FDIC SUGGESTED LEGISLATIVE CHANGES

A number of changes to the law are necessary as a result of FIRREA. The following suggestions reflect the FDIC's views on some of the issues that are more substantive in nature. The list is not intended to be exhaustive.

Suggested Changes to the Federal Deposit Insurance Act (FDI Act)

1. FDIC BOARD OF DIRECTORS.

Issue

On February 28, 1993, the terms of all three of the FDIC's appointive directors expire at the same time, and the statute is unclear as to whether the directors then in office may continue until a successor is appointed. Further, in the future, the terms of the FDIC's appointive directors will again all expire at approximately the same time. Both provisions adversely affect FDIC operations and continuity.

Proposal

The February 28, 1993 expiration date for appointive members' terms of office should be eliminated to ensure that each can serve a full six-year term. Further, to ensure continuity, the appointive members' terms should be staggered, with termination dates coming no sooner than two years apart. If FIRREA is not amended to stagger the appointive members' terms and to eliminate the February 28, 1993 expiration date, it should be made clear that those appointive members then in office when their terms expire in 1993 may continue until a successor is appointed and confirmed. Without that clarification, the FDIC Board may have to operate for a period of time with only two *ex officio* members.

If an appointive member leaves office in the last two years of his or her term, the President should be able to appoint a successor for the remainder of that term and for the succeeding term as well.

2. INSUBSTANTIAL CONVERSIONS.

Issue

Conversion transactions (switches between BIF and SAIF) are generally restricted for 5 years. One institution, however, may acquire the deposits of another institution and convert them if the deposits so acquired do not represent more than 35 percent of the selling institution's deposits and also do not represent more than 35 percent of the acquiring institution's deposits. This test makes sense with respect to the selling institution, since it effectively keeps the selling institution in the market as a viable competitor. But it makes less sense when applied to the acquiring institution since the test has the effect of discriminating against smaller institutions.

Proposal

The 35 percent test should not be applied to the acquiring institution.

3. OAKAR AMENDMENT BANKS--PAYMENTS TO THE SAIF.

Issue

When a bank acquires a thrift under the Oakar Amendment, it begins to make a payment to the SAIF based on the bank's "Adjusted Attributable Deposit Amount." The AADA represents the deposits that the bank has taken over from the thrift. In effect, the bank pays a SAIF assessment based on those deposits.

Unlike ordinary SAIF assessments, however, the payment can never decline. FIRREA specifies that the AADA always increases: it grows at 7 percent per year or at the bank's overall growth rate, whichever is higher. (The AADA is subtracted from the bank's total assessment base for the purpose of computing BIF assessments.)

This requirement can produce anomalous results if the bank is actually shrinking rather than expanding--particularly if the bank is troubled. The bank may be required to make ever-increasing payments to the SAIF when its assessments would ordinarily be reduced.

Moreover, if the bank transfers deposits back to another SAIF member, the SAIF effectively gets a double assessment: it gets an assessment from the acquiring thrift, and it also continues to get the ever-increasing payment on the AADA made by the Oakar Amendment bank.

Proposal

A bank's AADA should be increased or decreased by the bank's overall rate of growth. The AADA also should be reduced by an amount equal to any deposits that the bank transfers to a SAIF member.

4. CROSS-GUARANTEES.

Issue

Before FIRREA, holding companies could effectively transfer their system-wide losses to the FDIC by concentrating the losses in one or two banks, and then allowing those banks to fail. FIRREA attempted to put an end to that practice. FIRREA specifies that, when the FDIC suffers a loss caused by the default of a depository institution, and the institution belongs to a holding company, the holding company's other depository institutions must indemnify the FDIC against the loss. The "cross-guarantee" rule was supposed to enable the FDIC to reach the good assets that belonged to the holding company system, without regard for where the holding company moved them.

The protection is inadequate, however. There are procedural problems related to the timing of the enforcement procedures. As a result, holding companies may be able to protect themselves against cross-guarantees by selling off healthy institutions prior to the failure of an affiliate and retaining the proceeds at the holding-company level.

Proposal

When a depository institution in a holding company system is failing, the FDIC should be able to invoke the cross-guarantee rules against all the depository institutions belonging to a holding company by serving notice on the holding company that the default by one of its affiliated institutions is "reasonably imminent." After that date, any proceeds that the holding company might receive as a result of disposing of an insured affiliate should be subject to FDIC recovery regardless of where held, and any institution sold should itself remain liable under the cross-guarantee. Also, if the failing institution is disposed of by the holding company prior to its failure, the company's other depository institution subsidiaries should remain liable under the cross
guarantee.

