The FDIC and RTC

experience

MANAGING THE CRISIS

Volume Two: Symposium

The Federal Deposit Insurance Corporation

Contents

Part IV, Symposium Proceedings

The FDIC hosted a 1½-day symposium on April 29 & 30, 1998 to examine the FDIC and the RTC experience in resolving troubled banks and thrifts during the financial crisis years of 1980–1994. This symposium, "Managing the Crisis: The FDIC and RTC Experience," featured current and former FDIC and RTC executives, executives from the bank and thrift industries, officials from other regulatory agencies, private sector professionals and scholars who discussed the strategies used by the FDIC and the RTC to resolve and liquidate the 1,617 banks and 1,295 thrifts that failed during this time period.

Appendices

Introduction

The FDIC hosted a one-and-a-half day symposium on April 29 and 30, 1998, to examine the FDIC and the RTC experience in resolving troubled banks and thrifts during the financial crisis years of 1980–1994. This symposium, “Managing the Crisis: The FDIC and RTC Experience,” featured current and former FDIC and RTC executives, executives from the bank and thrift industries, officials from other regulatory agencies, private sector professionals and scholars who discussed the strategies used by the FDIC, the FSLIC, and the RTC to resolve and liquidate the 1,617 banks and 1,295 thrifts that failed during this time period.

The symposium was the culmination of the FDIC’s effort to review the various methods used by the FDIC and the RTC to resolve failed institutions and dispose of the residual assets held by the agencies, and to publish the findings in an historical study. Symposium moderators and panelists were furnished, in advance, with draft copies of the relevant chapters of the publication, *Managing the Crisis: The FDIC and RTC Experience*, for their review and comment. The moderators and panelists all delivered oral presentations following their review of the materials provided, and their presentations are organized according to the order of the symposium’s agenda. All speakers were provided the opportunity to review and edit their remarks prior to publication of this book. All charts and graphs used by the speakers in their presentations are included in the appendix.

The symposium began on the morning of April 29th with an introduction by John Bovenzi, the Director of the FDIC’s Division of Resolutions and Receiverships. The “Resolutions” panel discussed the evolution of the resolution strategies developed by the FDIC and the RTC during the timeframe under study. The luncheon was highlighted by an address from FDIC Director Joseph Neely. The “Asset Disposition” Panel examined the innovative techniques used by the FDIC and RTC to dispose of the substantial volume of failed bank and thrift assets. John Heimann, Chairman of Global Financial

Institutions for Merrill Lynch & Company, Inc., capped the first day as the featured speaker.

The symposium program on the second day began with the “Managing Bank Crises in Other Countries” panel, which examined how other countries either have resolved or plan to resolve their banking problems. The “Reflections and Looking Ahead” panelists provided their perspectives on the FDIC and RTC’s accomplishments, as well as their thoughts on the future. Approximately 220 people attended the symposium on both days.

The views expressed by the symposium participants are their own, and are not necessarily those of the FDIC.

AGENDA

Managing the Crisis: The FDIC and RTC Experience

Wednesday April 29, 1998

8:00 a.m.–9:15 a.m.	Registration and Continental Breakfast
9:15 a.m.–9:20 a.m.	Greeting and Housekeeping Items
9:20 a.m.–9:30 a.m.	**John Bovenzi**, Director Division of Resolutions and Receiverships, FDIC Welcoming Remarks
9:30 a.m.–11:30 a.m.	Resolutions *The large number of bank and thrift failures in the 1980s and early 1990s created challenges not seen in the U.S. financial system since the 1930s. The FDIC and the RTC modified basic resolution strategies with an eye toward maintaining public confidence and financial stability, without sacrificing other public-policy objectives. This panel focuses on the issues and strategies that arose in connection with these bank and thrift failures.* Moderator: **Jim Wigand**, Deputy Director, Division of Resolutions and Receiverships, FDIC Panel Members: **Robert Hartheimer**, Managing Director: Investment Banking Division, Friedman, Billings, Ramsey & Co. **Doyle Mitchell**, President, Industrial Bank, N.A. **Jim Montgomery**, Past Chairman, Great Western Financial **H. Jay Sarles**, Vice Chairman, Fleet Financial Group

		Stan Silverberg, Banking and Economic Consultant
11:30 a.m.–1:30 p.m.	Lunch	
	Keynote Speaker:	**Joseph Neely** Director, FDIC
1:30 p.m.–3:30 p.m.	Asset Disposition *The rapid increase of failures in the 1980s and early 1990s resulted in an unparalleled volume of assets in the hands of the FDIC and RTC. This panel will focus on the wide variety of techniques used by the FDIC and RTC to dispose of the substantial volume of assets once held by both agencies, and will discuss the respective merits of each of the different strategies used by the agencies.*	
	Moderator:	**Sandra Thompson**, Assistant Director, Division of Resolutions and Receiverships, FDIC
	Panel Members:	**Hubert Bell, Jr.**, Attorney, Law Office of Hubert Bell, Jr. **David Cooke**, Director, Barents Group, L.L.C. **Diana Reid**, Managing Director/Senior Advisor, Credit Suisse First Boston **Ted Samuel**, Former Chairman and Chief Executive Officer, Niagara Asset Corporation, Niagara Portfolio Management Corporation **Lawrence White**, Professor of Economics, Stern Business School, N.Y.U.
3:30 p.m.–4:00 p.m.	Break	
4:00 p.m.–5:00 p.m.	Featured Speaker:	**John G. Heimann**
	Mr. Heimann is Chairman, Global Financial Institutions, for Merrill Lynch & Company, Inc., and is a member of the firm's Office of the Chairman and Executive Management Committee. Mr. Heimann, who came to Merrill Lynch in 1984 as Vice Chairman of Merrill Lynch Capital Markets, served as Chairman of the Executive Committee for Merrill Lynch Europe/Middle East from 1988 to 1990, and became Chairman of Global Financial Institutions in 1991. While serving as U.S. Comptroller of the Currency from 1977 to 1981, Mr. Heimann was also a member of the FDIC's Board of Directors.	
5:00 p.m.	Reception	

Thursday April 30, 1998

8:00 a.m.–9:00 a.m. Registration and Continental Breakfast

9:00 a.m.–9:05 a.m. Greeting and Housekeeping Items

9:05 a.m.–9:15 a.m. **Gail Patelunas**, Deputy Director
Division of Resolutions and Receiverships, FDIC
Welcoming Remarks

9:15 a.m–10:45 a.m. Managing Bank Crises in Other Countries

The rapid rise of private banking in Eastern Europe and around the world and the emerging financial crises occurring in the Far East raise issues regarding how other countries deal with banking failures. This panel will focus on the resolution strategies used by other countries and how they differ from those typically used in the United States.

Moderator: **Thomas Rose**, Senior Deputy Director, Division of Resolutions and Receiverships, FDIC

Panel Members: **Arne Berggren**, International Banking Consultant

Bill Roelle, Head of Operations, Financial Services Group, GE Capital

L. William Seidman, Chief Commentator, CNBC-TV

10:45 a.m.–11:15 a.m. Break

11:15 a.m.–12:45 p.m. Reflections and Looking Ahead

The 1980s and early 1990s were times of great financial upheaval in the U.S. banking system, which resulted in significant changes in how bank failures are handled in the U.S. This panel will reflect on the agencies' most difficult challenges and accomplishments during this period, and provide a look ahead at what the future may hold.

Moderator: **Mitchell Glassman**, Deputy Director, Division of Resolutions and Receiverships, FDIC

Panel Members: **Jonathan Fiechter**, Director, Special Financial Operations, The World Bank

Paul Horvitz, Professor of Banking and Finance, University of Houston

Jack Ryan, Acting Executive Director of Supervision, Office of Thrift Supervision

DAY 1

Managing the Crisis: The FDIC and RTC Experience April 29–30, 1998

Introduction

Kate McDermott
Symposium Hostess

It is my distinct pleasure to introduce to you John Bovenzi, Director of the FDIC's Division of Resolutions and Receiverships. In this position, John oversees the FDIC's closing and receivership management activities for insured banks and savings and loan associations, which includes making payments to insured depositors and disposing of the failed institutions' assets. John was appointed to his position in November 1992 by then-Acting Chairman Andrew Hove. Prior to that appointment, Mr. Bovenzi served as the Deputy to FDIC Chairman William Seidman and the late Chairman William Taylor, assisting them in the day-to-day operations of the FDIC and the Resolution Trust Corporation. John joined the FDIC in 1981 and so his career pretty much matches that of the banking crisis period. Hopefully, there is no correlation between the two. Ladies and gentlemen, John Bovenzi.

Welcoming Remarks

John Bovenzi, Director
Division of Resolutions and Receiverships, FDIC

Thank you, Kate, and good morning. It is my pleasure to welcome you to the FDIC's symposium "Managing the Crisis: The FDIC and RTC Experience." This is the second of three FDIC symposia to be held in 1998. The first symposium on deposit insurance reform issues was held in January. The third symposium, an international conference on deposit insurance issues, will be held in September. This symposium is a direct result of an initiative begun by former FDIC Chairman Ricki Helfer. She asked the FDIC staff to conduct a comprehensive review of the banking crisis of the 1980s and early 1990s. The first part of that review, as mentioned, culminated in a two-volume study that has been made available to you. That study dealt with the causes of the banking crisis and the supervisory and regulatory responses to that crisis. In January of last year, the FDIC held a symposium on those issues and the proceedings are in Volume 2 of the study being made available to you today. I think you will find it a useful and informative product.

The second part of the FDIC's review of the crisis of the 1980s and early 1990s focuses on how the FDIC and the RTC actually handled the banks and S&Ls that failed. A two-volume study titled "Managing the Crisis: The FDIC and RTC Experience" is in the final stages of editing. The study will provide a detailed review of the various strategies used by the FDIC and the RTC to resolve failures—how they protected insured depositors and how assets were disposed of. Hopefully, it will be a useful guide not only for those interested in studying the past, but also for those trying to better understand the present or prepare for the future.

Everyone here who would like a copy will receive one. In addition, the proceedings of this symposium will be sent to you as well.

A great many people spent a lot of time on the project. I don't have time to thank all of them individually, but they do all have my appreciation and I would like to take a minute to just mention a couple of people. First, Ricki Helfer for having the foresight to start the project; next, Craig Rice, for managing the project in its early stages; also, Martha Duncan-Hodge, Kate McDermott, Mike Spaid, Jim Gallagher, Shelby Heyn-Rigg, Mary Ledwin Bean, Steve Stockton, Hank Abbot, Ann Gay, Frank Willis, Henry Griffin and Barbara Taft, for their commitment to seeing the project through. I would especially like to thank Bill Ostermiller who managed the project through to completion without whom this study would not have been completed. Finally, I would like to thank Acting Chairman Skip Hove, who showed continued support throughout the life of the project. Skip is testifying before Congress this morning and will join us later in the day. He's on his third tour of duty as Acting Chairman of the FDIC, and while we anxiously await the confirmation of nominee Donna Tanoue, I think it is important to acknowledge the important role Skip Hove has played at the FDIC throughout the 1990s, first in helping to manage the crisis itself, and then in effectively dealing within the FDIC during the difficult transition period that followed.

As for today's symposium, it is easy to forget what happened just a few short years ago. Today, the U.S. economy is booming and the financial sector is stronger than ever. In 1997, only one bank failed. This symposium will remind us of what it was like. What steps were taken to handle not one, but nearly 3,000 banks and S&Ls that were closed or received financial assistance. How were nearly $1 trillion in failed bank and S&L assets managed? How were hundreds of billions of dollars in insured deposits protected? What steps were taken to maintain public confidence and financial stability during this difficult period? These are the subjects that are before us today and tomorrow morning.

At the time, for those of you actually managing the crisis, it may have seemed like a thankless task. Nobody likes problems, particularly big ones, particularly when they are going to cost a lot of money. There are people who are going to look for someone to blame and those involved in the clean-up were an easy target. They were an easy target because in an undertaking of that size, some things will go wrong, and some things did go wrong. Hindsight makes it easier to put things into perspective. History seems to be judging the clean-up effort as having been better than it was judged to be at the time, and it is important that we understand the past. Why? Because it can help us now and in the future. Perhaps there are useful lessons that can help other countries dealing with their financial sector problems. There may be lessons for the future as we look at our own rapidly evolving financial sector, a financial sector experiencing mega mergers, technological and product advances, and ongoing globalization. The better we understand the past, both what went right and what went wrong, the better we can prepare for the future.

Today's symposium should offer some provocative thoughts on the past, present and future. I would like to thank our panelists in advance for taking the time to share their thoughts with us. This morning, we will begin with a panel on the resolutions process. Jim Wigand, Deputy Director of the Division of Resolutions and Receiverships, is in charge of resolutions for the FDIC and will serve as moderator of that panel. The five members of the resolution panel each bring a different and interesting perspective to the topic. The resolutions panel will be followed by lunch. We are fortunate to have FDIC Director Joe Neely as our luncheon speaker. Joe Neely joined the FDIC as a member of the Board of Directors in January of 1996. During the 80s and early 90s, Joe's vantage point was as a banker who participated in the FDIC's resolution process as a bidder. I'm looking forward to hearing his remarks and I'm sure you'll find them interesting.

This afternoon, Sandra Thompson, Assistant Director responsible for asset sales, will moderate the panel on asset disposition. Each of the speakers on this panel was actively involved in some aspect of the asset disposition process. Wrapping up the first day, we're pleased to have John Heimann, Chairman of Global Financial Institutions for Merrill Lynch, as our featured speaker.

Tomorrow morning we continue with a look at related issues in other countries, and the final panel will reflect on what happened and look ahead.

