APPENDIX B

DRAFT--MAY 11, 1988

EMERGENCY CONSOLIDATIONS

Analysis

Many bank holding companies coordinate their banks' activities so closely that the bank holding company system effectively operates as a single banking enterprise. Yet when a bank within the system fails, the FDIC must deal with such bank individually. In effect, the FDIC must act as if there is no connection between the failed bank and the rest of the system.

Some bank holding companies and their creditors have seen a way to turn this situation to their advantage. By concentrating poorer assets in a single bank, and then letting that bank fail, the bank holding company can shift the cost of those assets--the loss it would otherwise be forced to realize on them--to the FDIC. This technique amounts to a misuse of the FDIC's resources, which can do substantial harm to the Federal safety net for depositors.

Recent experience has also shown that creditors and shareholders can interfere with the Federal safety net in other ways as well. In many cases it is in the best interest of the local community and of the banking system for the FDIC to arrange open-bank assistance transactions. These transactions are designed to avoid the disruption that a bank failure would inflict on a community. Open-bank transactions may require the consent of creditors and shareholders of the holding company, however. In a number of cases the creditors and shareholders have delayed these transactions in an attempt to receive greater consideration than they would have been entitled to if the bank had failed. These creditors and shareholders have imposed added costs on the Federal safety net because of the FDIC's desire to prevent the closing of the bank.

The bill seeks to address these problems by establishing a special procedure to deal with failing banks that belong to multi-bank holding companies. The procedure is designed to improve the asset quality of a failing bank within a multi-bank system without affecting the health of the system as a whole.

The process begins when a bank's charterer--State or Federal--notifies the FDIC that a bank is in danger of failing, and asks the FDIC to start the process. The FDIC then decides whether the special procedure will reduce the risk to the FDIC fund, or alternatively, whether local economic conditions are such that resort to the special procedure is justified. If so, the FDIC may then certify to the Federal Reserve Board that it is necessary for the Board to exercise the new special powers made available under the bill.

Upon making the certification, the FDIC may specify one of the following new powers for the Board to exercise:

--The Board can order the holding company to transfer the stock of one or more of its healthy banks to the failing bank;
--The Board can order the company to merge one or more of its banks into the failing bank;
--The Board can order the company to merge the failing bank into one or more of its healthy banks; and/or

--The Board may order the company to provide such assets or services to the failing bank as may be needed for the bank to continue to conduct its normal business operations--e.g., bank buildings or data processing services.

The FDIC's recommendation may specify that the Board may exercise some or all of these powers. The Board may only exercise the powers that the FDIC has specified. On the other hand, the FDIC cannot compel the Board to take the action that the FDIC has recommended.

The Board must make a reasonable effort to see that the transaction does not involve the transfer of more assets to the failing bank than the bank needs to regain its health, taking into account the circumstances of the case. The FDIC may recommend a transaction, and the Board may order it, even if the assets so transferred to the failing bank are not sufficient to restore the bank to solvency.

Before the FDIC may make any recommendation to the Board, the FDIC must provide advance notice of the proposed transaction to every charterer--State and Federal--of every bank that would be involved. Each charterer has 48 hours to object to the recommendation. If any charterer objects within that time, the FDIC may only issue the recommendation if the FDIC's board of directors acts unanimously.

The Board has complete control over the specifics of any transaction that it orders pursuant to the FDIC's recommendation. The Board controls the procedures and scheduling.

No party may challenge an order issued by the Board or any action required by the Board in connection with any such transaction. Anyone who may be harmed by a Board-ordered action can take advantage of the bill's compensation provisions, but may not prevent the transaction from going forward.

No private contract can prevent or interfere with a Board-ordered transaction. Conversely, if a court declines to enforce a private contract because doing so would interfere with such a transaction, the court's action will not disturb the contract rights of the parties as among themselves.

Anyone who believes that a Board-ordered transaction has diminished the value of any valid and enforceable debt the bank holding company or any subsidiary bank might owe him, or of any equity interest he may own in the bank holding company or in any subsidiary bank, can apply to the Board within thirty days and ask the Board to appraise the debt or the equity interest. The Board must determine the value of any such debt or equity. Then, if the person tenders the debt or equity to the FDIC, the FDIC must buy it at the appraised value. This procedure provides full compensation for anyone whose property rights may be harmed by a Board-ordered transaction. It is the only procedure available to claimants for seeking such compensation.

The appraisal-and-tender rights created by this Act are only available to independent owners of the debt or equity of the bank holding company or of an

affiliated bank. The bank holding company itself and its affiliates are not given any such rights.

The appraisal-and-tender rights apply to any debt and any equity, but only to debt or equity that someone holds on or before the effective date of this Act. Anyone who acquires debt or equity after that date does not have appraisal-and-tender rights. There are two exceptions to the cut-off. A person who is owed money for goods or services that the bank holding company or bank has procured in the ordinary course of business may tender the debt to the FDIC no matter when the debt was incurred. In addition, a person who owns shares in a subsidiary bank may tender them to the FDIC no matter when he acquired them. This latter provision protects someone who has bought a minority share in an independent bank, and who continues to hold that share after the majority owners have sold their shares to a bank holding company.

A resulting bank may keep any branches or other offices it acquires as a result of a Board-ordered merger.