CHAPTER 4 – DEPOSIT PAYOFFS

Although purchase and assumption transactions are the most common resolution method, deposit payoffs are used when no acquiring institution can be found. When a bank or thrift is closed by its chartering authority, the Federal Deposit Insurance Corporation (FDIC) in its corporate capacity as deposit insurer makes sure that customers receive the full amount of their insured deposits. Customers with uninsured deposits and other general creditors of the failed institution are given receivership certificates that represent their uninsured claims that will be held against the failed institution's estate. In a deposit payoff, because there is no acquiring institution, the FDIC as receiver must liquidate all of the failed institution's assets.

Structure of a Deposit Payoff

Deposit payoffs currently have two forms: the straight deposit payoff[1] and the insured deposit transfer. A third form, the Deposit Insurance National Bank (DINB),[2] is rarely used and has not been used since 1982.

In a **straight deposit payoff**, the FDIC determines the insured amount due each depositor and prepares a check for that amount. Arrangements are made either for the depositors to come to the bank and get the checks or for the FDIC to mail the checks to the depositors.

In an **insured deposit transfer**, the FDIC also determines the insured amount due each depositor. Arrangements are then made with a healthy institution that is willing to act as agent for the FDIC and to pay insured deposits to customers of the failed institution. The FDIC transfers insured deposit accounts and secured liabilities of the failed bank or thrift, along with an equal amount of cash or other assets, to the healthy institution. Service to customers with insured deposits is uninterrupted. Each of these transactions is discussed on the following pages.

Straight Deposit Payoff

The straight deposit payoff method is generally the most costly method of resolution, because the receiver must liquidate all of the failed institution's assets, bear the cost of paying off all the customers with insured deposits, and monitor the estate for the creditors.

A straight deposit payoff is only executed if the FDIC does not receive a bid for a P&A transaction or for an insured deposit transfer transaction that will result in a lower cost than the payoff method

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[1] A straight deposit payoff is frequently referred to simply as a "payoff," since it is the only time the FDIC actually prepares checks for failed institution customers with insured deposits.

[2] The Banking Act of 1933 authorized the FDIC to establish a Deposit Insurance National Bank to assume the insured deposits of a failed bank. A DINB had a limited life of two years and continued to insure deposits still in the bank, but could not make loans. Depositors were given up to two years to move their deposit accounts to other institutions.

(as discussed in Chapter 2, The Resolutions Process). In a straight deposit payoff, no liabilities are assumed and no assets are purchased by another institution. The FDIC must pay depositors of the failed institution the total of their insured deposits.

In a straight deposit payoff, the FDIC determines the insured amount for each depositor and pays that amount to him or her. In the past, the bank customers would come to the bank to receive their checks from the FDIC. More recently, because of the size of some failed institutions and the geographic dispersion of their customer bases, the FDIC has paid insured deposits by mailing customers checks equal to the amount of their insured deposits. In calculating each customer's total deposit amount, the FDIC includes all the interest accrued up to the date of failure under the contractual terms of the depositor's account. In other words, the FDIC pays the entire principal plus all accrued interest, up to the insurance limit.

For example, a customer with only one individual account, a certificate of deposit in the amount of $80,000 with $15,000 in accrued interest ($95,000 total), would be paid the full $95,000. A customer with only one individual account, a certificate of deposit in the amount of $90,000 with $15,000 in accrued interest ($105,000 total), would be paid only $100,000 because of the insurance limit.

Any checks which a failed institution's customer has written but which have not yet "cleared" the customer's checking account are returned to the payee (person to whom the check was written), because there is no succeeding bank to pay the check. These checks are stamped "Bank Closed" before they are returned to the payee and are not considered "insufficient funds checks." Even so, this situation causes some disruption to the customers of the failed institution.

The deposit liabilities (both insured and uninsured deposits), together with all other liabilities of the failed bank or thrift, represent claims against the receivership estate. The FDIC as receiver retains all assets and liabilities and liquidates the assets of the failed institution for the benefit of all claimants entitled to payment from the estate.