As you can see, we have a distinguished group of commentators and participants for this symposium. I say commentators and participants because I hope all of you will participate over the next day and one-half. Many of you were actively involved in managing the crisis. In that regard, in addition to some of the names already mentioned, I will note the attendance of former director of OTS and member of the FDIC Board of Directors Jonathan Fiechter, and former acting CEO of the RTC, Jack Ryan. We're pleased that they will be in attendance with us. Also, in attendance is the person who probably knows more about managing the crisis than any other single individual, former FDIC and RTC Chairman, Bill Seidman. There are many other distinguished attendees here today, some currently or formerly from within the FDIC or the RTC, others were with other government agencies or with the private sector, advising, providing services, purchasing assets, or acquiring failed institutions. All of you deserve credit for your efforts in managing the crisis. All of you have a perspective and insights that can be shared. We look forward to hearing from each of you.

At this point, I would like to introduce the moderator for our first panel. Jim Wigand is the Deputy Director for Franchise and Asset Marketing in the FDIC's Division of Resolutions and Receiverships. In this role, Jim oversees the resolution of failing insured depository institutions and the sale of their assets. Jim worked at the RTC throughout its existence, holding senior positions primarily in the asset management and sales area. Jim is a graduate of the University of Maryland with an MBA from the University of Chicago's Graduate School of Business. Please join me in welcoming Jim Wigand.

PANEL 1

Resolutions

Jim Wigand, Deputy Director, Franchise and Asset Marketing
Division of Resolutions and Receiverships, FDIC

It is like old home week here. Most of you I have run into over a period of time over the last 10–15 years, and I must admit that it is a real pleasant surprise to see so many familiar faces out here today.

I want to welcome you to our symposium's first set of panelists who will provide some perspective and thoughts on how the FDIC and RTC resolved troubled financial institutions during the 80s and early 90s. Some of you who are not local and those of you who are local to Washington may have noticed where our symposium is located. This hotel is right across the street from Arlington National Cemetery which is probably the most famous cemetery in the United States. Now, many of you also may recall that in resolving and liquidating failing institutions, we used metaphors and analogies that were death related. We referred to open institutions having negative capital as the living dead. We described the role of receiver to the uninitiated as part coroner, part undertaker, and part executor. When you think about it, all of those descriptions actually are very appropriate.

Well, to wind down and complete this macabre metaphor, maybe we should view this morning's panel as a walk through the cemetery of failed banks and thrifts. When we pass memorials to specific resolution battles, let's reflect on the strategies that proved successful and the ones that were less so. We also should pause from time-to-time at individual tombstones to consider the unique circumstances of an institution's demise and its resolution.

Now, joining us for the stroll this morning, we have a very distinguished panel. Bob Hartheimer, Doyle Mitchell, Jim Montgomery, Jay Sarles, and Stan Silverberg. Bob Hartheimer, who graciously agreed to be a panelist after Harrison Young found out last week that he had to be in South Korea today, is Managing Director at the investment banking firm of Friedman, Billings, Ramsey & Company, and is a senior member of the firm's financial services practice. Formerly, he was the FDIC's Director of Resolutions and while at the FDIC, oversaw the sale of over 200 failed banks and the creation of five bridge banks during the early 1990s. Prior to joining the FDIC, Mr. Hartheimer worked at Smith Barney and Merrill Lynch as an investment banker, specializing in financial institutions. He earned a BA from Hamilton College, and an MBA from the Wharton School at the University of Pennsylvania.

Our next panelist is Doyle Mitchell, who is President of Industrial Bank, N.A., the second largest minority-owned commercial bank and the third largest minority financial institution in the U.S. Starting in the bookkeeping department of the bank founded by his grandfather, Mr. Mitchell has held positions in the accounting, loan, audit and operations departments of the bank. By 1989, he had been appointed Assistant Vice President, Commercial Loans and, in 1991, Vice President. In 1993, he succeeded his father as President of Industrial. Among Mr. Mitchell's other activities, he serves on the board and is president of the U Street Theater Foundation, and sits on the boards of several organizations, including the District of Columbia Chamber of Commerce and the American Institute of Banking. He received a B.S. in Economics, with a concentration in finance and accounting, from Rutgers University.

Next to Mr. Mitchell is Jim Montgomery. Mr. Montgomery is Chairman and CEO of newly-chartered Frontier Bank, and is the former Chairman and Chief Executive Officer of Great Western Financial Corporation and its principal subsidiary, Great Western Bank. Starting his financial services career over 40 years ago at Price Waterhouse, Mr. Montgomery initially joined Great Western in 1960 as Assistant to the President. He left in 1964 to become Director and President of United Financial Corporation, and then returned to Great Western in 1975 as President. Mr. Montgomery previously has served on the boards of the Federal Home Loan Bank of San Francisco and the California Chamber of Commerce, and served as Chairman of America's Community Bankers of America. He is currently a director of Freddie Mac. Jim holds a bachelors degree in accounting from UCLA.

Our next panelist is Jay Sarles. Mr. Sarles is Vice Chairman and Chief Administrative Officer of Fleet Financial Group and oversees strategic planning and acquisitions, Fleet's administrative functions, and the financial services lines of businesses such as Fleet Mortgage and Fleet's credit card operations. Mr. Sarles is also Chairman of Fleet Bank, N.A. Mr. Sarles is active in several philanthropic and professional endeavors, serving as Chairman of the Metropolitan Boston Housing Partnership, and is on the board of trustees of Lifespan, a Providence, Rhode Island based health care system. He received a bachelor of arts degree from Amherst, and attended the program for management development at the Harvard Business School.

Our last panelist this morning is Stan Silverberg, who has been an independent consultant since he retired from the FDIC 11 years ago as Director of Research and Planning. Mr. Silverberg started his career at the Bank of America, then worked at the OCC and Office of the Secretary of Treasury. He joined the FDIC in 1967 and worked on developing FDIC policies for deposit insurance and bank resolutions, and also supervised liquidation issues. Mr. Silverberg had the lead staff role in the Continental Illinois case. Stan earned a B.A. from the University of Wisconsin, a Masters and Ph.D. in Economics from Yale University.

I would like to thank the panelists for taking the time from their busy schedules to be with us today to share their perspectives on managing the crisis. But, before I turn the podium over to Mr. Hartheimer, let's take a few minutes to review resolution activity and some of the resolution techniques employed during the crisis.

As you can see on the screen to my right, and for those of you who may have trouble reading the slides, copies can be found in your symposium folder, the crisis period started out with 22 failures in 1980, of which 11 were banks and 11 were thrifts. The first jump in failures resulted from thrifts incurring losses arising from having to pay high interest rates on deposits and holding large portfolios of lower-yielding fixed-rate mortgages. Over 100 institutions failed in 1982, although these numbers include 40 mutual savings banks that technically did not fail, but received some form of open bank assistance, such as net worth certificates.

The next wave of failures between 1984 and 1987 was tied to energy and agricultural lending in the commercial banking sector, and real estate lending on speculative projects, particularly in the energy belt for savings and loans. However, here too the figures do not tell the complete story because included in the figures are 265 banks having concentrations of 25 percent or more of the loan portfolios in agricultural or energy-related loan products that survived as a result of forbearance programs.

In 1988, the sharp decline in oil prices, the explosive growth in real estate development, and banks' increased concentrations in real estate lending caused significant losses to commercial banks, particularly in the southwest, resulting in 279 failures, the highest number of bank failures since the Great Depression. However, total financial institution failures did not peak until 1989 when Congress passed FIRREA with its provision of funds to resolve the savings and loan crisis. Upon its creation, the RTC assumed responsibility for 262 institutions already placed into conservatorship. Another 56 were added by year-end, resulting in a total of 533 banks and savings and loans having almost $175 billion in assets failing in 1989.

Failure rates remained high in 1990, 1991 and 1992, as real estate problems spread across the country, particularly in the northeast and west. In fact, in 1991, 78 percent of total failed bank assets were from northeast-located institutions. Savings and loans that failed were more geographically dispersed, but there were concentrations of some large failures on the west coast.

By 1994, the volume of financial institution failures had dropped off to its lowest level since the beginning of the crisis. Only 13 banks and 2 savings and loans failed in that year. The resolution crisis was over, but the asset disposition crisis was still running.

Now, what types of resolution methods did the FDIC and RTC employ to handle the crisis? By far, the most common method was through a purchase and assumption transaction, or what we call a P&A. A P&A is a closed bank transaction in which a healthy institution, known as the franchise acquirer, purchases some or all of the assets of the failed bank or thrift, and assumes some or all of the liabilities, including the insured deposits. The franchise acquirer usually pays a premium for the assumed deposits, thereby decreasing the cost of resolution.

Now, there are many variations of a P&A transaction. For example, in a whole bank, all-deposit P&A, all the assets and all of the deposits are conveyed at resolution to the franchise acquirer. In a P&A with loss sharing, the franchise acquirer purchases certain asset pools in which the FDIC has agreed to share generally 80 percent of any losses from book value. Now, at the other end of the spectrum, a clean bank, insured deposit only P&A is almost identical to another resolution method known as an insured deposit transfer or IDT, as we call them. In both instances, only insured deposits and loans secured by deposits are transferred to the acquiring institution. The substantive difference between these two types of transactions really lies in the duties the acquirer must perform related to the transaction itself.

The FDIC and RTC used other resolution methods much less often. The RTC never used open bank assistance, although as mentioned earlier, the FDIC has used this technique in which a failing bank remains open or is merged, with FDIC assistance, to resolve problems considered to be transitory in nature. Deposit payoffs occurred infrequently and constitute only 7 percent of all resolutions conducted. In this transaction, after the institution has been closed, the insured depositors are paid either directly by the FDIC, or through a bank acting as a paying agent, the full amount of their insured funds. All assets remained in the receivership estate to be liquidated over time and fund the claims of the uninsured depositors and other creditors. Now, since the imposition of what we refer to as least cost, this type of transaction also serves as the baseline from which the costs of other resolution transactions are measured.

While that is a quick summary and review of resolution activity, I would now like to turn the podium over to our panelists so we can listen to their perspectives on managing the crisis. After all panelists have spoken, we will open up the floor to questions and answers. May I introduce our first panelist, Bob Hartheimer.

Bob Hartheimer
Managing Director: Investment Banking Division
Friedman, Billings, Ramsey & Co.

Thank you, Jim. I am pleased to be here and I think many of us in the audience and myself consider Harrison Young a friend and have great respect for what he did for the FDIC. My memories go back to his constant challenging of the structures and the methods of resolution that Harrison pushed us to create and to think about all to the benefit of the government and us as a whole. It is unfortunate he's not here. But, I guess he's in

South Korea and he's in the middle of raising money for a Thai bank, so he is carrying his experience internationally.

I've had a chance to look at some of the materials that are being prepared for the upcoming volumes, and I do want to congratulate the group at the agency for the work they've done. I have to say there are a number of things I had forgotten about. It has only been two years since I left the agency, but the material seems very comprehensive and I look forward to those publications.

Jim asked me to focus in 10 or 15 minutes here on four items that came into the work that I did in resolutions at the agency. So, I'm going to kind of dive into those and just give some of my thoughts. I'm not going to spend a lot of time describing them. I think everyone really understands what they are. The four areas I'm going to talk about are bridge banks, cross guarantee authority, least cost, and the FDIC or government acquiring an ownership interest in failed institutions.

In bridge banks, I guess what I believe about bridge banks is that they were and I think will continue to be a very important tool for the FDIC to use in certain situations. It allowed our team to receive higher values for every bank and it's unfortunate that Crossland is not technically a bridge bank, but for all of us who worked on Crossland, we all believe it is a bridge bank, but it has a different structure. It was a conservatorship, but for all intents and purposes, it was a bridge bank. Every situation we went into where we created a bridge, where we ran the bank, saved money for the fund, and it also, I think, assisted the community that the bank was in. In some cases, it avoided decimation of the institution and its employees, but primarily it saved money which was our first objective. In the case of Crossland, I believe there would have been about $1 billion of additional loss; some of the people here remember when Crossland failed, we had two very ugly bids, one from Chase and one from Republic. Republic tried to buy Crossland three different times. Their bid, if I'm not mistaken, was $5 million and they refused to manage one asset, which actually is what put us over the edge in terms of creating this bridge because we couldn't walk into a situation and immediately manage the assets, and Chase's bid was only for half of the deposits and it really was not optimal. But, that created the opportunity to re-invent bridge banks which John Stone, Bill Roelle and Roger Watson and others had created and executed in the late 80s.

I also think it is the same with First City. The second time, I wasn't around for the first time, but I believe that the orderly manner in which we handled First City as a bridge allowed all the bridge banks to be sold and make so much money for the government, and in fact, created a lot of work for the legal division in terms of the lawsuit that First City entered into because there was money left over.

I believe that bridge banks should not become the norm. Many banks can be sold without a bridge and I understand there was a failure a couple of weeks ago—proud that it included loss share. That is something I'm not going to talk about, but it was an area we spent a lot of time with and there were those who believed it couldn't be done in small banks and I understand it was a $40 million bank that sold with the loss share—

that's great. But, in a situation like that, you can get your arms very quickly around the institution and be able to sell it contemporaneously with a sale or with a failure.

As we all know, there has been criticism of the government competing with other institutions while managing a bridge, and I actually think that is absurd. I think that is an academic argument or an argument of journalists to create some controversy in their publications. The bridge banks that we controlled and oversaw the management of, we never managed them ourselves, we were very conscious of the fact that we did not have experience in running banks. We hired good people to run banks. We directed them very distinctly, not to compete effectively on rate, and to essentially just take the institution, determine how to best organize it, and work with our group in Resolutions to sell it. I think the criticism was ill-founded. Those are my thoughts on bridge banks—with only 10 or 15 minutes, you can go on and on with these topics all day.

Cross guarantee authority—I actually was not at the agency when cross guarantee came into being in 1989, but I believe it is a very important tool, right up there with FDICIA in terms of its importance. It is unfortunate that when the cross guarantee authority came into being, we had a banking system that was essentially uneven around the country. We had states like Texas that had grown up with large chains of banks and that really caused for messier resolutions, but it effectively allowed the government to avoid taking the bad pieces of these chains of banks and watching managements of those banks move bad assets and things into those banks. The use of the authority was effective in two different ways. It was effective in allowing us to take healthy banks along with failed banks and as we think back to First City, there were really only two banks at First City, maybe a third—I really didn't study First City before coming here today—but as I remember, we were able to sell almost all of the 20 First City banks as whole banks without any assets passing to the agency, and that really was useful to offset the value of the bad banks that First City had in Dallas and Houston.

