Statement of Mitchell L. Glassman, Director,
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on the Condition of Financial Institutions:
Examining the Failure and Seizure of an American Bank
before the
Subcommittee on Financial Institutions and Consumer Credit; House Committee on Financial Services;
2128 Rayburn House Office Building
January 21, 2010

Chairman Gutierrez, Ranking Member Hensarling and members of the Subcommittee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding the resolution process used when an insured depository institution fails. These hearings are an important way for Congress and the public to understand the statutorily-driven process for resolving depository institution failures and the work we do to ensure that there is minimal disruption to bank customers and the communities these institutions serve.

In 2009, the FDIC resolved 140 insured institutions with over $171 billion in total assets. While the economy is showing signs of improvement, recovery in the banking industry tends to lag behind other sectors. We expect to see the level of failures continue to be high during 2010.

My testimony will describe the FDIC's basic process for handling the failure of insured depository institutions. In addition, I will explain the FDIC's cross-guarantee authority and how it is applied, with specific reference to the resolution of nine insured depository institutions commonly controlled by FBOP Corporation, a registered bank holding company headquartered in Oak Park, Illinois (FBOP). Finally, I will discuss how the FDIC continues to position itself to ensure it has the necessary resources and expertise to handle the level of bank failures expected over the near term.

Overview of the Resolution Process

Insured depository institutions that fail are administered in a manner that fosters stability of the banking system and fulfills the FDIC's obligations to the failed institution's customers who have insured deposits. This responsibility is basically administered through two steps:

- The *resolution process* involves collecting information on the assets, liabilities and franchise value of a failing insured depository institution, marketing strategies, soliciting and accepting bids for the sale of the institution, determining which bid is least costly to the Deposit Insurance Fund (DIF) and working with acquiring institution(s) through the closing process (or paying insured deposits in the event there is no acquirer).

- The *receivership process* involves performing the closing function at the failed institution, liquidating any failed institution assets not purchased by the acquirer and distributing any proceeds of the liquidation to the FDIC, to the failed institution's customers who had uninsured deposit amounts and, if there are sufficient funds, to other creditors with approved claims.
- The goals of the resolution and receivership processes are to:
- Provide depositors timely access to their insured funds.
- Resolve failing institutions in the least-costly manner, as required by law.[1]
- Manage receiverships to maximize net return in order to fulfill our statutory obligation to all creditors of the receivership.

The FDIC normally uses, depending on the circumstances, two basic resolution techniques:

- A *purchase and assumption (P&A) transaction* occurs when a healthy institution (generally referred to as the acquiring or assuming institution) purchases some or all of the assets of a failed bank or thrift and assumes some or all of the liabilities, including insured deposits. Typically the acquiring institution will receive assistance from the FDIC to complete the transaction. As described in more detail later, the FDIC approaches a wide pool of potential acquirers with terms of the P&A transaction to solicit bids. The acquirer may pay a premium to the FDIC for the assumed deposits, which decreases the total resolution costs. If timing considerations do not allow the FDIC to have an acquirer on hand at the point of failure, a bridge institution may be established as an interim step to preserve the failed institution's franchise.

- A *deposit payoff* occurs when there are no potential acquirers for the failing institution willing to bid more than it costs the FDIC to simply pay insured depositors. In this transaction the FDIC pays all of the failed institution's depositors the full amount of their insured deposits either by writing checks or by having a paying agent assume the deposits.

  In a deposit payoff, and in some P&A transactions, 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. Receivership certificates are paid under the priority system established by statute. A receivership certificate entitles its holder to a pro rata share of the receiver's collections on the failed institution's assets. If the FDIC believes it will be able to receive enough funds from winding down the failed bank, we will make advance payments on receivership certificates.

The FDIC is the primary federal regulator for the majority of FDIC insured institutions. The FDIC also has backup enforcement and examination authority over all institutions it insures. We work closely with the primary federal regulators and, where deterioration of an institution is noted, the FDIC often participates with the primary regulator in an on-site examination. Thus the FDIC becomes familiar with the issues confronting troubled institutions. This enables us to do some pre-planning in the event the institution fails.

The FDIC normally begins its formal resolution process upon contact from the troubled institution's chartering authority advising of the bank's expected failure. Once the FDIC receives notification, staff contacts the chief executive officer of the failing institution to discuss logistics, to address senior management's involvement in the resolution activities and to request loan and deposit data from the institution or its data processing servicer.

