred to the acquiring or agent institution is calculated the same way for both P&As and IDTs, as shown in exhibit 2-5.

Exhibit 2-5
FDIC's Amount of Cash to be Transferred Calculation

Cash from FDIC = Liabilities Assumed – Assets Purchased – Premium

An example of this calculation is a failing institution with total deposits of $120 million, of which $100 million is insured. The least cost bid submitted contained a $5 million premium to acquire the insured deposits and an offer of $48 million to purchase a package of loans. The FDIC would pay $47 million to the acquiring institution, as shown in exhibit 2-6.

Exhibit 2-6
Amount of Cash to be Transferred Calculation Example

Cash from FDIC	=	Liabilities Assumed	–	Assets Purchased	–	Premium
$47 million	=	$100 million	–	$48 million	–	$5 million

[14] Subrogee is a term used when the FDIC pays the insured depositors the amounts of their insured deposits and then substitutes itself in the place of the insured depositors in the claims process.
[15] If the premium is for *all* deposits (not just insured deposits), the FDIC can reimburse the acquirer for all deposits *provided* that the transaction is the least costly of all possible transactions.
[16] Purchase and assumption transactions are discussed fully in Chapter 3, Purchase and Assumption Transactions. Insured deposit transfers are a form of deposit payoff, and are discussed fully in Chapter 4, Deposit Payoffs.

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 recommendation includes a copy of the least cost analysis and information about the share of the estimated loss that should be absorbed by customers with uninsured deposits. It also addresses whether an advance dividend[17] should be paid to customers with uninsured deposits so that they can receive a portion of their claim while the FDIC proceeds with the resolution and disposition of the remaining assets.

The FDIC Board of Directors is ultimately responsible for determining the least costly transaction. The board may direct that the winning bid determination be delegated to the appropriate division director. Once the Board has approved the transaction, the FDIC staff notifies the acquirer(s), all unsuccessful bidders, and the chartering agency. The FDIC then arranges for the acquirer(s) to sign the appropriate legal documents before the institution's closure. At that time, the FDIC staff meets with the acquirer(s) to coordinate the mechanics of the closing procedures.

Closing the Institution

The final step in the resolution process occurs when the institution is closed, and the assets that the acquirer purchased and the deposits that it assumed are transferred to the acquirer. The chartering authority closes the institution and appoints the FDIC as receiver (usually on a Friday).[18] The FDIC as receiver is then responsible for settling the affairs of the closed bank or thrift. Such activities include balancing the accounts of the institution immediately after closing, transferring certain assets and liabilities to the new owner, and determining the exact amount of payment due the acquirer. The settling of various accounts between the receiver and the acquirer is called "settlement." This process takes from 6 to 12 months, depending on the size of the failed institution. See Chapter 7, The FDIC's Role as Receiver for more information.

The acquirer reopens the bank or thrift usually by the next business day, and the customers of the failed institution automatically become customers of the acquiring institution with access to their insured funds. As receiver, the FDIC is responsible for operating the receivership, including collecting on the failed bank's assets retained by the receiver, and to the extent possible, satisfying the creditor claims against the receivership. In cases where the FDIC provides continuing assistance, such as in a loss sharing transaction, the FDIC will monitor the assistance payments for the duration of the agreement, typically over several years.

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[17] Advance dividends are payments made to uninsured depositors soon after a bank fails based on the estimated value of the receivership's assets. Advance dividends typically range between 50 cents and 80 cents on the dollar of the receivership claims.

[18] Friday closings give the FDIC time to work over the weekend. Generally, the new institution opens for business on Saturday and resumes normal operations the following Monday.

Resolution Timeline

The entire resolution process is generally carried out in 90 to 100 days, not including the post-closing settlement timeframes. It officially begins when the chartering authority advises the FDIC that an insured institution is in imminent danger of failing (although the FDIC monitors troubled institutions on an ongoing basis, the letter is a formal requirement), and ends when the chartering authority appoints the FDIC as receiver. Sometimes the usual resolution process cannot be fully completed before the institution fails, such as in cases of sudden or severe liquidity problems, for example, a systemic deposit run. In those instances, the FDIC usually does not have the time to prepare a review of the assets on site,[19] leaving a greater likelihood that the FDIC will retain the failed institution's assets while structuring a more immediate solution for the institution's deposits and other liabilities. Three primary alternatives available in the face of such time pressure are a transfer of only the insured deposits, a payoff of the insured deposits, or the formation of a bridge bank. Insured deposit transfers and deposit payoffs are discussed in Chapter 4, Deposit Payoffs; bridge banks are discussed in Chapter 3, Purchase and Assumption Transactions.

A timeline of a typical resolution process is shown on table 2-1.

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[19] When there is insufficient time to perform an on-site review, the FDIC uses its research model to value all or most of the assets. The research model is based on the FDIC's historical recovery experience for six broad categories of assets as reflected by a sample of prior bank failures.