FEDERAL RESERVE BANK *of* ATLANTA

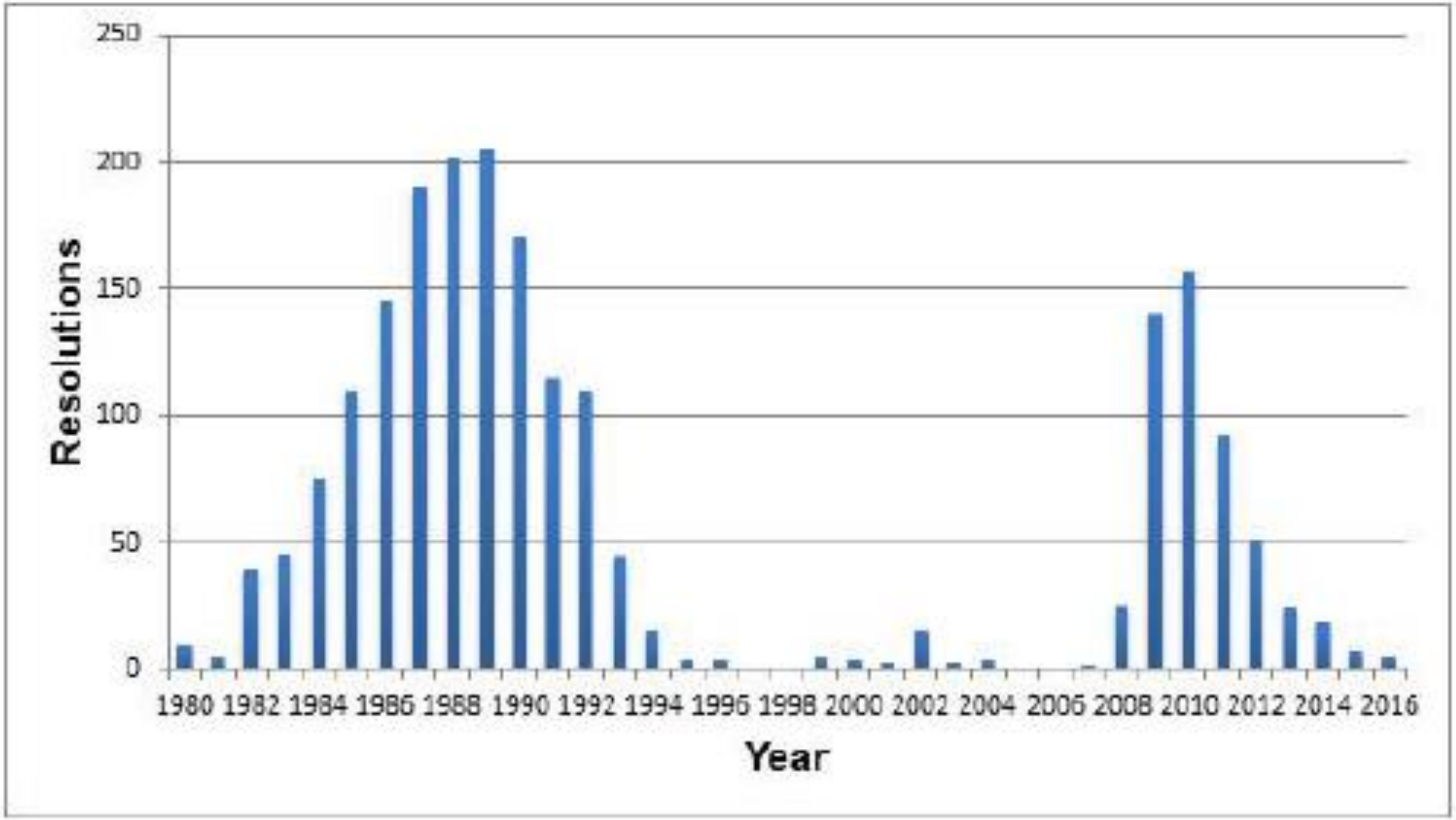
U.S. BANK RESOLUTION MECHANICS

Larry D. Wall

Federal Reserve Bank of Atlanta

FDIC EXPERIENCE WITH BANK FAILURES

Figure 1: FDIC Resolution Activity 1980–2016[5]