And I think people really understand why it makes sense to take the healthy banks at the time of resolution. There were a few situations where there were healthy banks that were sisters or brothers of failed banks, and the decision was made at the time of the failure of the unhealthy bank not to take the sister bank, and that also can work. There was one situation in Maine called Coastal Bank, which is around today, it was a wholly owned sub of a bank called Suffield—it might have been a savings bank or thrift in Connecticut—and Suffield failed before I got to the agency. I don't really know why Coastal was not taken at the time, but it turned out that Coastal ended up surviving, and today is doing very well. We got involved late in the process, the RTC and the old Division of Liquidation were involved in trying to determine the way to resolve Coastal, because of course the FDIC believed it owned Coastal. But, that was enough leverage to get Coastal to come to the table. A very creative resolution—it really wasn't a resolution but a creative transaction that was developed which went to the board of the FDIC and ultimately a lot of money was moved from the equity position of Coastal to the receivership of Suffield without having to take the bank. So, I think this tool can work in both ways. The FDIC doesn't have to be so quick to take healthy banks if it can figure out ways to use the leverage of the law to gain the value without necessarily having to sell. A very important tool—almost obvious for all of us that went through Resolutions 101 in the early years and hopefully it never goes away.

Least cost—I guess least cost was my least favorite requirement, and probably that is shared by others here. I think least cost was only loved by the GAO and others who tried to reduce every decision to an analytical decision. As many of us know, resolutions is not a science. There isn't a script that you follow. It is really an art and everyone is different and it is very difficult to come up with a least cost analysis, yet I had to sit before many FDIC boards and explain assumptions. I want to thank many of those boards for being flexible and understanding and believing in the assumptions that we came up with—some of which were a little creative—but if they weren't creative, you would have found that you wouldn't be able to have been creative in some of the resolutions that were done. Ultimately, I think we came up with good assumptions that had their basis in logic and in what was expected to occur. Many of those assumptions did occur and I think as the materials will come out in this next volume, you'll see that the costs of resolutions were generally at or below what were the least cost assumptions at the time. Having said that, it was not a fun thing to do.

I also think it virtually eliminated the creativity that Wall Street was responsible for in terms of open bank and early resolution assistance. Many people spent a lot of hours trying to figure out how to resolve First City. We can talk about that—the lawsuit is over. There is a lawsuit out, I've been told I'm being deposed. It hasn't happened yet, thankfully, for Meritor, but many banks tried to save themselves, as you might expect it being human nature, before failure. Once least cost came into being, you essentially couldn't compare the cost, you couldn't auction a bank before it failed and come up with a creative open bank solution. So, you usually had one group sponsored by bank management and in some cases bank management was suspect and in other cases they weren't, but you couldn't ever really compare that to anything. So, we had trouble convincing the FDIC board that those open bank solutions would be the least cost solution. It stifled creativity and so I'm mixed on my feeling of least cost.

The last thing I will just mention is the topic of acquiring an ownership interest by the government. As you might expect, I'm fairly enthusiastic about this and I hope the agency does this going forward. I think history has shown that when there are a lot of failures, prices are reduced. There are not a lot of buyers, and it is very little value that you are giving up at the time of resolution for the insurance fund to take an ongoing position. It is important for that ongoing position to be a neutral position from a management standpoint. There were great criticisms of Continental and of First City the first time—that the government position somehow had some influence in managing the institution. I can tell you that in Continental's case, I was involved very late in the resolution process—I was involved in the sale of the securities the government held, and I remember Holly Rademacher who was the CFO complaining to me that Roger Watson wouldn't tell him a thing about how to run the bank and they were upset about that. I actually think that was good of Roger to do that because that is not what the government's role should have been. Yet, the government played a significant role in creating the value that the shareholders ultimately received for Continental and there is no reason that the government shouldn't share in that value.

In the case of the thrift, American Savings Bank, the government had a 30 percent position. We thank Jim Meyer and his colleagues for creating an unbelievably complicated transaction. Once the FDIC was convinced about the sale of ASB, the government's position was initially estimated to be $200 or $300 million. Washington Mutual acquired it, the value at that time was $400 million, and ultimately when the position was sold, it was worth $600 million. That is really a lesson in—except for managing of the assets and the assistance agreement—there is really no direction by the FRF of how to manage that institution. That is really great to see a structure work like that.

So, I'm very positive. I would like to see more of it. I'm afraid that in the near term we're not going to see too many resolutions. It is somewhat a shame there is so much more enthusiasm and now so much more understanding about how to handle these things and I think we would all like to see this chapter happen again, but I guess there are others in the country and on the Hill that wouldn't want to see that.

Those are my thoughts on those four items. I would be happy to talk to you in the Q&A if anyone has any questions, and I would like to turn it over to Doyle.

Thank you.

Doyle Mitchell, President
Industrial Bank, N.A.

Good morning. I will approach this from Industrial Bank's experience in going through the resolution process, and then also try to point out some things that I think are very important to a lot of the communities in which we typically do business. In doing so, hopefully I will address branch breakups and interim capital assistance and other issues that were relevant to us as a minority bank participating in the process.

I want to thank the FDIC for holding these symposiums and in particular, recognize Former Chairman Helfer in holding these symposiums after the crisis is over. Hindsight is 20/20, but only if you look. I think it is extremely important that we go back and do that and prepare for the future, if necessary.

In 1993, I participated in a session at the National Bankers Association, the minority bank trade association, where individuals from the FDIC or other consulting firms explained to us what was happening in the thrift industry.

At the time, I had been President about six months at Industrial Bank. We had established a fairly assertive vision for the bank, where we thought we would someday establish branches in regional areas around Washington, D.C. I had no idea it would happen nearly so soon. So, in September or October, we started to investigate the thrifts in our area that were going to close and how we might be able to participate. We actually closed on two branches of one of the thrifts in June of 1994, long before I ever thought we would acquire branches in Prince Georges County, Maryland. I knew Prince Georges County, Maryland was an attractive area. It had a lot of the flight of the middle class from Washington, D.C. into that county and is an attractive market for our institution.

The transaction did become very complicated on a number of different fronts. The first front being that we had a Washington, D.C. charter for our bank, although we were regulated by the Comptroller of the Currency, probably the only one of that nature in the country. And, the thrifts that we wanted to bid on were in Prince Georges County, Maryland. If you recall, that was about the time that the whole interstate banking debate was starting to heat up and although the RTC did have intrastate and interstate branching override authority, the interstate branching authority was something that they did not want to touch, and I can understand why. It was being actively debated in Congress at the time.

So, we had a problem. We had a District bank and we had branches that we wanted to purchase in Prince Georges County, Maryland. The transaction from the crisis standpoint was small. From our standpoint, it was fairly large. We were looking at two branches that had about $40 million in deposits. We were about $190 million in total assets at the time.

I think the difficulty came as we looked at the benefits under the minority program in the way the law was originally crafted. I think that there was good intent on the part of Congress to recognize that there had to be some protection of services in low- and moderate-income neighborhoods and minority neighborhoods of banking services which typically seem to decline after an acquisition. But, along with the least cost test, which I think is always notorious in these acquisition situations, there was an inherent conflict in the way the law was documented. It presented a lot of conflict right within the Resolution Trust Corporation itself in how to interpret that, and actually how to implement it. I think those involved in the resolutions process wanted to protect the services in minority neighborhoods. The lawyers said there was a least cost test, so there was a constant conflict. I would urge that if there is any future legislation, that it be carefully crafted so that those conflicts don't occur in the future.

Now, why a minority program? I think from our experience at the bank, it's clear there is a need to protect banking services in low- and moderate-income areas, and those areas which tend to typically be predominately minority populated. We have over 60 years in areas that have been neglected and underserved by mainstream financial institutions. We've been able to do well. Four of our seven branches in Washington D.C., out of a total of nine, are in low- and moderate-income census tracts in Washington, D.C. We have learned it can be labor intensive to serve those markets that do not fall into the mainstream of financial services. But, at the same time, we have found that we can make a profit and also uplift those particular communities.

Well, let me kind of move on and discuss some particulars. For us, serving those communities is important and for those who live there, we are an important part of that community. And although we can't, at this point, do it on a national level and we don't hit the charts, if you will, in terms of large statistics, other minority banks around the country do the exact same thing. That is why you see so much objection when our institutions close or are looking to be sold to non-minority institutions, or why you have public debate when major institutions close branches in those neighborhoods, particularly in this case after an acquisition.

One of the things that we think worked very well was the branch breakup. It allowed institutions like ours to look at individual branches within a branch system. In this case, we bid on John Hanson Federal Savings and Loan, which had approximately nine branches. At the time it was resolved, it was about $150 million. The branches were spread out from north of Baltimore to southern Prince Georges County, Maryland. And, for an institution like ours, we had a focus on only 2–4 branches. We ended up choosing two that we thought we would bid on. And although I believe the efforts were to sell John Hanson as a whole institution, later it was broken up by branch. You could bid individually on branches, clusters of branches, or the whole institution and I believe the deciding factor probably was the least cost test.

In that vein though, I believe by breaking it up, you got more interest from community banks that wanted one or two branches. They had a branch on the eastern shore and I believe a community bank down there purchased the branch on the eastern shore. We had no interest in it, but a bank operating on the eastern shore certainly did. In the end, it probably brought a greater premium to the RTC by breaking the branches up and offering them in a number of different ways, either in clusters, per branch, or as a whole institution. So, I think that is something that works extremely well. I think it is something that all community banks would like to see in the future. Our branches that we targeted, obviously, were much more valuable to us than they would be as part of a whole bank resolution. I think that has the effect of raising the premiums.

The second thing that I believe has the effect of raising the premiums is the minority institutions program itself. For those branches that have a particular interest to us that others may not have, has the effect of raising the premium to the RTC and FDIC.

There were a number of benefits that we were able to take part in. There was in the law a "preference" and I say that in quotes because it was essentially zeroed out by the least cost test. But the way it was implemented was if a minority institution bid within 10 percent of a bid of another institution, the minority group was allowed to go back and re-bid. We won one of our branches hands down. It was that valuable to us. It was a branch that had some office space and we bid very aggressively. The other one we were able to purchase from the core acquirer.

Interim capital assistance was a good program for those trying to establish new minority institutions in minority neighborhoods. It originally was designed for that purpose, to be short-term interim capital assistance. It was later expanded so that existing institutions could make use of it as well. We probably used about 25 percent of what we were actually eligible to take down. It came in the form of a note and we were very risk adverse. We raised about $1.1 million in our own capital and took a million dollars in the interim capital assistance, which we will pay off when the time comes.

It was a good provision. It was a smart move to expand it to existing institutions because although it was intended to develop new banks, there were not a lot of new groups coming together to take advantage of some of the resolutions in those neighborhoods. There were some that were successfully created, but our position had always been that we, as existing institutions that were profitable and sound and that had been operating in these neighborhoods for a long time, could probably do a better job.

It proved a little true in the acquisitions process when there was a minority group out of Connecticut that wanted to actually buy all of John Hanson. The short story was that group came forward and made a bid that they could not actually close on, and much to our displeasure, we had to bid on it twice. There was a second round of bidding in which we increased our bid particularly for that one branch that had the office space.

It did prove as to why the ICA was useful not only for short-term interim capital for new institutions, but for those that had been in existence for awhile.

We were able to purchase loans, which was another very attractive part of the program. We sold some of those loans. I'll talk to you a little bit about the accounting treatment under the sale, and we were able to occupy the entire branch on one of those owned facilities "rent-free." I put that in quotes because the way we had to treat it from an accounting standpoint, there was some and is some existing amortization costs to that.

In terms of what our accountants did, we weren't real happy, but we went along with it and, in the end, it was a more conservative approach, but it benefited us more so than taking short-term benefits. We made a small profit on the loans. We didn't get rich on any sale by any stretch of the imagination. Our auditors did not allow us to book a profit. What they did was add it to, as part of the premium. They took all of the benefits that we had under this minority program—and I think this was an excellent way to treat it rather than to shoot for the short-term benefits, such as occupying the branch on a rent-free basis for five years. They assigned a value to all the benefits under the program and said we must amortize them over the period that applied, which was five years. So, we're writing that down. Of course we had to write it down as core deposit intangibles and core deposit values, and they also incorporated the profit on the sale of the loans. They actually looked at the discount and made that a segment of the premium, or actually deducted it for capital purposes as part of the premium. So, we didn't get the short-term profit benefits from that, but what we did get was an immediate impact to tangible capital from that treatment.

That is really the conclusion of my remarks and in summarizing, I think the important thing is that we all recognize the importance of financial services in low- and moderate-income areas. They can be very difficult to find for those in those neighborhoods. We just opened a branch in Washington, D.C. in what I would consider a moderate to middle class income neighborhood—a very stable bedroom community in Washington, D.C. where the home ownership rate is probably well over 60–70 percent. But, ironically, we are probably the only one of two branches within that neighborhood. There has been a lot of consolidation. There has been a lot of branch closings, and actually the building we are in was the home of Meritor Savings when they were taken over and eventually the acquiring institution left. That is what our mission has been—to serve those particular neighborhoods where those individuals need financial services. That is how we've made our niche. That is how we've made money. They handle their business very well. So, I would encourage going forward, that the programs are crafted with the branch breakup as a way to resolve institutions. I think there probably should be a study conducted on branch closures in minority neighborhoods, and a study on the public policy benefits of offering benefits to any institution that may want to acquire branches in low- and moderate-income neighborhoods. Again, I would also be happy to take questions when we get to the Q&A. I'll turn it over to Jim at this time.