After the FDIC receives the requested data, a team of FDIC resolution specialists visits the institution to gather additional information. The FDIC values assets of the institution, determines the resolution options to be offered, and prepares an information package for potential bidders to access through a secured website. Based on recommendations by the FDIC staff, the FDIC's Board of Directors approves the resolution options to be used for the failing institution.

Once the necessary information has been gathered and possible resolution options are determined, the FDIC begins marketing the failing institution as widely as possible to encourage competition among prospective bidders, which are primarily existing financial institutions. A list of prospective bidders is assembled based on initial criteria that include a prospective bidding institution's overall condition, size and capital level; business plan; geographic market; and minority-owned status. The FDIC also considers the institution's safety and soundness rating, as well as the ratings pertaining to information technology, anti-money laundering, consumer compliance, and community reinvestment. The resulting list of potential bidders will then be notified of a potential acquisition opportunity. Private investors that do not already control a bank charter must obtain clearance from a chartering authority, satisfy any holding company requirements, and be in the process of obtaining deposit insurance before being allowed to participate in the bid process.

After executing confidentiality agreements, all qualified bidders have access to the information package on the FDIC's secure website, which includes financial data on the institution, legal documents and descriptions of the resolution options being offered, the due diligence process, and the bidding process. The FDIC resolution options typically will include an option to assume all deposits or only insured deposits. The FDIC also advises the bidders about the types and amounts of assets that will pass to an acquirer, which assets the FDIC plans to retain, the terms of the asset sale (such as loss sharing arrangements[2] and optional asset pools[3]) and other significant conditions that are part of the proposed resolution method.

After reviewing the information provided on the secure website, interested bidders may also perform on-site due diligence to inspect the books and records of the failing institution to assess the value of the franchise. This process ensures that each bidder is well informed about the circumstances of the failing institution.

After due diligence, bidders submit their proposals to the FDIC by a specific bid deadline. This generally occurs one week prior to the scheduled closing. Bids consist of two parts: (1) the premium the bidder is willing to pay for the failing institution's franchise and (2) the amount the bidder is willing to pay to acquire the failing institution's assets.

The FDIC will analyze all bids to determine whether they conform to the bidding instructions and assess the cost of each bid to the DIF. The FDIC determines the least-costly resolution transaction by evaluating all possible resolution alternatives and computing costs on a net present value basis. The FDIC is required by law to use a realistic discount rate and document any assumptions used in the evaluation, including any assumptions with regard to interest rates, asset recovery rates, asset holding costs, and payment of contingent liabilities.

Once the least-costly transaction is determined, FDIC staff notifies the acquirer(s), all unsuccessful bidders, and the acquirer's chartering authority makes its final regulatory decisions about the transaction. The FDIC then arranges for the acquirer(s) to sign the appropriate legal documents before the institution's closure.

The chartering authority closes the institution and appoints the FDIC as receiver, usually on a Friday. The FDIC as receiver then begins the process for settling the affairs of the closed institution. Generally, this includes 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 to the acquirer.

In a P&A transaction, the acquirer usually reopens the institution the next business day, and the customers of the failed institution automatically become customers of the acquiring institution with access to their insured deposits (or all deposits, depending on the nature of the transaction). If the FDIC cannot arrange for an acquirer to assume the insured deposits, the FDIC will take steps to get insured depositors their funds as soon as possible. In some cases, the FDIC will arrange for insured depositors to be paid, usually by check or through a paying agent (such as another insured institution). In other cases, the FDIC may create a temporary new depository institution to give insured depositors continued checking and other deposit services while they arrange to transfer their accounts to other local banks.[4]

The FDIC is responsible for operating the receivership, including managing and selling any assets retained by the receiver, and to the extent possible, satisfying the creditor claims against the receivership. In cases where the FDIC has an ongoing involvement with the acquirer, such as in a loss sharing transaction, the FDIC will administer the loss reimbursements and monitor the acquirer's performance for the duration of the agreement, typically over several years.

Cross-Guarantee Authority

As part of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Congress adopted amendments to allow the FDIC to recoup losses to the insurance fund by assessing a claim against insured institutions under common control for losses caused by the failure of an affiliated insured depository institution.[5] The cross-guarantee authority was designed, in part, to prevent the insurance fund from suffering losses, such as those incurred in the 1980's in multi-bank holding companies in Texas. The closings of the subsidiary banks of First RepublicBank Corporation and MCorp, bank holding companies headquartered in Dallas, Texas, are two such examples.