5. TEMPORARY SUSPENSION OF INSURANCE.

Issue

The FDIC may suspend an institution's deposit insurance temporarily when the institution has no tangible capital--but only if it has filed a Notice of Intention to Terminate Deposit Insurance (which initiates an action to terminate the institution's insurance permanently). Before the FDIC may issue such a Notice, however, the FDIC must give thirty days notice to the institution's primary Federal supervisor. The primary regulator may agree to shorten or eliminate the time period required for notice.

In some emergency situations, however, the FDIC must be able to issue a temporary suspension order even though the FDIC has not yet filed a permanent Notice. In such cases, the 30-day waiting period negates the effectiveness of an immediate temporary order.

Proposal

The FDIC should be able to file its Notice at the same time it enters its suspension order in exigent circumstances.

6. FINAL ORDERS.

Issue

The Administration's version of FIRREA defined the term "order which has become final." The definition was deleted by Congress on the assumption that it was superfluous language. The definition is necessary since it assists the FDIC with proceeding to enforce such orders, including, for example, cease and desist orders.

Proposal

The term "order which has become final" should be defined in the FDI Act.

7. DIRECTORS AND OFFICERS--INDEMNIFICATION.

Issue

When the FDIC has successfully brought an administrative action against an institution-affiliated person, the institution has on occasion indemnified the person for his expenses--including any civil money penalties and attorneys' fees--and has even pre-paid his salary or other expenses in anticipation of the institution's own failure. Indemnification of this kind nullifies the deterrent effect of the administrative action. It also amounts to a raid on the resources of the insurance funds, as the amounts so diverted to the offending person are not available to the institution's creditors if it fails.

Proposal

The payment by an institution of attorney's fees and civil money penalties for an institution-affiliated person against whom the FDIC has successfully brought an administrative action, and pre-payment of salaries or other expenses in anticipation of failure of the institution, should be prohibited.

8. FDIC PRIORITY OVER CLAIMS OF SHAREHOLDERS.

Issue

In the past, several courts have recognized that the FDIC has priority over shareholders of closed institutions in claims against directors, officers, accountants and other professionals. The priority is based on the belief that shareholders should be last in all meaningful ways. During the FIRREA debate, an amendment was introduced to codify this priority, but was not ultimately included in the legislation. A recent court of appeals decision has ruled against the FDIC's priority.

Proposal

We recommend that legislation be enacted establishing a priority for FDIC over shareholders for claims against directors, officers, accountants and other professionals in failed institutions.

9. FSLIC RESOLUTION FUND.

FIRREA provides that the assets and liabilities of the FSLIC are transferred to the FSLIC Resolution Fund ("FRF"). However, FIRREA does not state explicitly that the FDIC succeeds the FSLIC as receiver for pre-FIRREA receiverships, nor does it make clear the FDIC's role as manager of FRF.

In this connection, it is not clear that the FRF (and/or the FDIC as manager of the FRF) has and may assert some or all of the FDIC's rights under the FDI Act, or obtain appropriate benefits under the FDI Act. For example, the question of when the D'Oench doctrine may be asserted has arisen. In addition, lack of a clear basis for authority to act has resulted in problems with title companies.

Proposal

Congress should clarify that the FDIC succeeds the FSLIC as receiver for FRF receiverships, and that the FDIC has all the rights and powers under the FDI Act with respect to these pre-FIRREA receiverships. Congress also should clarify the FDIC's rights and powers as manager of the FRF.

10. EMERGENCY OVERRIDE OF STATE BANKING LAWS.

Issue

FIRREA provides that in certain emergencies the FDIC or the RTC may override state law where necessary to accomplish a sale of a failed savings association. A federal court has recently indicated that, when a bank participates in an emergency acquisition involving a troubled thrift, and the thrift is located in a unit-banking state, the bank may not retain the thrift's branches. We do not believe this is the intent of FIRREA, and it hampers the speedy and cost-effective resolution of failed thrifts.

Proposal

The law should be clarified to affirm that when the FDIC provides assistance for a merger involving a troubled thrift, and the statutory criteria exist for an override of State law, the FDIC or the RTC are authorized to permit the surviving institution to retain the troubled thrift's branches, even if the survivor is a bank.