Jim Montgomery, Past Chairman
Great Western Financial

Thanks very much. It is nice to be with you this morning. It is not a terribly pleasant subject to me that we're discussing this morning. I lived through the thrift crisis in the 1980s in this country, a lot of my good friends flew over the cliff, and it was not a pleasant thing. But, it is important, I think, for all of us to look back on that time and learn some lessons and make sure we don't repeat a lot of mistakes in the future.

I was asked to cover three subjects, dealing with the RTC, entire franchise deals and acquiring a franchise after conservatorship. I'm probably an expert on these subjects. I think we were probably, if not the RTC's number one customer, pretty close. Quoting from our 1993 annual report, "Since 1990, Great Western has completed 12 acquisitions totaling $14.2 billion in deposits." The names on that list are kind of interesting. The largest thrift failure, Home Fed of San Diego we acquired the remains of. The two most infamous thrift failures, Lincoln Savings with Charlie Keating in California, and Centrust Savings with David Paul in Florida, the remains of those two institutions became part of Great Western. It was an interesting time. It helped our company but that is the hard way to do it.

We involved ourselves in a lot of the activities that resolved thrift problems, including the management consignment program, which hasn't been mentioned. We did lend some of our senior officers to institutions to help work out problems. But, I want to spend a minute on one resolution program that we at Great Western did not take part in. I think it is a very important thing to look back on. I haven't seen it discussed a lot in the reflections on the thrift crisis and I think it should be focused on. That is the early resolution program adopted by the thrift industry with the help of the Federal Home Loan Bank Board and the then-FSLIC. That was the acquiring of one thrift by another using a technique called purchase accounting. Let me just give you some numbers.

As was mentioned earlier, the early thrift crisis was an interest rate crisis. There weren't troubled assets as such, but thrifts had a lot of fixed rate loans on their books and were paying more for deposits than they were receiving for loans. So, they were going broke with literally no problem assets. I think it's interesting that Great Western was one of the few major companies in the thrift business that did not take part in this resolution process of using purchase accounting. One of the reasons it's interesting is because I created the technique to do this. It was originally called the Montgomery Plan. I was sitting in a meeting of our trade association around 1980. We were all reflecting on how we could deal with this interest rate crisis in the business and how could we induce the healthy institutions to acquire the failing ones. Well, with my accounting background I was working on a process that, as I say, eventually became the Montgomery Plan. Under purchase accounting, most of you probably know you mark the assets of the acquired company to market. In this case, we're talking about a loan portfolio.

Let me give you some specific numbers because this is actually a case we were working on in Florida. A billion dollar institution, a billion dollars in deposits, essentially a billion dollars in loans and no net worth. Their net worth had disappeared because of the losses. Now, the loans were worth about $700 million in the marketplace at that time because they were at very low interest rates and we were in a double-digit interest rate environment. If you acquire that company, you mark the assets to market, which is to write them down to $700 million. The offset to the transaction is not to charge net worth, but to create a goodwill account under purchase accounting. Now, if you mark the assets to market, the technique that was allowed was to amortize that discount into income over about seven years. Accounting literature at the time allowed you to amoritize goodwill to expense over 30 years. So, look at the implications for your financial statements. You amortized the discount on loans in the income—about $45 million a year for seven years. What is hitting your expense account is $10 million a year because you're amortizing the expense over 30 years. The Montgomery Plan said that taking that example, the FSLIC's cost of resolution should be $300 million, because that is the difference between the assets and the liabilities. But, if they were to, in effect, fund the amortization of the goodwill over 30 years—in other words, write a check to the acquiring institution for $10 million a year each year for the 30 years, everyone would benefit. The government would spread out the cost of their resolution over 30 years, the institution that is doing the acquiring would have seven years of very good income stream under which it could restructure the assets of the acquired institution, and I thought everyone would benefit.

The reason that we didn't use the program is because it was changed in one very important way. What the government said is, we'll allow the write down and the creation of the goodwill account, but we won't fund the amortization of the goodwill. It was at that point that I erased my name from the Montgomery Plan. My point was, if I acquire deposits of $1 billion that I have to pay out at par, and I acquire assets of $1 billion that are worth $700 million, I've paid $300 million for that transaction, regardless of what the accounting says. So, we said we wouldn't do that.

It was an interesting thing that happened during that time. We created $27 billion of goodwill on the balance sheets of the thrift industry in the beginning of the 1980s through this accounting technique. Now, did that cause the thrift crisis? Certainly not. Did it add to it? Yes it did, because, what you had was a seriously undercapitalized industry growing on a rather thin tangible capital base, and what happened afterwards is a lot of bad assets were created by people like David Paul and Charlie Keating, who got a hold of these institutions with very little capital investment and then we had the second wave of the thrift crisis, which was the asset-based problem. It was a much larger problem because this technique allowed time buying for institutions, and a lot of things happened in the 1980s that were not very pleasant.

It is interesting that when the seven-year period ran out towards the end of the 80s and there was still a lot of goodwill on the books, that is when a lot of failures took place. That is not a coincidence. It is something that I think is interesting to look back on and I'm frankly surprised that I have not seen this discussed very much in the literature about the thrift crisis. Now, maybe it is in the studies that we're being presented with this week. I hope so, because I think it is a very important lesson to be learned.

To bring it up to date, I was interested when I picked up a newspaper about six months ago and read that the required capital for a new thrift institution had been reduced from $3 million to $2 million. I found that rather curious and I wondered why that took place. This comes at a time when the cost of deposit insurance to an institution, new or old, is essentially nil. I wonder why we would want to capitalize institutions at a relatively small amount, times are good, things are wonderful, and I'm not predicting another crisis in the offing, but I think the most important thing we have to have in our financial institutions is a strong capital base. The line of defense between the crazies and the insurance fund, if you will, is having people with their own serious money at risk. So, I'm a little surprised that we reduced that capital requirement to where it is.

We are capitalizing a new thrift institution, which was mentioned, Frontier Bank in Utah. We are capitalizing it at $6 million and I think that is a lot more sensible for an institution. I just think it's important to look back. Do I blame the Federal Home Loan Bank and the FSLIC? No. I think it was kind of a smart move on their part because what they were able to do was resolve a lot of cases without writing any checks. From their standpoint at the moment, it probably made a lot of sense. The problem was, without tangible capital, those institutions really were not able to make it, even under lower interest rate environments, without doing a lot of risky things. And we have seen the results of that.

I remember results very well and people tend to blame the regulators during some of this crisis. Well, I testified before Congress at the beginning of the 1980s saying that the unlimited use of brokered deposits in the deregulated world was going to be a disaster. I'm sorry that I'm as right as I was, but think about it. It was the first time in the history of the world that we would insure the cash flow of a seriously undercapitalized institution with very few questions asked. Now, where were the examiners? Let me tell you—you can do a lot of mischief between examinations, if you can pick up the phone and ask Wall Street to send you as much money as you want, put it in hundred thousand dollar increments, and pay a higher rate than someone else.

I remember in the old days, under rate control, we all paid the same rate and we could only have 5 percent of our deposits from money brokers. We said two things at the beginning of the 1980s. You can pay anything you want to for deposits and you can get as much as 100 percent from money brokers. We had an institution in California that grew from zero to $2 billion literally overnight and lost it all. Now, that can all take place between examinations, so you can't really blame the regulators. The reason I remember this particular example so well is that this institution had no retail branches, one office on the second story of a building, and got all of their money by telephone. That office happened to be the second story of a Great Western building, and when the T.V. focused that evening on this great failure, all you could see was the Great Western sign.

These are important things to remember. We ought to be very vigilant to make sure that we don't forget these lessons of the past, and repeat them in the future.

Thank you.

H. Jay Sarles, Vice Chairman
Fleet Financial Group

Good morning. I would like to read you a couple sentences from a December 1992 Harvard Business School study to set the stage for my remarks.

"At 5:00 p.m. on April 22, 1991, the tension at Fleet Financial Group headquarters was palpable. By the end of the day, William Seidman, the Chairman of the FDIC, would announce the name of the firm that would win the right to acquire the failed Bank of New England. To Terry Murray, Fleet's Chairman and Chief Executive, acquiring BNE in an FDIC-assisted transaction would be a strategic coup. BNE held solid Massachusetts and Connecticut franchises that Fleet needed to become the dominant, super-regional commercial bank in New England. Furthermore, the transaction would be low risk to Fleet, the FDIC would take ownership of all BNE's nonperforming assets. Murray had stitched together a partnership with Kohlberg, Kravis & Roberts (KKR) in record time to raise the capital that Fleet needed to make a serious bid. The only question was whether the FDIC would find it more appealing than the bids submitted by Bank of America and Bank of Boston."

Needless to say, as history bears it out, we were the winning bidder.

What I would like to do this morning is spend a little time giving you our view of how it happened, how it worked, and why it was successful.

To give you a little bit of history, the Bank of New England failed in January 1991. A bridge bank was established immediately thereon. From February to April, the FDIC ran a due diligence and bidding process. The deal structure, as indicated, was a good bank/bad bank. The good bank would be divested of all nonperforming assets, including a right to put future nonperforming assets. There would be a bad bank created that either the bidder in a separate transaction could manage, or another party could manage. We were the successful bidder, as you know, in April of 1991 and the actual transaction closed in July of 1991.

What made it work from our standpoint? It was very attractive from a financial standpoint. In the short term we enjoyed guaranteed earnings from the good bank and we had fee income from the bad bank. Furthermore, it gave us the opportunity to build a very strong franchise in New England. So, it wasn't just earnings; we ended up with a tremendous franchise in New England. Finally, we could minimize the risk because we had the right to put to the FDIC any assets that turned bad over the next three years. So, in a time where there was tremendous risk and tremendous uncertainty, we had an ability to get rid of those bad assets. We could clearly determine what our risk was and it was an operating risk and not a loan loss risk. Because of the reasons outlined, the transaction gave us the opportunity to attract almost $300 million in capital from KKR.

The way the transaction was structured, Fleet Financial Group was the purchaser, but we had raised money from KKR—$283 million. Initially, KKR wanted to structure a joint venture with Fleet—a 50/50 joint venture to purchase Bank of New England. Through five days of negotiation, we convinced them that would not be a successful way to win the bid nor to manage the company, and we convinced them to invest in Fleet, thus enabling us to bid on Bank of New England. But, they were concerned because while they were getting a clean bank with Bank of New England, they had Fleet to deal with and we had our own problems. So, they came up with an innovative structure, Dual Convertible Preferred. Essentially, they made a $283 million investment in Fleet. They were in a position either to convert that up into Fleet shares, 22.5 million Fleet shares, or down into a 50 percent interest in Bank of New England. The downward conversion, which is something neither of us wanted to happen, was there in case Fleet had problems. It would give them a 50 percent interest in a clean bank and preserve the value of their equity investment.

The prize was obvious. It was a $15 billion bank with a very strong franchise. We [Fleet] and KKR invested $500 million in capital to capitalize the bank. We ended up with $200 million in annual earnings out of this, after 18 months, or essentially a 40 percent return on our equity. KKR made an investment in Fleet of $283 million. Today it is worth $2.25 billion or a profit of $2 billion.

Now, to be fair about it, obviously there has been a tremendous run-up in bank stocks. But, if you look at it from when they invested the money to when we renegotiated the downward conversion out, their investment essentially went from $283 million to about $1.0 billion. They received about a 35 percent compounded return. For those of you who would be interested, that compares to a 17 percent compounded return for the S&P 500 in the period.

From our standpoint, it gave us the size, the earnings, and the capability to grow into the $100 billion financial institution we are today, the tenth largest bank in the U.S. in terms of size and market capitalization. Without the Bank of New England deal, we would not be where we are today.

What made it work for Fleet was our experience in mergers and acquisitions and our ability to get costs out. Short term, what drove this deal for us was we received a clean bank, we were able to get $350 million in costs out, and we convinced the FDIC that Fleet could make the transaction work. Obviously, getting a clean bank put us in a position to have strong earnings, a major help to Fleet at the time. We also got fee income from the RECOLL subsidiary. Without question, much of the quick turnaround and the profit was because of the turnaround in the economy, fueled by lower rates. But, it was clearly something where because of the structure and because of our capabilities in mergers and acquisitions and cost savings, we were able to turn it into a winning situation in a short period of time.

Looking at the transaction from the FDIC's point of view, three things were accomplished for the FDIC. First, they got a quick resolution of a large bank failure. It was six months from the time they put it into receivership until the time we took ownership of it. This obviously freed up their resources to deal with the continuing issues that were confronting the banking business. One-third of the financial institutions in New England went broke in this period, so there were obviously a lot of call in terms of their resources. Also, it returned the management of the bank to the private sector.

Secondly, it attracted new capital to the banking sector in the form of KKR's $283 million investment. Third, and most important in my view, by the structure they came up with, by putting it in the hands of a New England bank, it really went a long way to helping stabilize the New England banking environment. I think that was key, from the regulatory standpoint, because Fleet was now in a position to lend money again. We were in a position to support the local economy at a time when it desperately needed it.

For the next couple of minutes, I would like to just touch on one of our subsidiaries—RECOLL. As part of the BNE transaction, we ended up forming a subsidiary called RECOLL, which entered into a five-year contract with the FDIC to manage BNE's bad assets. This operated independently from the bank. Tom Lucey is in the audience. He was picked to run this operation and he toiled over the next several years with the FDIC to make it work. It was a big job. He was handed $6 billion in assets on the first day of the job—with no company, no people, etc., other than the people at the Bank of New England. We put an additional $750 million in assets into that subsidiary during the next two and one-half years.

How did RECOLL work? On the next slide you can see it was a wholly-owned subsidiary of Fleet. Its sole purpose was to manage and liquidate the bad bank. At one point, we had 1,200 employees. I think the structure that the FDIC came up with was innovative and worked very well. Essentially, we got paid, as a percentage of net cash collected, and that was defined as actual cash collections, less interest expense and less two times the expenses. We got paid starting at 1.5 percent and it could run up ultimately to 26 percent, depending on how much we collected over the period. We never got to the 26 percent. We got to 18.5 percent and as I said totaled about $140 million in fee income over three and one-half years. So, from that standpoint, it worked very well.