In the United States, laws provide that all depositors are paid from the receivership estate before any general creditors (such as, suppliers, trades people, or contractors) or other unsecured creditors. The FDIC in its corporate capacity pays the customers with insured deposits up to the insurance limit. These customers actually exchange their claims against the receivership estate for the insurance payments from the FDIC in its corporate capacity, so that the FDIC in its corporate capacity is substituted as the claimant for the amount of insurance payments made. This process is called "subrogation," and the FDIC is the "subrogee." Therefore, claimants against the receivership estate include the FDIC in its corporate capacity as the payer of deposits.

For example, a customer with one individual account, a certificate of deposit in the amount of $80,000 with $15,000 in accrued interest, would be owed $95,000 by the receivership estate. If that customer accepted $95,000 in cash from the FDIC in its corporate capacity, then the customer was paid the full amount due to him. The customer "subrogated" his claim to the FDIC. The customer

now has no claim against the receivership estate; instead, the FDIC in its corporate capacity now has the $95,000 claim.

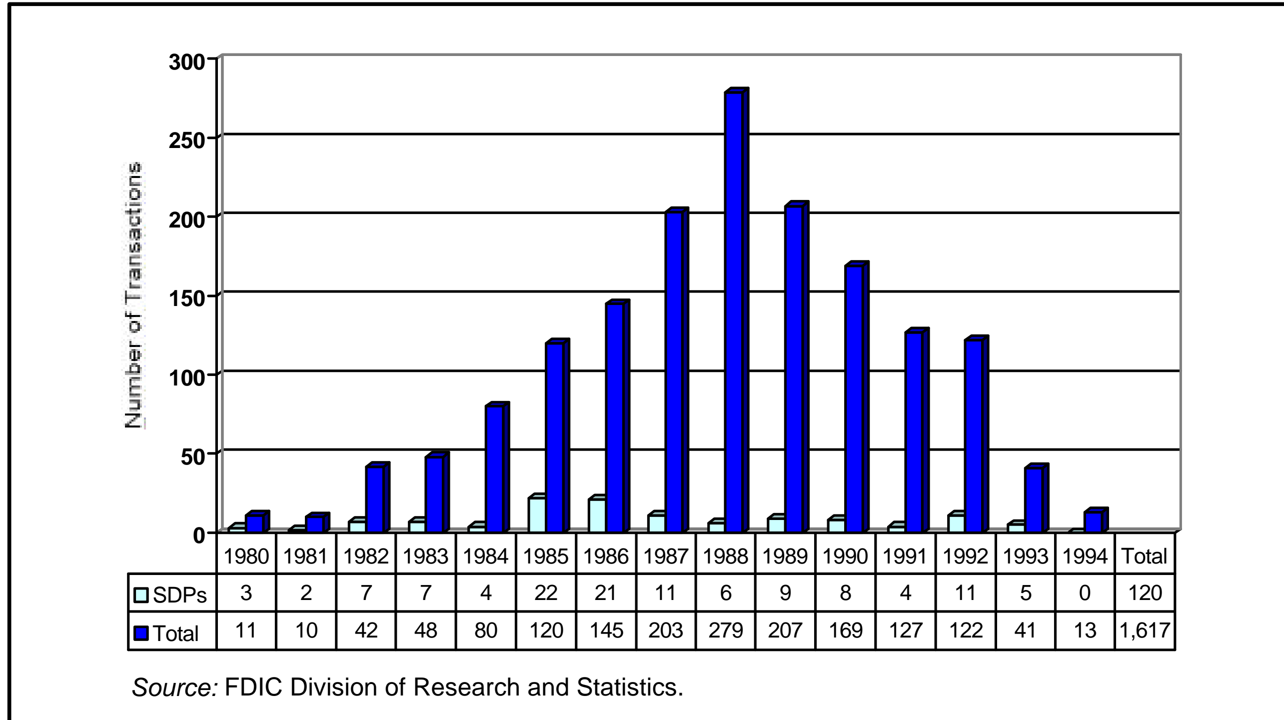
Deposit payoffs occur more often in smaller banks rather than in large banks. Prior to 1982, the largest bank failure handled through a straight deposit payoff was the $78.9 million Sharpstown State Bank, Houston, Texas, in 1971.[3] On July 5, 1982, Penn Square Bank, N.A. (Penn Square), Oklahoma City, Oklahoma, which had $516.8 million in total assets, failed. Penn Square, with $470.4 million in deposits in 24,534 deposit accounts, was handled as a DINB. The largest straight deposit payoff since 1982 was for Independence Bank, Los Angeles, California, which failed January 30, 1992. Independence Bank, which had $564.2 million in total assets, had $503.4 million in deposits in 33,677 accounts. The largest straight deposit payoff handled by the Resolution Trust Corporation was Brookside Federal Savings & Loan Association (Brookside), Los Angeles, California, which failed November 16, 1990. Brookside had total assets of $450.1 million and total deposits of $416 million in 15,414 accounts.