In these two cases most, but not all, of the subsidiary insured depository institutions were closed by the chartering authorities with losses absorbed by the FDIC. The other subsidiary banks remained open, with their value retained by the parent holding company. At that time, the FDIC was unable to require the commonly controlled institutions to cover the losses from the failed institutions. The subsidiary banks of First RepublicBank Corporation, which were closed in 1988, resulted in a loss of $3.9 billion. The MCorp failures, in 1989, cost the insurance fund $2.8 billion. At that time, these were the FDIC's two most expensive bank failures. Both cases illustrated a gap that the owners were able to exploit where the owners retained value in their surviving banks, while at the same time the FDIC absorbed all of the losses in the failed banks.

The 1989 cross-guarantee provisions in FIRREA allow the FDIC to require other insured depository institutions that are commonly controlled by the same company to cover these losses. As with its other decisions about the resolution transaction for a failed insured institution, the FDIC's manner of utilizing its cross-guarantee authority is designed to result in the least-cost to the DIF of resolving the problems of the commonly controlled group. The cross-guarantee statute allows the FDIC, based on its analysis of a particular situation, to pursue an immediate assessment of cross-guarantee liability on the commonly controlled institutions, to postpone the assessment for as much as two years after the default has occurred, or to provide waivers for any insured depository institution from the cross-guarantee liability. Exercise of the cross-guarantee authority can lead to the closing of a commonly controlled insured institution(s) if the amount assessed for the failure costs of the other insured depository institution(s) cannot be paid. However, the FDIC may postpone or waive the assessment if, in the FDIC's judgment, doing so would be in the FDIC's best interest to better achieve the least-costly resolution of the commonly controlled insured institutions. In making this decision, the FDIC must analyze the circumstances surrounding the impact on the institution that results in a potential cross-guarantee assessment to determine what action is in the best interests of the DIF.

In applying this standard, some of the key considerations in pursuing a cross-guarantee include whether the FDIC would achieve a higher return if the institution were sold as an open bank; whether any commonly controlled institutions are likely to fail at a later date and thereby increase the losses to the DIF; or, whether by postponing the assessment, the loss would be expected to grow and value available to the FDIC would dissipate.[6]

FBOP Corporation Closures

On October 30, 2009, the FDIC entered into a P&A agreement with U.S. Bank National Association of Minneapolis, Minnesota, a wholly-owned subsidiary of U.S. Bancorp, to assume all of the deposits and purchase essentially all of the assets of nine failed banks owned by FBOP.[7] These insured depository institutions are shown in Table 1 in descending order by total assets.

Table 1. FBOP Corporation Subsidiary Depository Institutions (10/30/09)

	Name	City	State	Total Assets ($ Millions)
1	California National Bank	Los Angeles	CA	$6,989.40
2	Park National Bank	Chicago	IL	4,701.00
3	San Diego National Bank	San Diego	CA	3,560.00
4	Pacific National Bank	San Francisco	CA	2,086.20
5	North Houston Bank	Houston	TX	325.3
6	Madisonville State Bank	Madisonville	TX	237.8
7	Bank USA, NA	Phoenix	AZ	194
8	Citizens National Bank	Teague	TX	120.7
9	Community Bank of Lemont	Lemont	IL	85
				$18,299.30

The FDIC received notification of intent to close seven of the nine subsidiary banks from the chartering authorities (the Comptroller of the Currency (OCC), the Texas Department of Banking, and the Illinois Department of Financial and Professional Regulation). Notification was not received for Park National Bank and Citizens National Bank. However, the FDIC was aware that these two institutions were in deteriorating financial condition and had poor future prospects.

The OCC had identified Park National Bank as a deteriorating problem institution with financial and managerial weaknesses, such that it posed a distinct possibility of failure. Citizens National Bank was also deteriorating and had close financial links to the other FBOP banks. Park National Bank, because of its problems, was subject to an OCC Consent Order, addressing weaknesses in capital, the allowance for losses, liquidity, and asset quality. Further, weaknesses in the organizational structure and business activities of FBOP created significant interdependence among all nine institutions and the holding company. For example, loan participations among the nine commonly controlled institutions were extensive. Park National Bank and Citizens National Bank had substantial volumes of loans purchased from and serviced by other commonly controlled institutions within the FBOP organization. Because of significant interdependence, the ongoing operations of both banks would have been adversely impacted by the failure of their seven commonly controlled institutions.