Interestingly enough, we had no public policy issues in terms of the acquisition of Bank of New England—the good bank—but we did have a lot of issues in terms of RECOLL in New England. It goes, in my view, to two things. One was the collection philosophy—a liquidation approach. The FDIC is charged with liquidating these assets at least cost to the fund. So, at a time when New England was struggling, businesses were saying, we don't want liquidations to happen, we want support. So, there was a tension between the businesses and ultimately the politicians and the FDIC mandate. Secondly, RECOLL was obviously incented to collect those assets because it was only cash that counted. If you restructured the loan, until you sold that loan, you didn't get paid. So, there was a feeling that RECOLL was out there liquidating as fast as possible in order to make a profit. In the political environment, that was a tough one. There are a number of people in this room who worked with us. We went to hearings before the Senate and the House and we dealt with the staffs of various New England Senators and Representatives. It was a tough political environment.

One of the things we learned early on was that just saying no wasn't going to work. We set up a group in RECOLL that did nothing but deal with the staffs. We had a hotline with the FDIC to deal with any issues that they got. Most importantly, we came up with an innovative structure which Mitchell Glassman and I worked out. This was the "soft seven" portfolio structure. Those were loans that were classified, mostly loans to small businesses, but they were loans the businesses were paying interest on, were current on, and the only reason they were classified was because there wasn't enough collateral to support them. Fleet bought those loans out of RECOLL and took them back into the banking system. The FDIC was innovative enough to realize we needed to do that. We bought $780 million of them, but the FDIC gave us the right to put them back if they went bad over the next three years. That program was an enormous success in terms of taking assets in liquidation and putting them back into the banking system. It basically went a long way in dealing with the public policy issue. Once we put that program in place, then the number and volume of complaints came down dramatically. As I said, I would give the FDIC enormous credit for their flexibility and for their understanding of what had to be done.

Finally, in terms of lessons, I believe this was a very good private/public partnership between Fleet and the FDIC through this period of time in terms of structuring the deal, working out the deal, working with RECOLL. They were innovative and they were flexible. I wasn't necessarily a believer then, but I have become a believer that the accelerated asset disposition process in cleaning things up is the right way to go, I think we've seen that in terms of how quickly the financial system bounced back.

One last thought: you need to be politically sensitive. You can't operate in this country without understanding that and responding to both economic considerations and political considerations. Fleet and the FDIC, I think, did a reasonably good job on that front. The economic recovery was a huge help. Without that, it would have been much tougher slogging. Much of what I have said here really goes to the fact that the resolution process has to be flexible to meet the conditions at the time.

I close with one last remark and that goes to this question of least cost. I just want to thank the FDIC for the creative use of least cost assumptions with regard to BNE.

Thank you very much.

Stan Silverberg
Banking and Economic Consultant

I'm pleased to be here and to have an opportunity to see some people that I haven't seen in a while, people that I've worked with and some old friends. I've been asked to talk about too big to fail, open bank assistance, and forbearance. That is a lot. Let me see if I can run through some of this fairly quickly.

First of all, it is hard to get excited about these things. We have had a strong economy and no significant failures for five years. We've eliminated competition from insolvent institutions and undercapitalized institutions. As a result, we've got record bank earnings and very high stock valuations. If we have a troubled bank, it is likely to be carefully examined by healthy institutions and snapped up without any assistance, unless it is substantially insolvent. I think that as long as there is a strong banking environment, there will be fewer failures, and most resolutions are going to bypass the FDIC.

Still, I think that we can't go on the assumption that there aren't going to be failures and some of these problems that we've dealt with in the past aren't going to come back. Otherwise, life at the FDIC is going to be very, very boring over the next decade.

Let me make a brief comment on forbearance. In principle, everyone, especially economists, hated it; but when it has been employed consciously with respect to groups of banks with appropriate monitoring, it has actually worked fairly well. Two programs in particular, the savings bank net worth certificate program and the farm bank program, both had heavy political support. My recollection is that Bill Isaac publicly opposed both of them and complained about them. With respect to the savings bank program, I think the FDIC staff felt that with appropriate restrictions on their behavior, that you could take an insolvent savings bank, make an assumption that interest rates were going to remain relatively constant, and factor in that long-term assets would appreciate as they approached maturity and that would offset some of the earnings losses. And then there were some benefits from a delayed resolution. The numbers actually led you to the conclusion that this really was not a particularly risky program, we didn't have to assume that rates were going to decline to make this program work out, and many of the savings banks in fact did ultimately survive and recapitalize. Some did not.

What conclusions can we come to from a forbearance program? Well I think, again, if it is monitored carefully and you don't let undercapitalized or insolvent institutions expand or behave inappropriately, under certain circumstances it seems to work. Whether it is something to happen and to be used in the future, that is hard to say.

I would like to mention that there was another very substantial forbearance program in the late 70s and the 80s. That related to the treatment of sovereign risk loans. Had the regulators insisted on realistic write-offs of Latin American loans, a number of the money center banks would have been in much deeper trouble than they were, and perhaps some would have become insolvent. That too was a situation where the delayed recognition of losses gave banks time to eventually work out of their situation. It is not as though those loans became good—earnings from other sources offset delayed write-offs. So, again, something that is hard to defend in principle, worked.

Let's talk a little bit about too big to fail. There are two questions here. One is, why do we do it? I think that is easier. And, what do we mean by it? And that may be a little harder.

I think the "why" is basically that if you have a situation where there are no good options to deal with a large failing bank, you've got to try to do something else. I think the Continental case stands out because concerns were real. There were, in fact, a few purchase and assumption possibilities. Not only would they have been very expensive, but I think they would have been subject to more political criticism than the transaction that ultimately occurred. The notion of paying off Continental was never a serious consideration. I think it is important to appreciate that the FDIC did not have the capacity to pay off a bank that size, and quite frankly, I don't think the FDIC today has the capacity to pay off banks with a very substantial number of deposit accounts, at least not without many problems. Perhaps I'm wrong and I would be interested in hearing about that.

But, the concern too was that any significant loss to depositors would have probably had substantial impact on a number of money center banks that were in serious trouble. I recall that when the loan was made by a number of New York banks at the time to bridge Continental's liquidity situation, the most vocal supporter of that was John Magilacutty at Manufacturers Hanover and for good reason. Our concern was that they were clearly the most exposed bank and would have experienced a substantial run if, in fact, some depositor losses were inflicted on Continental. Unfortunately, it was not a good time for a P&A transaction. Continental, at that point, had little franchise value. There were few interested parties. Prevailing rules with respect to interstate branching or permissible activities limited foreign interests, and while there was a possibility of changing the law to accommodate a domestic P&A, the general environment was not a healthy one. The more logical bidders were not in very strong condition.

I think that in today's environment, until we started to look at the top two, three or four banks, it would be hard to think of a need to do open bank assistance for a bank in Continental's situation. Continental was perhaps the 10th largest bank at that time. I think there are lots of options today. There are, perhaps, at least a half-dozen strong foreign banks as well as domestic banks that would give you options for a very large P&A transaction.

But, the other aspect of too big to fail is, are we willing to impose losses on depositors in very large banks and whether we have the capacity to do it? There had been some proposals in the past to haircut large bank depositors in the P&A transactions. I think I wrote one of those for the American Bankers Association several years ago. But, the FDIC has never seemed to be enthusiastic about those options. So, I think what too big to fail has come to mean is that by and large, we are not going to have depositor losses in the largest banks; and in fact, it is my impression that we probably have not had any depositor losses in any bank over about $2 billion. Also, I don't think we have had any losses to foreign depositors in any U.S. bank failure.

Is this a cause for real concern? There is obviously concern about fairness, that similarly situated depositors can be treated differently in different banks—competitive concerns that uninsured depositors in smaller banks are exposed to loss and larger banks are not. There is also concern that short-term practicality is going to undermine longer run financial market discipline.

What is the reality here? First of all, smaller banks and medium sized banks, actually hold very little in the way of uninsured longer-term deposits. In most bank failures, the amount of uninsured depositors by the time the bank fails tends to be very, very small. Actually, it's the larger banks where that becomes an issue because if you started out with 50 percent of your deposits uninsured, there is a limit to how much depositor flight you can absorb without the regulators stepping in.

As far as the question of discipline is concerned, I think there is enough ambiguity and uncertainty in the law so that depositors are still not going to feel that comfortable in a large troubled bank. The large depositor is going to feel exposed and he's going to try to get out. There are pressures on fund managers to get out. The behavior of the bank itself is going to be influenced by the fact that if it gets into trouble, it's going to have a liquidity problem. So, I think that whether or not we impose those losses, people behave as though those losses are going to be imposed and I don't think discipline is substantially undermined. I have to confess to having some ambiguity in my own feelings on this issue, and I'll come back to this.

There is also a lot of supervisory discipline that we didn't have before. We have risk-based insurance premiums. Not only is there a cost associated with it, but for a publicly owned bank, it is very easy to determine that a bank is paying a high deposit insurance premium by just looking at its financial statements. There is a greater willingness to pursue enforcement actions and again for a publicly-owned bank that is going to be considered a material event and require disclosure.

We've got improved data quality. The quality and speed of reporting is such that large banks have got to be very sensitive to the market implications of getting into difficulty. So, if there is a problem about not imposing losses on depositors in large banks, as a matter of principle, I don't think the actual behavior of the institutions is going to be dramatically influenced by that fact. Maybe a series of bail-outs of depositors in large bank failures will change that. But, at this point I wouldn't have great concern.

On the other hand, I do believe that on occasion, imposing losses on depositors has actually produced some positive results. When depositors at Penn Square were paid off, it got an enormous amount of attention. It had a substantial impact in the marketplace, and actually caused the Federal Reserve to ease interest rates at a time when Fed policy had probably been too tight. Occasionally that kind of market phenomenon can have a positive effect in terms of forestalling overly aggressive behavior. That was 1982. In 1983, there was an opportunity to pay off Midland Bank and Texas Bank. The Comptroller was reluctant to close the bank. The bank was not paid off. Eventually, there was a P&A. I have this vague feeling that if Midland Bank had been paid off, that some of the subsequent problems in Texas would have been reduced. Again, this is all hindsight and it is easier to look at something like this as a matter of hindsight. Also, it isn't clear whether it is the FDIC's role or whose role it ought to be to sort of shock the market and impose that kind of behavior.

Well, what about the future? I think that consistency is a nice thing to have, but the reality is that sometimes you have to depart from consistency, and I think the FDIC, by and large, has done that at appropriate times, and sometimes done it reasonably well. I think that the more serious issue when we talk about too big to fail relates to what about the three or four or so really big banks. Could we do a P&A with Chase or could there be a P&A connection with the forthcoming NationsBank/Bank of America combination? Maybe you can and maybe you can't, but I think the answer probably is that there are so many potential difficulties that policy ought to be geared so that it doesn't happen. What that probably means is perhaps more monitoring, perhaps a higher capital requirement or a higher threshold where enforcement action occurs. Presumably there is no great difficulty if a large, complicated institution is under pressure to recapitalize and sells off parts of its institution. It is a lot easier if that is done at an early stage than if it's done in connection with a failed bank transaction. So, I think the answer there has got to be that the best way to deal with it is to make sure it doesn't happen and to take the appropriate action to forestall anything that may be happening.

As a final comment, I'm also left with a couple of question marks about big bank failures. One is the ability to impose losses on depositors in very large banks. The other is whether there is any real system in place to deal with a situation where a large U.S. bank with foreign branches fails. Each country has its own rules. There are capital requirements that are imposed on foreign branches, and to assume that the FDIC would somehow be in control of a resolution, probably is not correct.

Again, I think those problems are so complicated that the appropriate strategy is to make sure they don't happen and to deal with those few U.S. banks that have sizeable operations abroad in a way to make sure that any potential problem is resolved well before failure is a possibility.

Thank you.

Wigand: At this point in the program, we're going to turn to our question and answer session. While the participants, meaning you in the audience, are perhaps jotting down some questions you may have, I'm going to follow-up with some comments that Stan made and ask questions of the other panelists and that is, what do you think about the too big to fail doctrine, particularly in light of the consolidation of the banking industry where we're going to have a fairly segmented banking industry in which we have many banks which are small and operate in community niches, if you will, and a handful of very large institutions, the likes of which this country has never seen. So, given that question, why don't we just go down the row. I think Stan has already given some comments on that, but I would like to hear what the other panelists have to say.

Hartheimer: I guess my view is that in this country since deposit insurance was created, we've enjoyed a relatively calm banking environment from the standpoint of the depositor. Notwithstanding that banks are getting larger and larger, I think that while no one at the agency would ever admit that too big to fail exists, it has to exist. It brings up words that I remember from a couple years ago, of systemic risk and contagion and all these great, interesting words. But, I don't think there is discipline in the market that would really ever believe that this government would let Travelers/Citicorp fail. I think you have to take that along with the fact that it is a consequence of enjoying depositor protection. So, I believe it effectively exists, but you would never really know it until you and John walk up to that little conference room off the Chairman's office to say, well, we have a problem. How are we going to handle it?

Mitchell: From my standpoint, the doctrine obviously works counterproductively to community banks. We see a lot of people who limit their deposits to $100,000 and may not do so at other banks simply because they know that doctrine exists. At the same time, the issue for the FDIC to consider is that it insures essentially all deposits under that doctrine.

The problem with it also, the third thing is that it doesn't encourage that discipline. So when someone, a business and/or an individual, is placing their money in a financial institution, they have to be remotely concerned about the general health of that institution. Usually these failures don't come overnight. They can be forewarned. I don't think it encourages that kind of market discipline that I think should exist.

Finally though, if there was such a policy, it could force deposits out of the banking system altogether and even though it may not be fair to community banks, that is not something I think we as community banks would want to see either.