From 1980 through 1994, the FDIC managed 120 straight deposit payoffs out of a total of 1,617 failed and assisted banks, or 7.4 percent of all closings. Chart 4-1 shows the distribution of straight deposit payoff transactions per year from 1980 through 1994, and exhibit 4-1 shows the benefits and other considerations of straight deposit payoffs.

[3] Irvine H. Sprague, *Bailout* (New York: Basic Books, Inc., 1986), 117.

Chart 4-1

Straight Deposit Payoffs Compared to All Bank Failures and Assistance Transactions 1980-1994



	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	Total
SDPs	3	2	7	7	4	22	21	11	6	9	8	4	11	5	0	120
Total	11	10	42	48	80	120	145	203	279	207	169	127	122	41	13	1,617

Source: FDIC Division of Research and Statistics.

Exhibit 4-1

Straight Deposit Payoffs

Benefits

- *Customers with insured deposits receive money quickly without having to wait for proceeds from the liquidation of receivership assets.*

Other Considerations

- *Customers must find a new bank and set up new accounts.*
- *Customers with uninsured deposits are not paid the uninsured amount.*
- *Customers experience a loss of service, including the return to payees of checks that had not cleared the customers' accounts.*
- *Customers lose interest on funds from the date of failure until the FDIC check is deposited in an account elsewhere.*
- *Community can experience economic disruption from the loss of an institution.*
- *Receivership bears the cost of liquidating all of the assets of the estate*
- *Usually considered a "last resort" resolution method due to its high cost to the insurer.*

Insured Deposit Transfer

In 1983, the FDIC created the insured deposit transfer (IDT) transaction as an alternative to the straight deposit payoff. In an IDT, the insured deposits and secured liabilities of a failed bank or thrift are transferred to a healthy institution (the agent institution), and the FDIC makes a matching payment of cash and/or assets to the institution. The agent institution pays customers with insured deposits the amounts due to them or, if a customer requests it, opens an account in the agent institution. Thus, service to customers with insured deposits continues uninterrupted. All insured deposits are made available to their owners, checks drawn on those accounts are honored, and interest-bearing accounts continue to earn the same amount of interest as they were earning at the failed institution. However, the agent institution may change the interest rate after 14 days; if a change is made, customers must be given at least 7 days notice. Alternatively, customers with insured deposits may withdraw their balances and close their accounts.[4]

An insured deposit transfer minimizes the disruption to customers and to the local community caused by a straight deposit payoff. An IDT also reduces the FDIC's costs to handle the failure since the accepting institution acts as the paying agent on behalf of the FDIC and disburses insured funds to depositors. The agent institution generally pays a premium[5] for this right; although, there have been rare instances when the FDIC paid an agent institution to perform this function. Insured deposit transfers are a way to extract some franchise value for the failed institution's deposits even when an agent bank is unwilling to enter into a purchase and assumption transaction. In an IDT, the receiver retains all the remaining assets and liabilities of the failed institution that are not passed to the agent institution.

From 1980 through 1994, the FDIC oversaw 176 insured deposit transfers out of a total 1,617 closings, or 10.9 percent of all failed and assisted institutions. Since IDTs were created in 1983, through 1994, they have represented 62 percent of the total deposit payoffs while straight deposit payoffs represented 38 percent. Chart 4-2 shows the distribution of IDTs per year from 1980 through 1994, and exhibit 4-2 shows the benefits and other considerations of insured deposit transfers.