FBOP had engaged in extensive efforts to sell one or more of the subsidiary banks or branches and had attempted to raise new capital for itself and its subsidiary banks through a sale of a minority stake in FBOP Corporation and other means. These efforts were unsuccessful.

In early September 2009, the FDIC began marketing the seven institutions for which it had received notice of imminent failure. The banks were offered on a stand-alone basis or linked with any combination of the seven. One of the transaction options offered each of the seven institutions as a whole bank (acquirer assumes either all or insured deposits only) with a loss-share arrangement on the assets.

In late September, after analysis, the FDIC also offered Park National Bank and Citizens National Bank on a stand-alone basis without loss share or as a linked bid for all nine institutions with loss share. Offering these two banks without loss share was done to determine if any bidder believed the institutions had positive value and would be willing to acquire them without any assistance from the FDIC. No bidder was interested in purchasing either institution without FDIC assistance. In light of this lack of interest, and given FBOP Corporation's financial condition, which the Federal Reserve had rated unsatisfactory, as well as the condition of its subsidiary banks, the FDIC concluded that any further efforts by FBOP to sell the banks and/or raise capital had little chance of success.

On October 20, 2009, the FDIC received 41 bids from 18 bidders for some or all of the nine FBOP institutions. The least costly bid for the seven commonly controlled institutions alone would have cost the FDIC $1.85 billion. As demonstrated by the bids, if the FDIC did not apply cross-guarantee to Park National Bank and Citizens National Bank – and those banks would have closed separately in the foreseeable future – the total cost to the FDIC would be $2.91 billion. By contrast, application of the cross-guarantee allowed for the resolution of the entire group for $2.54 billion. This avoided an additional loss to the DIF of $316 million. These bids confirmed that absent substantial assistance from the FDIC, no other institution was willing to acquire Park National or Citizens National and that the immediate assessment of the cross-guarantee was least-costly to the DIF.

Neither Park National Bank nor Citizens National Bank would have qualified for a waiver or any delay in the assessment of the cross-guarantee liability because this would have resulted in higher costs to the DIF since both banks had serious problems and were in deteriorating condition and were very likely to fail. If Park National Bank or Citizens National Bank could have repaid the losses incurred by the DIF from the failure of the other group members, their charters would not have been revoked and the institutions would have remained open. However, neither institution had the ability to pay the assessment that the FDIC issued on October 30, 2009. As a result, the OCC made the determination to close the institutions and appoint the FDIC as receiver. As it turned out, the overall least-costly bid for all nine FBOP banks was for all nine institutions jointly. Table 2 shows the expected losses to the DIF resulting from the failure of all nine FBOP commonly controlled institutions.

As mentioned earlier, the FDIC is required by law to choose the least-costly transaction available when resolving failing banks. The FDIC goes to great lengths to ensure the process of marketing failing banks is open, fair and competitive. All potential buyers with access to a transaction have the same competitive opportunity, with the final selection being the bid that is least-costly to the DIF.

Table 2. Estimated Deposit Insurance Fund Losses (12/31/09)

		($ Millions)			
	Name	Assets	Deposits	Estimated Loss	Loss as a % of Deposits
1	California National Bank	$6,989.40	$6,133.20	$951.10	15.50%
2	Park National Bank	4,701.00	3,687.20	667.6	18.10%
3	San Diego National Bank	3,560.00	2,897.80	374.2	12.90%
4	Pacific National Bank	2,086.20	1,722.60	220.2	12.80%
5	North Houston Bank	325.3	304	48	15.80%
6	Madisonville State Bank	237.8	226	32.3	14.30%
7	Bank USA, NA	194	167.8	20.8	12.40%
8	Citizens National Bank	120.7	98.2	24.9	25.40%
9	Community Bank of Lemont	85	68	23.3	34.30%
		$18,299.30	$15,304.80	$2,362.50	15.40%

Resolution Capacity and Tools

As I mentioned earlier, we expect a continued high level of failures during 2010. Over the past several years the Division of Resolutions and Receiverships has enhanced its staffing levels in response to the increased workloads. The Division started 2009 with approximately 400 employees -- steadily increasing that number throughout the year to the current staffing level of 1,161. The FDIC Board of Directors in December approved a further increase in the Division's staffing to 2,310 for 2010. Most of these new employees have been hired on non-permanent appointments with terms of up to five years, so that we will be able to downsize our workforce appropriately when the current workload subsides. Through our re-employed annuitant program, we also were able to bring back a significant number of experienced retirees, who brought competencies and operational expertise needed to meet the mission requirements of the agency.