Montgomery: We're going to open Frontier Bank on June 1st. I think by year-end, we will be too big to fail. I don't want to belabor this. I agree with what has been said before. I think you don't telegraph it in advance, but in fact there are banks that are too big to fail and we're just not going to let it happen.

Sarles: I would agree. With the very large banks, they probably are too big to fail. I think you go to Stan's point. You've got to make sure that they are very aggressive in maintaining capital in those banks so it limits the chance of a failure. You need strong supervisory involvement if problems happen to try to begin to think through what you need to do and basically prevent it from happening. Third, I think you need to begin to think through changes in the Federal Deposit Insurance approach. While that probably is an anathema with the politicians, I think with the changes in the financial services business that we need to begin to address that and determine whether something like that is absolutely necessary for some of these large banks. Maybe it is only necessary for banks under a certain size. I think we need a debate on that. In my view, one of the greatest disasters that happened was because of brokered deposits. The problem that Jim said should have been a small problem was magnified by growth from brokered deposits. We allowed banks that were community banks with $15 million in assets, that might have grown to $100 million and after failure could cost you $10 million. Instead they grew to $2 billion in six months with brokered deposits and cost the fund $300, $400 or $500 million. The brokered deposit situation has to be changed.

Wigand: All right—thank you. Now, it is going to be the participants', the audience's turn. We have several people placed throughout the room with microphones. Do any of you have any questions for our panelists?

Joseph: My name is Milton Joseph. This is really a question for Mr. Silverberg, but I think perhaps Mr. Montgomery might have a thought on this. It is a thrift related question. During the early 80s, without being redundant, obviously the problem was systemic interest rate environment and the whole host—no need to repeat all that. But, to me, one of the real tragedies of the thrift industry was Financial Corp. of America—the Charlie Knapp situation. He was the granddaddy, really, of what turned later into the real thrift problem, the credit quality problem. When Knapp was allowed to merge with American, which was really sort of a sleepy but not a problem high net worth ratio S&L, he got the ability to really go forward. I was just wondering, what motivated, in Mr. Silverberg's opinion and perhaps Mr. Montgomery's opinion, the federal regulators to allow somebody with that kind of background who really typified what was wrong with the S&L industry to gain the ability to run an institution of that size, which ultimately created a real thrift catastrophe?

Silverberg: Without commenting on Charlie Knapp, perhaps Jim will, I would just say that you had a situation where the industry was dramatically undercapitalized. I would be much more critical of the regulators. I think that there was an attempt to grow out of the problem. There was an unrealistic assessment about the benefits of commercial real estate lending for institutions that had no experience in the area, and that turned out to be the worst possible time to get involved in the activity. But, I think that when you come down to it, the Bank Board didn't have the funds and they weren't getting the funds from Congress. It was like trying to keep a lot of balls up in the air with the hope that somehow a combination of lower interest rates and other events would bail them out. But, it really was sort of a classic case of rolling the dice when you are trying to deal with too many insolvent institutions.

Montgomery: Charlie was one of a number of flamboyant operators in the business at the time and there was a lot of cheerleading going on from Wall Street and other places about that situation. One of the things that I've always found very strange, we did some studies inside Great Western when we were working on this so-called Montgomery Plan. There was a prevailing thought that the business was the victim of high interest rates, and once interest rates came back down, these seriously undercapitalized institutions were going to be okay. Our studies showed that wasn't the case. You couldn't make one of those things turn around, no matter how low interest rates got, unless you did some very crazy things on the asset side of the balance sheet, which is what happened in a lot of cases. There was a lack of understanding of the fact that once an institution's capital was gone, that capital base was very important not just for safety but for earnings, and they didn't have enough of a spread type of income available to them from traditional thrift activities to take an institution that didn't have capital and make it viable. I think the misunderstanding of that situation caused a lot of people to incorrectly think you could grow away from this problem. While you can see some interesting, dramatic results in some institutions on a short-term basis, it didn't seem sustainable and it turned out not to be.

Burdick: I'm Glen Burdick from A.E.W. Capital Management. A couple of the panelists, particularly Bob and Jay, touched on incentives, I think from both the public sector and from the private sector, and I think both in a positive way. To follow-up on that question, I would be interested in the panelists' perspective on whether the incentives that the public sector, i.e., the FDIC, received under various programs generally were fair, appropriate, and are there particular things, if we get into this situation in the future, are there particular areas where incentives may be better focused from the public sector?

Sarles: I think the challenge at the time for the FDIC was to attract capital into the system and to deal with an onslaught of problems and so forth. So, I think what they were trying to do with a combination of their own thinking, Wall Street, etc., was to come up with different ways and different means of incenting people to put capital at risk or to get involved. That is to their credit. I think that part of the problem is that because it is a public entity and because of this, you've got a doctrine of least cost and all the rest of it, there is a conflict there. I'm all in favor of a process that at least puts it out to a bid-type situation and offers incentives because I think that works best in attracting capital in this country and attracting management. The more you can do the better. The difficulty is that the minute you begin offering an ability to wheel and deal, you're going to have people second-guessing saying, oh, they didn't follow this rule, or oh, you didn't do this right—my God, haul them up before Congress and let's beat the living whatever it is out of them. That is too bad. There is a tension there. On the one hand, you want all the incentives possible. On the other hand, it isn't possible when you're a government agency. So, there is a line and I thought they did a pretty good job at it.

Hartheimer: In chatting with Jay before we all started, we were just talking about the banks Fleet bought. Jay had a comment which I thought was interesting. He said, yeah, it was relatively easy and then loss sharing came, and that was a little bit more difficult, which is a good sign, I think. But, it also tells me that while I'm a big proponent of incentives, I think the environment has to be right. When I got to the agency in 1991, with Crossland being the first real big one—I had gotten there right after New Hampshire had occurred and Southeast, and that was not an environment where incentives worked because there were no buyers and no one believed that the real estate world was going to turn around. So, I think that the agency has lived through and people here have lived through environments where incentives work and incentives don't work. I think you need to look at the environment and try to figure out whether you can push the envelope a little bit. If you have just enough bidders, then you layer in incentives. What was it—Michael Douglas said, "greed is good." It worked great for us in the early 90s when there were a lot of buyers. You could have the discipline of creating a structure, forcing bidders to bid only on that structure. It used to drive all of us crazy when bidders would lob in at the last minute a bid that was "nonconforming" and when the environment got better in 1992, we felt pretty good about saying you only can bid on this structure. But, it is the environment, I think, that drives the incentives and I think it has to first be looked at and then the agency should continue to push the envelope, as I believe they are doing.

Crocker: Don Crocker. There were at least four versions of the bridge bank. One was the Southwest plan, the bridge bank, the conservatorships, and also the management consignment program. Each one had a different approach to trying to figure out how do you keep this institution without losing all its depositors, without creating additional losses to the fund, and I'm interested in what the panel thinks of the best of the various versions for the future?

Silverberg: I think that there is obviously a distinction between the conservatorships which was just sort of a hold reaction in which the institutions could then be divided up and so forth and the bridge bank. Bridge banks became an option after I had left the FDIC. It was not an option, for example, with Continental. I always had mixed reactions to them. On the one hand, it would be nice if you could effect a clean transaction immediately without having to go through the bridge bank process and have the government involved heavily in that process. But the reality was that in a complicated transaction, it has been very hard to do.

Sarles: Our experience was very positive. I thought the bridge bank concept worked extremely well with Bank of New England. It worked because, in my view, there was a management team there. The minute we were picked as a bidder, we became involved and it was a short process to closing. What it did was it kept intact the franchise. It kept intact the customers, and that was a large part of what we saw in terms of the value. As long as the process is short, I think it can work very well and I think it is a terrific vehicle for creating the most value for the fund and for the ultimate buyer. What I'm not in favor of is having long-term ownership, in the public sector. I think if you want to get some of the upside, that it would be as an investor in the ultimate buyer of the bank, and not holding it from that standpoint. But, I thought the bridge bank concept worked extremely well. If they closed it down and tried to auction pieces, I don't think they would have done anywhere near as well in terms of recoveries. So, I'm a big proponent of it as a very workable solution.

Montgomery: I think these are all time-buying devices. I think they all work reasonably well. We had some good experience with a management consignment program. But, I just think any of those things should be tools to be used in the future to buy time until you can get a real resolution.

Mitchell: I would agree with all the comments, but since my experience is not extensive with it, I'll just defer to Bob.

Hartheimer: I guess as you think about each of the structures you mentioned, they all really came at different times in the crisis for different reasons. The conservatorships really were created because there was just a supply of failures that it was impossible to sell them off. So, it did buy time. The management consignment program, I'm not that familiar with, but my sense is it was really before the big crisis and it was a way to just forestall any activity at a time when the FSLIC had no money. Bridge banks—really the secret in all of this, when we talk about the protection of the depositor, that is a given.

What we found as the secret is how best you dispose of the assets because, until the last couple years, you couldn't imagine people paying anywhere near the value for deposits that are being paid today and people are paying upwards of 30 percent of deposits today. But, back in the early 90s/late 80s, you would pay 5, 6, 7 or 8 percent. But, there was a huge differential in the value of assets and the cost of assets. You could lose 20 percent of your asset value overnight if it wasn't managed right. So, I think these tools were really best used to manage the asset disposition and that is how they should be used going forward. I don't think you're going to see many conservatorships because it is unlikely that you will see the supply of failures. But, you should see bridge banks if you have complicated situations to take some time to figure out how best to dispose of the primary assets.

Murden: Bill Murden, Treasury Department. I have a two-part question on open bank assistance that I would like to follow-up on. Japan recently used open bank assistance for its banks in a way that is different from FDIC's experience. So, the first question is what the panel's views might be on the appropriate conditions that should accompany open bank assistance in terms of management and shareholders, etc.? The second, [what are] the pros and cons and the various forms of open bank assistance in terms of subordinated debt, preferred stock, asset purchases and so on?

Wigand: Are you directing your question to anyone in particular, or do you want to hear all panelists' views?

Silverberg: Anyone who has been through the process would tend to be very skeptical of open bank assistance, but if you don't know what the future situation is going to be and what the options are, maybe you've got to at least keep it on the table or under the table, as a possibility. If you've got an option of bringing in a new bank, bringing in new management and so forth, that is easier to rationalize. However, there have also been a lot of changes that make closed banks somewhat more attractive. Depositor preference, the fact that some of the provisions in FIRREA allow easier closure of branches and impose limits on existing contracts and so forth. There is some advantage to acquiring a closed bank rather than putting in assistance and having somebody else come in. But, again, I think there is a strong feeling in this country that if an institution has gotten into difficulty and become insolvent, the marketplace says it ought to go out of business.

Sarles: I'm not in favor of open assistance, but you may need that approach once in a while. If you use it, in my view, you wipe out the existing shareholders and management.

Montgomery: I don't have anything to add.

Mitchell: I would have to agree with the comments that were made. When a bank is on the verge of failing, it ought to be closed and prior to that is when management and the shareholders have their opportunity. So, they should be wiped out.

Hartheimer: I guess I would only add if you can attract a significant amount of outside capital, which would be in the first-loss position, I think you can find situations where that would make some sense. The problem is, there is never enough capital and there is always a differing view of the condition of the bank the examiners have. And in Japan, I'm not really that familiar with what is going on there, but my guess is that they have big problems and they need to be creative instead of just taking over all of these banks. If there are piles of money around the world that are kind of hovering to be invested, I think they ought to try and see if they can get those piles of money to be the first-loss positions, versus the Japanese Treasury.

Wigand: As you will note in your agenda for this symposium, we do have a panel tomorrow which will actually be talking about international banking issues associated with failures, you may want to ask this question at that time as well.

Comment: On open bank assistance, I might mention that we did have a program that worked pretty well, I gather, in the 1930s—the RFC. There was a use of preferred stock and bonds that helped capitalize banks that I gather were considered to be solvent. But, again, it was a program that I think hindsight gave fairly high marks to.

McKinley: I'm Don McKinley of the FDIC. Maybe this is for Bob and Stan, but when you look at the current legal environment of prompt corrective action, systemic risk, least cost test, and you look at the nature of the banking industry as it has changed, non-bank activities, bank activities, perhaps you have some type of assessment of the reaction time that the government might have in responding to that hypothetical large bank closing. How do you see the FDIC's ability in terms of reactive time as compared to the time we had in the past to respond to the large failures like Continental or First Republic?

Hartheimer: Well, I spent my Thanksgiving—I think it was 1994—courtesy of Chairman Helfer, preparing a plan for a big failure of a bank that had some derivative problems. I think that it's one of the situations for which you never can prepare enough, but we had a team of probably a dozen people that spent four or five days, we put a plan together. No one really expected this bank to have problems, but it was a good exercise—it wasn't great that it was over Thanksgiving. But, it was a good exercise to do. I think you at least outlined the things that you know you have to face when you get there. But, it is something that could be handled by the agency. You'll continue to go through trial runs, but I think it is just—it keeps the resolutions thinking young in a sense by continuing to think about how you handle derivative contracts or the sales of subsidiaries in non-bank activities and things like that. I don't think it is anything the agency can't handle if it happens.

Silverberg: I just think that the quality of available data and the quality of accounting and audit reports are much better than they were in the past. The speed and ease of access and so forth is much better. In the case of publicly-traded banks, I think there really has been a quantum improvement over the past decade.

Wigand: Unfortunately, that is all the time we have for questions. At this time, I would like to once again extend my thanks and I'm sure the audience would like to extend their thanks to the panelists for coming today. We certainly appreciate hearing their perspectives on resolution activity during the crisis years, and I think the comments that we've heard are very insightful.

We are breaking for lunch now. Lunch will be served in five minutes in the room right next door—the North Ballroom—and then we will be reconvening here at 1:30 for the asset disposition panel. See you then.