REGULATORY STRUCTURE IN THE UNITED STATES

- Bank regulatory agencies in the United States
  - Office of the Comptroller of the Currency (OCC)
    - Nationally chartered banks
    - Almost all large banks are regulated by the OCC
  - Federal Reserve System (FRS)
    - State chartered member banks (members of the Federal Reserve)
    - All bank holding companies (BHCs)
  - Federal Deposit Insurance Corporation(FDIC)
    - State charted nonmember banks
- Resolution of failed banking organizations
  - All federally supervised and insured banks resolved by the FDIC
  - BHCs historically resolved in bankruptcy court
  - Dodd-Frank authorizes FDIC resolution of BHCs in some cases

BEFORE STARTING THE RESOLUTION PROCESS

- FDIC obtains information on banks it does not supervise
  - Financial statements filed by the bank with their supervisor
  - Confidential reports by the other supervisory agencies
  - FDIC has backup authority to examine any bank
- FDIC collects insurance premiums ex ante and has a fund to cover resolution costs
  - Congress has also appropriated funds in the past when the insurance fund proved inadequate

RESOLUTION PROCESS

- Grounds for resolution
  - Law generally requires a bank to be put into resolution if within 90 days of it being determined to be critically undercapitalized (tangible equity is less than 2 percent of total assets)
  - State and federal chartering laws provide additional grounds and the FDIC may terminate a bank’s deposit insurance

RESOLUTION TIMELINE

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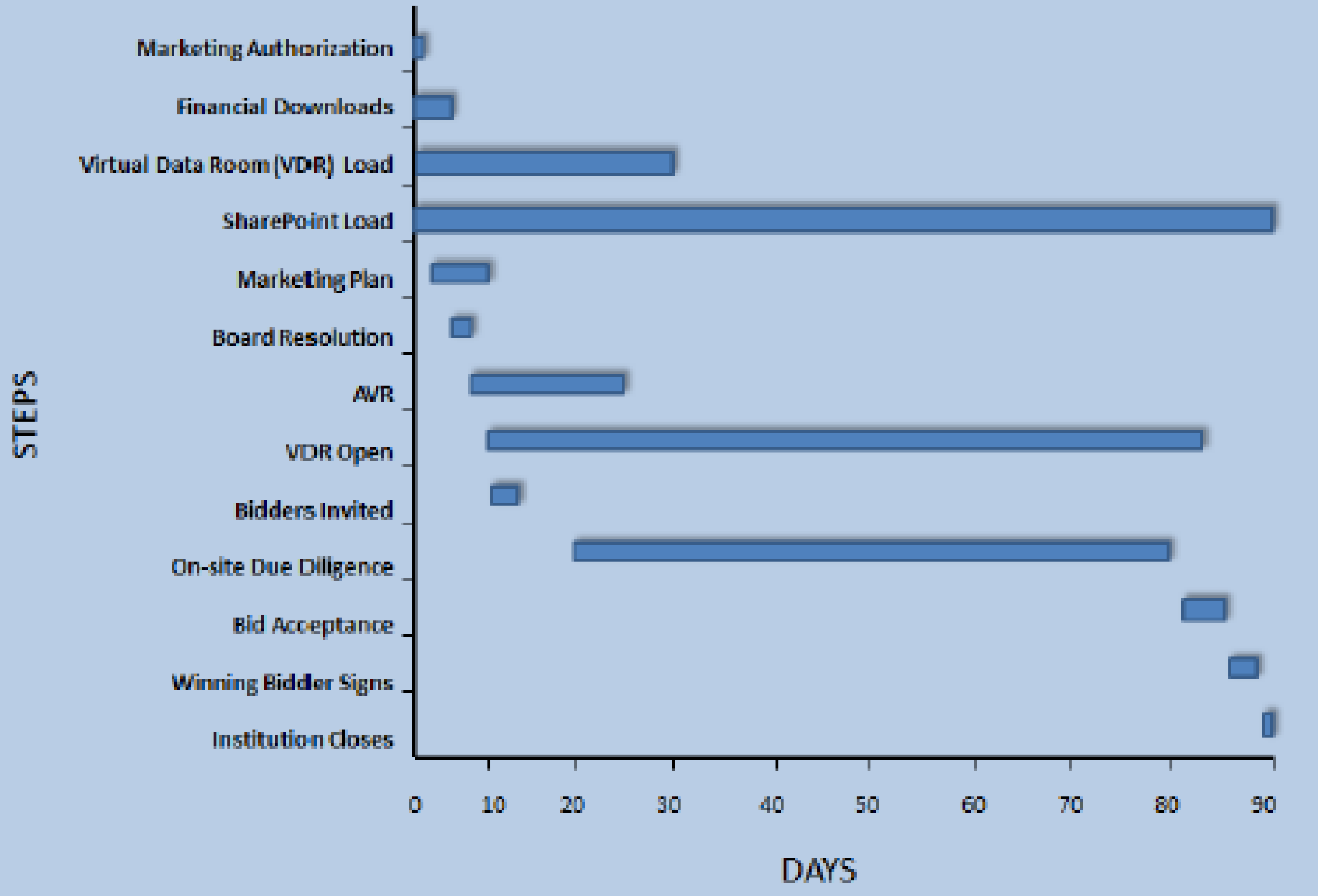
Figure 2: Timeline of a Typical Resolution Process