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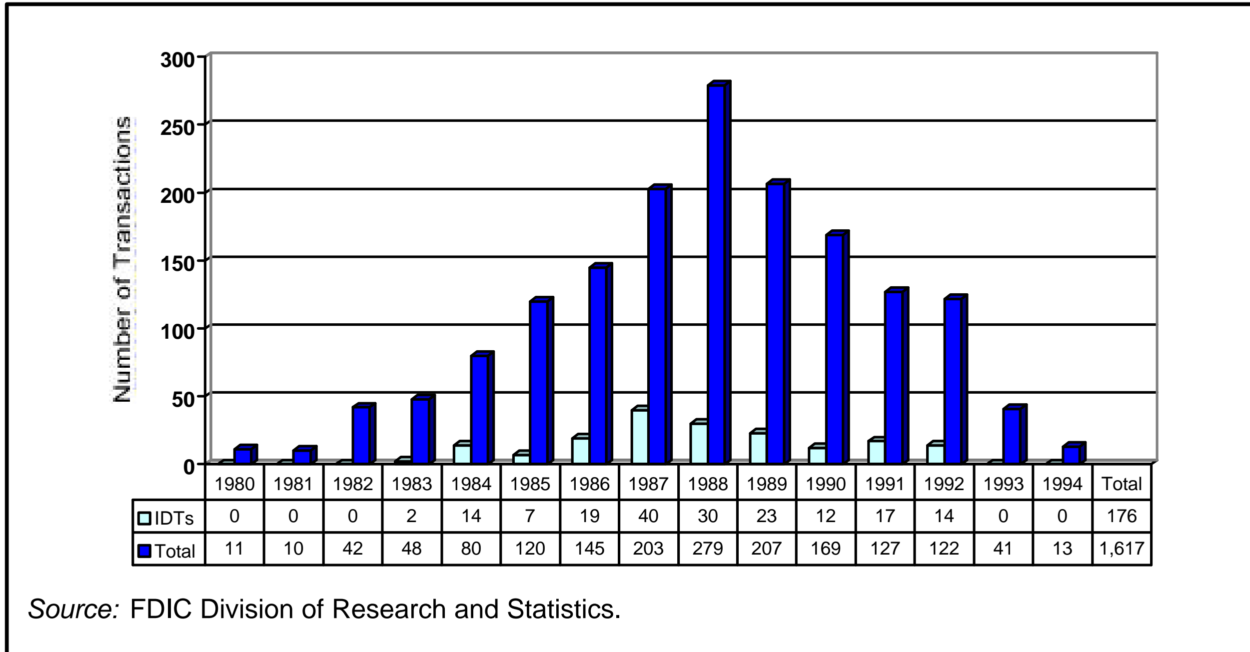
[4] If a depositor does not take action to claim the transferred deposit within 18 months after the failure, the agent institution is required to transfer the funds to the receiver, who then escheats the funds to the state, that is, turns the property over to the state in the absence of legal heirs or claimants.
[5] A premium is an amount paid for the franchise value of a failed institution's deposits.

Chart 4-2

Insured Deposit Transfers Compared to All Bank Failures and Assistance Transactions 1980-1994



	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	Total
IDTs	0	0	0	2	14	7	19	40	30	23	12	17	14	0	0	176
Total	11	10	42	48	80	120	145	203	279	207	169	127	122	41	13	1,617

Source: FDIC Division of Research and Statistics.

Exhibit 4-2

Insured Deposit Transfers

Benefits

- *Customers with insured deposits suffer no loss in service.*
- *Customers with insured deposits have new accounts in a new bank, but old checks can still be used.*
- *Agent institutions have the opportunity for new customers.*
- *Customers with insured deposits continue to earn the same rate of interest on their accounts for at least 14 days.*
- *The FDIC's administrative costs are reduced.*

Other Considerations

- *An institution must be willing and technically able to become an agent bank.*
- *Customers with uninsured deposits are not paid the uninsured amount.*
- *Receivership bears the cost of liquidating all or almost all of the assets of the failed institution.*