Luncheon Address

Introduction

John Bovenzi, Director
Division of Resolutions and Receiverships, FDIC

It is my privilege today to introduce our luncheon speaker, Joseph H. Neely, a native of Grenada, Mississippi. He attended the University of Southern Mississippi, where he obtained a Bachelor of Science degree in Business Administration, majoring in Finance. Joe continued his studies as a Graduate Fellow at the University of Southern Mississippi and earned an MBA degree. Joe Neely began his banking career in 1977 with Grenada Sunburst Banking System, serving in the lending area of the bank. In 1980, he joined the Merchants National Bank of Vicksburg, where he served as Senior Vice President. In April of 1992, Joe was appointed Commissioner of the Department of Banking and Consumer Finance for the State of Mississippi. In July of 1995, President Clinton appointed him to the FDIC Board of Directors.

Joe Neely became a member of the Board of Directors of the FDIC on January 29, 1996. I can attest that since coming to the FDIC, Joe has been an active participant in FDIC activities. He takes his responsibilities seriously, regularly asks tough questions to be sure the job is being done right, yet Joe is always approachable and extremely supportive of the staff.

It has been a pleasure to work with someone as dedicated and as sincere as Joe Neely, and when Skip Hove, our original luncheon speaker was called to testify before Congress this morning, Joe was gracious enough to accept a last-minute invitation to fill in. Despite the late notice, I'm sure you will find his comments thoughtful and interesting. Please join me in welcoming FDIC Director Joseph Neely.

Joseph Neely
FDIC Director

Thank you, John.

On behalf of the corporation, let me welcome everyone here. I hope you find that this day and a half is worthwhile to you and worthy of your time and attention, and I hope you are able to take something away from this. I know that to many of you in this room, this is a very personal subject to you and a good bit of your hide, so to speak, is invested in this process that we're reviewing here. Thank you again for coming because without your participation this conference and symposium wouldn't be what it is.

We use military comparisons a lot in making analogies, in making points, and the military a lot of times is very appropriate to use in such situations. I know many times in talking to bankers and as a supervisor, and even as a banker, I always felt that a military perspective pretty much described the proper structure of a bank where the shareholders were like the generals. The shareholders are the ones that staff the army, or they pick the staff they want to carry out the mission. The directors are the strategists and do just that—set strategy and set direction for the bank and if the directors try to do a whole lot more than that, they are probably complicating the issue. If anybody else tries to direct the bank, other than directors, sometimes you can have a problem.

The CEO is more like the field marshal or the director in the field. The CEO leads the bank and says, "we want to go in this direction—let's go over here." Management is like the lieutenants—the management of the bank takes care of the day-to-day operations and makes those decisions and arguably runs the bank. Then the employees are like the ground troops. The employees are the ones that actually take the battle to the enemy, if you will, and carry out the directives of all their supervisors.

In this light, in military affairs there is something called the fog of battle. This refers to uncertainty—the uncertainty of your terrain, the uncertainty of enemy forces you may face, the uncertainty of the adequacy of your own forces, or events over the horizon that may have a bearing on the battle at hand. The art of military leadership consists of bringing order out of all of this chaos, an art that requires one to continually adapt to changes in situations in the field in order to obtain the objectives or obtain the achievements that you seek to achieve.

Please bear with me for a moment or two as I defer to our former Chairman and well-respected Bill Seidman, who is here today. His statement in the FDIC's 1990 annual report, I enjoyed very much. I was telling him earlier today. Going back to the last 10–12 years of FDIC annual reports and reading certain excerpts from the Chairmen as they recapped the year's events and made prophecies about events to come, Bill said in the 1990 report, "Entering 1990 it was clear to everyone associated with the FDIC that it would be a very difficult year for the agency. We would struggle with mounting problems in the banking industry, particularly in real estate portfolios. We would face the prospect of additional losses to the Bank Insurance Fund. We would have our first full year addressing the savings industry problems through the operations of the

Resolution Trust Corporation, and as back-up supervisor of savings associations." But, Chairman Seidman concluded that as the year unfolded, "1990 presented difficulties and challenges far beyond anyone's expectations."

The FDIC and the RTC were truly in the midst of the fog of battle where uncertainty reigned. Years of economic expansion can erase a lot of bad memories. We've heard reference to that this morning—current economic and banking conditions tend to move some of the events so personal to many of us further and further into the past. But, the world is different now than it was then. As time passes, it becomes harder and harder for many people to recall how threatening the banking and thrift crisis of the 80s and early 90s was. Many of you remember, however, because you worked day in and day out to face the crisis and to keep the threat at bay.

One of my favorite sayings is that an organization is in trouble when it has more memories than it has dreams, and that is true. I think it is very important, particularly with some of the events taking place today, that we have to take a very proactive attitude at the FDIC. But you are also equally familiar with the saying, that those of us who do not remember our history are doomed to repeat it.

And that is what this conference is all about. I was particularly impressed with a comment by Doyle Mitchell this morning. He said that hindsight is 20/20, but only if you look. So, that is what we're doing hopefully this day and a half.

How bad was it? Just how bad was it? Focusing on 1990, the excerpts of the 1990 annual report, Bill Seidman's comments, commercial banks in 1990 earned $16.6 billion for the year. In contrast, commercial banks earned $15.3 billion last quarter of last year. Year-end 1990, there were 1,046 banks on the FDIC problem list. As you well know, this was down from well over 1,500 banks at one time, with over $530 billion in problem bank assets.

At year-end 1997, there were 71 commercial banks on the problem bank list, and they held $5 billion total in problem bank assets. Likewise, at year-end 1997, there were 21 thrifts on the problem thrift list with $2 billion in total problem thrift assets. In 1990, 168 banks failed after three consecutive years of having over 200 banks fail annually and massive failures in the thrift industry. Those 168 banks held about $14.5 billion in assets. That was bad enough. But, in 1991, 124 banks failed and they held assets close to $54 billion. Last year, one commercial bank failed and it had assets of slightly over $27 million. In 1989, 330 thrifts failed with total assets of $136 billion. Last year, no thrift failed and no thrift has failed in the last 21 months—rather staggering given the focus of what we're here about for this day and a half.

Over a 15-year period from 1980 to 1994, a federally insured depository institution failed on an average of every other day. At the height of the crisis, the five-year period 1988 through 1992, a bank or savings institution failed on average every day. On one day, institutions holding one-third of the banking assets in the State of New Hampshire closed—in one day.

Looking at it another way, during the 15 years of crisis that this symposium covers, institutions holding one-fifth of the assets of the banking system—20 percent of the assets of the entire system—either failed or received federal financial assistance just to stay open. During that threatening time, not one person lost a cent in a federally insured account. The FDIC and the RTC managed to liquidate hundreds of billions of dollars in assets and through the hard work and leadership of many people who are participants in this very symposium, and many, many other people working for the sister agencies—the FDIC and the RTC—many people in this room, many people watching this through live remote, many people who have gone on to other careers and many people who have retired. Order was created out of chaos and our objectives were met. We are here today and we'll be here tomorrow to discuss just how that happened and to distill from that experience lessons for the future, should we ever have to face similar prospects again.

The objectives were simple to express but difficult to achieve—to maintain public confidence while restoring financial stability. Stability is a goal, not a given. Either directly or indirectly, everything the sister agencies did was aimed at achieving those objectives, while encouraging market discipline, consistency and cost effectiveness. The FDIC and the RTC were constantly doing things to meet those objectives. Obviously, they met them.

In essence, the strategy of the agencies was to make a bank failure a non-event for an insured depositor. Before the creation of the FDIC, depositors had learned from experience that if they kept their money in a bank, it might not be available when they needed it and they might lose a large portion of it as well. As a general practice between the years 1865 and 1933, depositors of national and state banks were treated in the same way as other creditors. They received funds from the liquidation of the bank's assets after those assets were liquidated. The time taken at the federal level to liquidate a failed bank's assets to pay the depositors and close the books averaged about six years, although in at least one case it took 21 years.

From 1921 through 1930, more than 1,200 banks failed and were liquidated. From those liquidations, depositors at banks chartered by the states received on average 62 percent of their deposits back. Depositors at banks chartered by the federal government received an average of 58 percent of their deposits back. Given the long delays in receiving any money and the significant reduction in deposits that were returned, there is no wonder at all why anxious depositors would withdraw their savings at any hint of a crisis or any hint of a problem, thus triggering bank runs.

With the wave of failures in 1929, it became apparent that the lack of liquidity resulting from the resolution process that was currently in place contributed significantly to the economic problems and consequences in that period of time in the United States.

The FDIC in the 1930s, and the FDIC and RTC in the 80s and 90s, gave insured depositors access to their funds as quickly as possible and uninsured depositors as much of their money as possible as quickly as possible to maintain public confidence in the system and to restore liquidity in the economy. For all insured depositors, this was an absolute guarantee. For the vast majority of depositors in the most recent crisis, the subject of this symposium, this meant virtually no loss of access to their money. Banks may fail, but as far as insured depositors were concerned, the banking system continued to operate without pause.

As circumstances changed in the 80s and 90s however, the agencies changed their way of doing business to follow the strategy of making a bank failure as much of a non-event to depositors as possible. The rising tide of bank failures prompted innovation and creativity. Until 1983, for example, the most typical bank failure resulted in a settlement of deposit insurance by either an FDIC-assisted merger or by a direct payment to the insured depositor—the insured payout where depositors would line up to get their money from the FDIC. Fifty-one of the 123 banks that failed in the 60s and 70s were resolved through a deposit payout. As a general matter, few of the failed banks' assets were passed on to the acquiring institutions in those times.

In 1983, the FDIC pioneered the use of a new technique—the insured deposit transfer—where the agency auctioned a failing bank's insured deposits to a healthy bank. The premium that the acquiring bank paid helped lower the resolution cost. Depositors had an account in a healthy bank as a result—with immediate access to money—usually the next business day after the transaction.

For uninsured depositors, the FDIC developed a methodology for getting an advance dividend into the hands of uninsured depositors as early as possible. This advance dividend was an estimate of what the uninsured depositors would receive if assets were liquidated. Innovation, therefore, made things easier for both the insured and uninsured depositors and provided liquidity for the economy.

Measured by type of transaction, about 74 percent of the resolutions of failed banks in the year 1980 to 1994 were purchase and assumption transactions. About 11 percent were insured deposit transfers, 8 percent were open bank assistance, and a little over 7 percent were deposit payoffs. We saw a slide this morning, the pie chart showing that very thing.

I want to touch on just a few of the other innovations that the agency developed. The most dramatic attempt by the FDIC to pass assets from failed banks quickly back into the private sector was a whole bank transaction, a variation of the P&A—the purchase and assumption. Along with liabilities, almost always both the insured and uninsured deposits and virtually all of the failed bank's assets, were passed to the acquirer for a one-time cash payment. Whole bank transactions kept down the volume of assets that the agency had responsibility to liquidate and therefore preserved the liquidity of the deposit insurance funds and the transactions transferred risk from the agency to the acquirers. Overall, the FDIC completed 202 whole bank transactions from the years 1987 to 1992, almost one-fifth of the total number of transactions during the period.

As the volume of bank failures in the mid- to late-80s increased, the FDIC began to look for ways to pass more of the failed banks' assets to the acquirer. One way of doing this was through a put option. The FDIC and later the RTC would require an acquirer to take assets but gave them an option to return or to put back the assets they did not want to keep. This innovation also conserved liquidity in the insurance fund.

The third innovation in the resolutions process was the creation of asset pools, pioneered by the RTC, which gave investors the flexibility to bid on pools of similar loans at prices set by the agency. Potential acquirers were often reluctant to assume large loan portfolios that did not fit their current business strategies. By selling loan pools separately from the deposit franchise, the resolution options were expanded.

Another wrinkle in the P&A methodology was the loss sharing transaction whereby as many assets as possible were transferred to the acquiring bank and the acquiring bank managed and collected the nonperforming assets. As an incentive to enter the arrangement, the FDIC agreed to absorb a significant portion of the loss on a specified pool of assets with the acquiring bank liable for the remaining portion of the loss. Each of these innovations and others were designed to encourage the private sector to become more involved and to take more of a role in the resolution of failed banks.

In that regard, probably the most innovative method the RTC used for asset disposition was equity partnerships—joining in partnership with private investors who would use their expertise and their efficiencies to recover more value from troubled assets than the agency would have been able to recover. In all, the RTC created 72 such partnerships which had a total asset book value of about $21.4 billion.

The agencies also looked to the private sector for guidance and for additional resources. For example, in 1990 the RTC was holding more than $34 billion in mortgage loans. After a disappointing performance in bulk sales, the RTC turned to the mortgage-backed securities market for assistance in liquidating these mortgage portfolios and establishing its own securitization program. It couldn't have been more successful. The RTC sold approximately $43 billion in mortgage loans through this program—more than 500,000 single-family, multi-family, commercial, home equity and mobile home loans were repackaged and sold as securities.

In all these innovations, and in all others, the FDIC and the RTC exhibited flexibility by changing their ways of doing business to adapt to changing circumstance. They exhibited independent thinking, embracing the new and the untried methods. The FDIC exhibited a desire to apply that flexibility and independent thinking in ways that would preserve the liquidity of the deposit insurance fund and to hold down the cost of bank failures. The agencies made mistakes, and we'll talk about those mistakes, as well as successes, over the next day and a half. But, by the end of the day, the FDIC and the RTC performed their mission—maintaining public confidence and assuring stability. It has been said this morning that it is awfully easy to look back and to criticize. What I always said as a banker and have said since then is that I don't think we ever want to find out what the cost of the alternative might have been.

The agencies didn't manage the failure of institutions—that was simply a means to an end. The end was managing the crisis.