Note: The timeline represents the actual sequence of marketing steps but start times and durations can vary significantly.

RESOLUTION PROCESS

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1. Marketing Authorization—Starts when chartering authority sends a letter to a bank saying it is critically undercapitalized or insolvent
2. Ordinarily the FDIC meets with the bank's board of directors to
   – Explain the resolution process
   – Obtain approval for due diligence by regulatory approved financial firms
   – Request detailed loan and deposit data for FDIC analysis
   – This step may be skipped if severe liquidity problem or fraud exists
     • In these cases the FDIC retains the assets and works on a solution for the deposits
3. Information obtained for virtual data room (for bidders) and for FDIC use in developing the resolution strategy
4. FDIC then decides how to structure the sale

RESOLUTION PROCESS

5. Asset Valuation Review
   – FDIC mandated to follow least costly resolution
   – To comply FDIC needs to estimate its cost under various alternatives including liquidating the bank
6. FDIC ordinarily markets the bank to qualified bidders who are likely to have some interest
   – Bidder’s primary regulator must approve participation
   – Competition rules can be relaxed in the case of a failing bank
7. Virtual data room set up for potential bidders to evaluate the failing bank
8. On-site due diligence offered to bidders where feasible
   – Failing bank sometimes seeks new capital, resolution process continues until the bank is acquired or obtain a capital injection

RESOLUTION PROCESS

9. Bids submitted
   – Usually two parts: bid for insured deposits only (franchise value) and bid for the assets
10. Least cost analysis
    – FDIC determines which bid would result in the smallest losses to the FDIC
    – Compares bid with estimated losses from liquidation of the bank
    – Lowest cost option is approved
11. FDIC Board approves the transaction
12. Institution is closed
    – Closure usually on Friday at the end of the business day
    – FDIC takes over as receiver and settles the affairs
    – Acquirer takes control and typically opens the next business day

RESOLUTION PROCESS

- Types of purchase and assumption transactions
  – Basic P&A – Acquirer obtains cash, marketable assets, and possibly premises of failed bank. The FDIC retains everything else
  – Whole bank P&A – Acquirer buys all of the assets “as is” (no FDIC guarantees)
  – P&A with optional shared loss – FDIC shares some losses with the acquirer
  – Bridge Bank P&A -- FDIC creates a bridge (temporary) bank to continue operations if it needs more time to sell or liquidate the bank
- Deposit Payoffs
  – FDIC does not sell the bank but rather pays off depositors in one of three different structures
- FDIC Resolution handbook discusses other methods it has used in the past

RECEIVERSHIP PROCESS—POST CLOSING

- FDIC as receiver is also responsible for non-deposit claims
- Priority for payment

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

RECEIVERSHIP PROCESS—POST CLOSING

- FDIC receivership powers—similar but not identical to bankruptcy trustee
  - FDIC resolves any claims against the failed bank.
    - FDIC issues public notice and claimants must file within deadline set by the FDIC
  - FDIC can repudiate any burdensome contract within reasonable time
  - FDIC can request stay of legal proceedings for 90 days
  - FDIC can pursue fraudulent transfers by obligors of failed institution
  - FDIC may sue professionals who caused losses to the institution