11. OFFICIAL FDIC SIGNS/ADVERTISING.

Issue

FIRREA says that savings associations (as opposed to all SAIF members) must use the SAIF sign, and that banks (as opposed to BIF members) may use the FDIC's pre-FIRREA sign. There already are banks that belong to the SAIF, however, and savings associations that belong to the BIF. Accordingly, the FIRREA rules can lead to confusion.

In addition, FIRREA eliminated--without explanation--the FDIC's power to regulate the way in which insured institutions advertise their insurance. This power should be restored to the FDIC in order to make it clear that the FDIC can police the use of these signs and the institutions' advertisements. The power should be broad enough so that the FDIC can address various related advertising expressions (e.g., "insured by the FDIC").

Finally, the FDIC should have power to control other uses of the official signs and of the FDIC logo--e.g., manufacture of the signs and their use by nondepository institutions.

Proposal

An institution's right to use the BIF or SAIF sign should depend on whether the institution is a BIF or SAIF member, rather than on whether the institution is a bank or savings association.

The FDIC should have authority to regulate the advertising of FDIC insurance by depository institutions. The FDIC also should have authority to control the manufacture, reproduction, or use of the official signs and the FDIC logo by any person.

12. THRIFT SUBSIDIARIES.

Issue

Insured savings associations must give the FDIC prior notice of the acquisition or establishment of a subsidiary or of the conduct of any new activity through a subsidiary. A few Federal savings banks--those that were chartered as savings banks prior to the Garn-St Germain Act--are exempt from this requirement. There is no good policy reason to treat these savings associations differently from the rest.

Proposal

The exception should be deleted.

13. ACTIVITIES BY CONVICTED PERSONS.

Issue

FIRREA improved the FDI Act's provisions that are designed to prevent certain criminals from participation in the affairs of depository institutions. For example, FIRREA extended the sanctions for suspension of an indicted officer or director to reach cases where "an agreement to enter a pre-trial diversion or other similar program" is entered against such a party, as well as when a "conviction" is entered against such a party.

Section 19 of the FDI Act prohibits depository institutions from employing people who have been "convicted" of crimes involving dishonesty or breach of trust. Section 19 is narrower than the suspension authority of the FDI Act, however, in that it does not include pretrial diversions or similar programs.

Proposal

Section 19 should be extended to reach people who have entered into agreements to enter a pre-trial diversion or other similar program.

14. DISCLOSURES BY UNINSURED DEPOSITORY INSTITUTIONS.

Issue

As a result of FIRREA, uninsured savings associations must disclose the fact that their deposits are not Federally insured. They must make this disclosure both in their advertising and in their periodic statements of account. The FDIC may issue regulations prescribing the manner and content of the disclosure and may enforce its regulations against uninsured thrifts just as though they were FDIC-supervised banks.

The term "savings association" artificially and improperly limits the application of this rule, however. For example, in some States there are uninsured industrial banking companies--yet the FDI Act classifies these companies as "banks," not "savings associations." In addition, there are other nondepository companies that market debt securities in a manner that resembles the deposit-taking activity of savings associations.

Proposal

In order to protect the public against false or misleading practices with respect to deposits in uninsured depository institutions, the FDIC should be given the power to determine when such disclosures are required.

15. "457 PLAN" DEPOSITS.

Issue

The FDIC insures most trusteed employee benefit plan deposits on a "pass-through" basis, i.e., the deposits are insured on the basis of the ownership interests of the plan participants (employees) in the deposits. But so-called "457 plans" (deferred compensation plans established by states, local governments, or nonprofit organizations for their employees under section 457 of the Internal Revenue Code) are unique in that the Internal Revenue Code expressly provides that the funds remain solely the employer's property and are subject to the claims of the employer's creditors. Accordingly, the FDIC legal staff has long maintained that 457 plan participants have no ownership interests in the funds that would support pass-through insurance. Thus, the FDIC position has been that, as a matter of law, 457 plan deposits cannot have pass-through insurance even though there may be no valid economic or policy reasons for insuring 457 plan deposits differently from other trusteed employee benefit plans.

Proposal

While the FDIC is holding a public hearing on March 14, 1990 to clarify its understanding of the nature of 457 plans, if Congress thinks these plans should be insured on a pass-through basis, like other trusteed employee benefit plans, it should consider amending the law to provide a clear legal basis for extending deposit insurance to these plans.