In addition, we use a large number of private contractors and outside law firms to help us respond quickly to immediate workload requirements related to the closing of failed institutions. Last year, we significantly expanded our workforce of Receivership Assistance Contractors. The eight receivership assistance firms under contract to us recruited and trained over 5,700 staff from banking and finance to address our workload needs.

We have also expanded geographically by opening temporary satellite offices on both the West and East Coasts to manage the bank closing and receivership activities throughout the country. The West Coast office, located in Irvine, California, became operational in April 2009 and is now staffed with approximately 500 FDIC employees and contractors. The East Coast office, located in Jacksonville, Florida, became operational in November 2009 and also has approximately 500 FDIC employees and contractors.

The FDIC Board of Directors recently authorized another temporary satellite office in Chicago. That office will become operational during the second quarter of this year and will have approximately 400 FDIC employees.

Throughout this period, staffing for closing-related activities has been supplemented by the temporary assignment of employees from other divisions within the FDIC, such as bank examiners and other employees identified on a "ready reserve list." These employees supplement our workforce on the weekends to help us ensure that the closing process goes smoothly, then return to their regular jobs during the week.

To summarize, the FDIC has the experience, the geographic footprint, and the skilled professionals that will enable us to meet our statutory responsibility to the depositors, creditors and shareholders of a failed financial institution to minimize losses by achieving maximum recovery from the assets of a receivership.

Conclusion

As outlined in this testimony, the FDIC has standard procedures that go into effect when an FDIC-insured financial institution is in danger of failing. The best scenario is for a troubled institution to successfully take measures to become viable, profitable and to continue to lend and contribute to its community. Unfortunately, we are seeing more situations were institutions cannot recover from the losses imbedded in their balance sheets. Fortunately, the FDIC is well-positioned to carry out its responsibility to protect insured depositors, and maintain stability and public confidence in our banking system. Perhaps the greatest benefit of the FDIC's process is the quick reallocation of resources. It is a process that can be painful to shareholders, creditors and other stakeholders, but experience has shown that early recognition of losses with closure and sale of non-viable institutions is the fastest path back to economic health.

With respect to the FBOP failures, the FDIC believes its actions were consistent with these goals. Depositors of all nine commonly controlled insured depository institutions had immediate access to all of their funds and all book assets were left in the private sector.

Finally, we have the capacity and tools necessary to effectively and efficiently handle the expected 2010 level of insured depository institution failures. As Director of Resolutions and Receiverships, I know our staff has the full backing of our Board of Directors to provide us with the resources to do our job.

I would be pleased to answer any questions from the Subcommittee.

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[1] Section 13(c)(4) of the Federal Deposit Insurance Act, 12 USC 1823 (c)(4).

[2] Loss share is an arrangement whereby a pool of problem assets is sold to an acquirer under an agreement that the FDIC will share a portion of the losses. This structure

allows the FDIC to reduce the immediate cash outlays for a P&A transaction and maximize asset recoveries.

[3] Under certain transaction structures the FDIC will segregate assets of the failing institution into pools each containing similarly situated assets. The prospective acquirer may submit a bid to purchase one or more of these pools, specifying the price bid for each pool to be acquired.

[4] Section 11(m) of the Federal Deposit Insurance Act, 12 U.S.C. 1821(m).

[5] Section 5(e) of the Federal Deposit Insurance Act, 12 U.S.C. 1815(e).

[6] FDIC, *Statement of Policy Regarding Liability of Commonly Controlled Depository Institutions*, as amended, 1998.

[7] The FDIC and U.S. Bank entered into a loss-share transaction on approximately $14.4 billion of the combined purchased assets of $18.2 billion. U.S. Bank will share in the losses on the asset pools covered under the loss-share agreement. The loss-sharing arrangement is projected to maximize returns on the assets covered by keeping them in the private sector.

Last Updated 1/21/2010