- Office of Inspector General of the bank's primary supervisory (FDIC, OCC or Federal Reserve) reviews failure when the losses are "material"

RELATED LINKS

FDIC resources
- FDIC Resolutions Handbook https://www.fdic.gov/bank/historical/reshandbook/
- Professional Liability Lawsuits: https://www.fdic.gov/bank/individual/failed/pls/
- Crisis and Response: An FDIC History, 2008–2013 https://www.fdic.gov/bank/historical/crisis/
- Managing the Crisis: The FDIC and RTC Experience: (1980s and early 1990s): https://www.fdic.gov/bank/historical/managing/

Material loss reviews
- FDIC Office of Inspector General Reports of Bank Failures: https://www.fdicig.gov/reports-bank-failures
- Federal Reserve OIG home page: https://oig.federalreserve.gov/aboutus.htm
- Office of Comptroller of the Currency OIG – Home page: https://www.treasury.gov/about/organizational-structure/ig/Pages/default.aspx

International organizations and standards
- International Association of Deposit Insurers: https://www.iadi.org/en/

RELATED LINKS

Larry Wall's Deposit Insurance related publications

Articles

- "Multiple safety net regulators and agency problems in the EU: Is Prompt Corrective Action partly the solution?' *Journal of Financial Stab*ility. (September 2008), pp. 165-304 (With David Mayes and Maria Nieto).
- "Preconditions for a successful implementation of supervisors´ Prompt Corrective Action: Is there a case for a banking standard in the EU?" *Journal of Banking Regulation* (2006), pp. 191-220. (with Maria J. Nieto).
- "Resolving Large Financial Intermediaries: Banks Versus Housing Enterprises." *Journal of Financial Stability,* (2005), pp. 386-425 (with Robert A. Eisenbeis and W. Scott Frame).
- "The Major Supervisory Initiatives Post-FCICIA: Are They Based on the Goals of PCA? Should They Be?"(2002) *Prompt Corrective Action in Banking: 10 Years Later* edited by George Kaufman, 109-142 (with Robert A. Eisenbeis). This book is volume 14 of Research in Financial Services: Private and Public Policy published by JAI.
- "Reforming Deposit Insurance and FDICIA." *Economic Review*, Federal Reserve Bank of Atlanta, (First Quarter 2002) 1-16 (with Robert A. Eisenbeis).
- Subordinated Debt and Prompt Corrective Regulatory Action (June 2002). FRB Atlanta Working Paper No. 2002-18 ; FRB Chicago Working Paper 2003-03. (with Douglas D. Evanoff).
- "Taking Note of the Deposit Insurance Fund: A Plan for the FDIC to Issue Capital Notes." *Economic Review*, Federal Reserve Bank of Atlanta, (First Quarter 1997) 14-30.
- " 'Too-Big-To-Fail' After FDICIA." *Economic Review*, Federal Reserve Bank of Atlanta, (January/February 1993) 1-14. Reprinted in *Economic Review*, Federal Reserve Bank of Atlanta (2010, number 1).
- "Managerial Rents and Regulatory Intervention in Trouble Banks," *Journal of Banking and Finance* 20 (March, 1996) 331-350 (with Thomas H. Noe and Michael J. Rebello).
- "Government Deposit Insurance: Problems and Prospects." *Emerging Challenges for the International Financial Services Industry*, (1992), 157-176, edited by James Barth and Phillip Bartholomew.
- "A Puttable Subordinated Debt Plan for Reducing Future Deposit Insurance Losses." *Economic Review*, Federal Reserve Bank of Atlanta, (July/August 1989) 2-17.
- "Deposit Insurance Reform: An Analysis of the Insuring Agencies Proposals." *Economic Review*, Federal Reserve Bank of Atlanta, 69 (March 1984) 26-39

Notes from the Vault (CenFIS blog)

- Ending Too Big to Fail: Lessons from Continental Illinois, April 2016
- Using Market Information for Fail-Safe Supervisory Triggers (October 2015)
- Bail-in Debt: Will the Supervisors Pull the Trigger in Time? (August 2014).
- Too Big to Fail: No Simple Solutions, (April 2010).

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