16. GOLDEN PARACHUTES.

Issue

FIRREA provides the FDIC, in its role as conservator or receiver, with the power to disaffirm or repudiate contracts, including abusive "golden parachutes" of management in a failed depository institution. This authority, however, may not reach all abusive golden parachutes and, in particular, does not reach abusive arrangements in institutions that have not closed.

Proposal

FDIC should be empowered, as a supervisory matter, to prohibit or limit excessive or abusive golden parachutes in depository institutions, no matter what form they take or when they are provided.

17. POWERS OF UNDERCAPITALIZED STATE SAVINGS ASSOCIATIONS.

Issue

FIRREA prohibits state savings associations from participating in activities not permissible to Federal savings associations unless the FDIC determines the activity poses no significant risk to SAIF and the institution is in compliance with the capital standards prescribed under section 5(t) of the Home Owners' Loan Act. If an institution is not fully capitalized, the FDIC may not authorize an activity even if such a waiver is clearly beneficial to both the institution and the insurer.

Proposal

The FDI Act should be amended to allow flexibility where a determination is made that an activity will clearly benefit the institution in its recovery and poses no risk to the insurance fund.

18. REAL ESTATE APPRAISALS.

Issue

FIRREA mandates major reform in the real estate appraisal industry. All federally related transactions must have licensed or certified appraisals by August of 1990 and each state must have installed a certifying and licencing process by July of 1991. These deadlines may not be realistic and, as a consequence, may cause delays in a large number of real estate transactions due to a shortage of qualified appraisers.

Proposal

We recommend that FIRREA be amended to provide a phase-in program initially requiring certified appraisals only on large transactions. At the same time, it also should be amended to have a phase-in of the professional requirements in order to increase the supply of qualified appraisers to a level sufficient to handle the anticipated demand.

19. QUALIFIED FINANCIAL CONTRACTS.

Issue

FIRREA provided the FDIC with expanded powers as receiver and conservator. Specific provisions were made for certain securities contracts referred to as "qualified financial contracts." In enacting the legislation, three sentences concerning notice requirements were inadvertently omitted, and these omissions create inconsistencies in the statute. The FDIC has attempted to clarify these omissions by a policy statement.

Proposal

The missing sentences should be added to the statute to clarify and affirm the FDIC position regarding these contracts and to carry out congressional intent.

Suggested Changes to the Home Owners' Loan Act (HOLA)

1. ACTIVITIES OF FEDERAL SAVINGS BANKS.

Issue

FIRREA provides that after January 1, 1990, no State savings association may conduct any activity impermissible for a Federal Savings association unless the FDIC gives it prior approval. However, certain Federal savings banks--those that were chartered prior to the Garn-St Germain Act, and those that were once organized as State mutual savings banks--were permitted to continue to engage in activities and make investments to the same extent as they were originally authorized. For example, the affected Federal savings banks are permitted to acquire or retain junk bonds absent our taking action under section 18(m) of the FDI Act.

There does not appear to be any good policy reason to allow these institutions to exercise in the first instance powers that no other insured savings association may exercise. To be sure, the FDIC retains the power to determine that certain activities or practices present a serious threat to the deposit insurance fund, but the FDIC can only act after the fact.

Proposal

The grandfather rights should be deleted. In the alternative, Federal savings banks should not continue to exercise their grandfathered powers without the FDIC's prior approval.

2. THRIFT CAPITAL.

Issue

The Director of OTS has authority to allow an individual Federal savings association to exceed the 400 percent of capital ceiling for nonresidential real estate loans if the Director finds that the waiver will not pose a significant risk to the operation of the association.

This standard is too narrow, and does not take into account the broader issue of potential harm to the affected deposit insurance fund.

Proposal

Before the Director of OTS may grant such a waiver, the Director should be required to obtain the FDIC's concurrence. The FDIC should be able to provide its concurrence upon a finding that the waiver will not result in a significant risk to the affected Fund.

3. LOANS-TO-ONE-BORROWER

Issue

FIRREA makes savings associations subject to the same loans-to-one-borrower restrictions as national banks. Thrift institutions have not had the opportunity to develop effective loan participation networks to accommodate large loans that might otherwise exceed their individual lending limits, as banks have done for years. This places a short-term hardship on the thrift industry by restricting its ability to serve large borrowers.

Proposal

Provide a transistion period to phase in the loans-to-one-borrower restrictions.