One of my most memorable experiences concerning the FDIC was as a state supervisor when I worked very closely with a regional director who was retiring. We called a bank board in, and we had a problem situation and were preparing for a very intense meeting. We broke for lunch before we sat down with this bank board. He was leaving after about a 30-year career with the FDIC and I really wanted to pick his brain because I knew I was possibly going to end up on the FDIC Board. I respected him a lot. I asked him, “after your 25–30 year career with this corporation, what do you leave here with? What reflections?” We were on the 19th floor of the office building—that gives away the region—doesn’t it. He looked out the window and was in a very pensive and reflective mood, and there was some fellow walking across the parking lot to a bank that was across the parking lot. He said, “you know Joe, I think I leave here with one major overriding thought—that fellow right there (and I looked out the window and thought maybe it was somebody he knew), that fellow right there has no idea how close we came. That fellow right there is going to his bank to make a deposit or make a withdrawal with total, absolute, unquestioned confidence in the banking system and the deposit insurance system and the protection of his deposits. That fellow right there has no idea that the absolute financial underpinnings of this industry were under siege. That fellow has no idea that at any given time in the war room, information would come in and we would sit around and say, we can’t do it—we don’t have the resources—we don’t have the people—we don’t have the money—we don’t have the logistics—we can’t handle this. But we did. We had people making decisions well above their level of authority. We had people making decisions well above their delegations of responsibility. We had people working weekends away from home, weeks and months at a time. We had people making decisions at 3:00 a.m., learning how to eat pizza for breakfast. We had people who were doing things they probably weren’t commissioned or authorized to do, but they just did the right thing and moved on to the next challenge.”

Teddy Roosevelt once said that there are three things you can do—the best thing obviously you can do is the right thing. The next best thing you can do is the wrong thing. The worst thing you can do is to just do nothing. One of the dangers, I think, is to run in place. We need to be extremely cautious about that.

One of the things the FDIC didn’t do during the period covered by this symposium was that it didn’t run in place. People made decisions, the right decision or the wrong decision. They followed their heart. They followed their instincts, and they said that we just want to protect that gentleman walking across that parking lot because we’re not sure—we’re scared to think about how close we may be right now. We don’t have time to think about it. Let’s make the decision and try to do the right thing, and let’s just move on.

Another personal experience, if you’ll allow me, was when John Bovenzi talked to me about making this talk. I said to John that I came to the FDIC in January of 1996—I’ve been here two and a half years, approximately. I wasn’t here during this period. Skip Hove was here and I feel a little bit in awe of many of you who were here and fought the battle. I said, I don’t feel like I need to get up there and try to give the impression that I was here during that period of time, so I won’t. I’ll talk about where I was during that period of time.

During that period of time, many times on a Monday, I’d go to the bank, totally minding my own business, trying to maybe do the right thing every now and then. Little did I know that on Wednesday, I might be in some motel room or hotel room in a neighboring city with reservations having been made under some clandestine name or purpose. I was going through the proper clearances to be allowed to go into a room where a transaction was about to take place unlike any in America. I had the opportunity to go in and witness a bid meeting on several occasions, and to see the process work. Again, on Monday having no idea until I got the call that I might be in Baton Rouge, Louisiana, Jackson, Mississippi, or somewhere else. On Wednesday, knowing that I probably would go ahead and check into that hotel and spend the next 48 hours with my people trying to put together a bid presentation. No other business, no other entity, no other assets are transferred under such circumstances. As a banker, I was so in awe of watching the system work. What was even more impressive, as a community banker from Mississippi, bidding on what was at the time, in the scheme of things, an insignificant pool of assets or a relatively small institution, I was made to feel like that was the only transaction taking place at the time.

I was always impressed with the innovation, the creativity, the ingenuity and the imagination of the people I was dealing with. No deal was too ridiculous to consider because the issues at hand and the job at hand were too important.

And, on Friday, we would cross our fingers not knowing if we wanted to win or lose, because we knew we had to open on Monday, exactly one week from the time I got that first phone call. We were in a new market, in a new bank, with an acquired customer base that we didn't know. We didn't know a single one of them, wondering if we could retain those deposits, employees, and customers.

The second part of that is that I was there after the FDIC/RTC left. You went on to your next assignment and I was there with my new customers. Not only were all the bankers in awe and proud to watch the system work, but you can't imagine the gratification of sitting down with formerly uninsured depositors, fairly unsophisticated people in many circumstances, who had been tremendous beneficiaries of the system and for the first time were realizing it. To sit there and work with these people and make the introductions and try to get them to stay with your institution, and then watch them come to the appreciation of what had just transpired and how they had benefited as a result. Benefited from a unique system that doesn't exist anywhere else. It was quite a rewarding experience.

So, I wasn't here at the FDIC at that time, but I certainly saw it from a different perspective.

The seasoned military officers will tell you that the true enemy on the battlefield is uncertainty. In resolving the failures of the 80s and the 90s, the FDIC and the RTC were often in unknown territory, unsure of what would happen next, how their plans would be disrupted, but by keeping their eyes on the objective, their eyes on the goal, and their eyes on the mission, they overcame uncertainty. Perhaps, that is the greatest lesson we can take away from this whole experience.

Thank you.

PANEL 2

Asset Disposition

Introduction

John Bovenzi, Director
Division of Resolutions and Receiverships, FDIC

Our afternoon panel will focus on asset disposition. The moderator of that panel is Sandra Thompson, who is the Assistant Director of Asset Marketing at the FDIC. In this position she oversees the marketing and sales activity for the FDIC's asset inventory. Prior to assuming this position in March of 1997, Ms. Thompson was manager of securitization and mortgage-backed securities administration and was responsible for the administration of FDIC and RTC securities and equity partnership transactions. Ms. Thompson worked at the RTC from September of 1990 until its closing in December of 1995, and was assistant vice president of securitization management and directed the securitization and equity partnership programs for over $54 billion in loans and other assets. Prior to joining RTC, Ms. Thompson was an investment banker at Goldman Sachs & Company, where she worked on mortgage-backed securitizations for banks, thrifts and insurance companies. She holds a Bachelors in Business Administration in Finance from Howard University, and as you can see from all this, is extremely knowledgeable about a wide range of asset disposition activities that have gone on at FDIC and RTC. We're glad to have her moderating this panel. If you would welcome Sandra Thompson, we'll turn it over to her.

Sandra Thompson, Assistant Director, Asset Marketing Division of Resolutions and Receiverships, FDIC

Good afternoon. I must tell you that it was very difficult to prepare remarks for this panel's discussion. There are so many issues that should be addressed and each one deserves an appropriate amount of time and consideration. How do you really explain the magnitude of what was done? How do you put into the proper context that during the crisis the government sold over $1 trillion in assets without exacerbating the very problem it was supposed to solve? Do you explain that during the crisis the government acquired and had to sell assets that it never owned before, such as junk bonds, oil drilling rigs, energy and agricultural loans, derivatives, undeveloped land, environmentally impaired assets and subsidiaries? Or, do you talk about the fact that the government owned assets in all 50 states, Puerto Rico and the Virgin Islands, and had no central computer system? Do you discuss that at the height of the crisis, the FDIC and the RTC together owned over $126 billion in assets? How do you sell this many assets in a depressed market when you're mandated to obtain the highest possible price? Do you sell quickly or do you take your time? Do you talk about how soon you learn that you can't use the same marketing strategies that worked well when you sold the $100 million in assets, when you have $100 billion? Do you sell using in-house staff, or do you hire private contractors? Should the assets be sold from headquarters, or should you open sales offices around the country? How do you level the playing field so as to give equal opportunities to small investors and large investors, to community banks and Wall Street firms, to majority-, minority- and woman-owned firms? How can you ever describe the pressures of the extreme governmental and public scrutiny? How do you value your portfolio? Do you estimate projected collections or do you value initial cash flows? Do you sell assets with government guarantees, or do you offer seller financing? Do you sell with reps and warranties, or do you sell as-is? Which sales methods work best? Do you sell real estate through brokers, sealed bids, or auctions? Do you sell loans using bulk sales, securitizations, or equity partnerships? How do you ensure that your affordable housing program is effective? How do you explain that the government took the crisis personally, that many of the sales strategies were created only after we found out how some smart investor received a great deal from the not-so-smart government? How can you describe the feeling you get when you sell a package of loans for 70 cents on the dollar, only to later find out that your buyer repackaged and sold the same loans for 90 cents on the dollar?

How do you feel when the country reads daily, and in detail, of the huge profits investors receive when they buy assets you are responsible for selling? How do you explain that because of the crisis, assets were sold that had never been sold before? Because of the crisis, new markets were created for delinquent and defaulted loans. Because of this crisis, structures were developed that aligned incentives between buyer and seller. Because of the crisis, there is a commercial securitization market. Because of the crisis, partnerships were formed between the public and private sector. How do you make it clear that old strategies were enhanced and new strategies were developed, and that often trial and error dictated the evolution of the innovative methods that were used by the FDIC and the RTC to sell assets?

I'm not sure if all of these questions will be answered today, but this distinguished panel will address many of them.

Dr. Lawrence White will begin our discussion. Dr. White is currently a Professor of Economics at New York University, Stern School of Business, and from 1986 through 1989, he served as a member of the Federal Home Loan Bank Board. Dr. White is the author of numerous books and articles, including the *S&L Debacle: Public Policy Lessons for Bank and Thrift Regulation*.

Following Dr. White will be attorney Hubert Bell, owner of the Law Offices of Hubert Bell in Austin, Texas. Mr. Bell previously worked as acting general counsel for the Texas Banking Department, where he was directly involved in bank and regulatory matters during the late 80s. Mr. Bell will also talk about the asset that wasn't on the corporation's balance sheet—professional liability suits.

Following Mr. Bell will be David Cooke, currently a Director at the Barents Group, formerly an advisor to the Agency for International Development, the Treasury Department, The World Bank, and the International Monetary Fund. He was also formerly president of the Commercial Mortgage Asset Corporation and, prior to that, David Cooke was the executive director for the Resolution Trust Corporation from 1989 through 1992.

Following Mr. Cooke will be Ted Samuel, former Chairman and CEO of the Niagara Portfolio Management Corporation, where his company managed the liquidation of over $2 billion of assets from Goldome Bank. Mr. Samuel was also an Executive Vice President with NationsBank, where his group managed the first asset liquidation agreement for the FDIC. Mr. Samuel was also instrumental in developing many of the structures that were used to sell assets at the RTC.

Winding up the presentation will be Diana Reid, a Managing Director of Credit Suisse First Boston. Ms. Reid joined the First Boston Corporation in 1983 as a Vice President, where she was responsible for forming and trading their mortgage capital group.

Now, I would like to begin the panel's discussion with Dr. Larry White.

Dr. Lawrence White, Professor of Economics
Stern Business School, New York University

Thank you, Sandra. I'm very pleased to be here this afternoon. The FDIC is to be greatly congratulated on having this conference and on doing the studies. I can't claim that I've read every word in them, but I have scanned and skimmed them, and they are very impressive. They are going to be a very valuable resource for historians, and for others who want to learn from the experience of the 80s and the 90s. The men and women who are responsible for these studies really are to be commended.

Now, as a number of the speakers this morning reminded us, there was a world before the RTC, and that is what I'm going to be talking about.

As Sandra mentioned, I was one of the board members of the Federal Home Loan Bank Board from November of 1986 until August of 1989, when the Congress of the United States legislated me out of existence. They probably would have liked to have done more serious things to me than that, but that is all they could do.

I want to make a number of points about the experience of the agency in terms of asset disposition during the time I was there, and (as best I can tell) during the years before.

Let me start by saying that the agency was ill-prepared for the wave of S&L failures that began in 1985. This is not meant to be a slam at the men and women at the agency. I constantly had great respect for their expertise, for how much they did in a comparatively small amount of time with a comparatively small amount of resources.

But, the industry of the 1980s was a very different industry than it had been in the 1960s and the 70s. Jim Montgomery: with all due respect, the industry of the 60s and 70s was a very sleepy industry. And, the agency was geared to that industry of the 60s and the 70s. Even the wave of interest-rate-generated failures of the early 1980s, the interest rate mismatch, the borrowing short and lending long problems of the industry of the early 80s, had really not prepared the agency for the wave of problems that engulfed it in the middle and late 80s.

Now, asset disposition, which is what this panel is about, was really a neglected area at the agency. The major action was in making deals via whole bank resolutions. This was an efficient way of disposing assets. The disposition of assets on a one-by-one individual basis out of a receivership was laborious, it was time-consuming, and quite honestly it was outside the leadership's expertise. I, for sure, didn't know a whole lot about disposing of assets, about selling real estate. I didn't even know a lot about deal making, but at least I felt I could guide the process of deal making and worry about incentives and good stuff like that. I didn't have a clue about selling real estate, except one clue that I'll mention later on.

Whole bank resolution was strongly favored. It was the way to preserve the firm's going-concern value, any firm-specific capital that might still be there in the institution, and it was the way of keeping assets in the hands of those who were most likely to manage and dispose of them in an effective manner.

As most of the people in this room know or will remember, assets were acquired by the agency when an institution was liquidated—i.e., when there was a transfer of deposit accounts only, or when there was an insured deposit payout, or when we transferred most of the assets of an institution but there were some assets that were so "stinky" that the acquirer said, "I don't want them—you keep them." Either way, we would end up with those assets. If my memory serves me correctly, as of year-end 1987, we had about $7 billion of these mostly stinky assets owned by the agency, ranging from single-family homes to commercial properties to mortgages to loans in foreclosure to securities. Almost by definition, these remaining assets were going to be the stinky assets because the good assets were the ones that either we could transfer with the S&L at the time of disposal, or we could sell them pretty readily, pretty quickly.

Asset disposition was clearly a major problem for the agency. First, the agency was a poor manager of assets, which was a special problem for asset categories like residential real estate that required active management. This point was really driven home to me in May of 1989, relatively late in my tenure. I had volunteered to go on the Phil Donohue Show. Using 20/20 hindsight, I'm not sure it was such a great idea because I really got my backside handed to me on a platter. But, at the time I thought that I should try to go out, tell the story as best I could.

In preparing for that appearance, I was briefed by the FSLIC staff on a wide range of topics and issues. In fact, on the show I wasn't asked about anything that I was briefed on. But one of the things that I was briefed on was some residential real estate that the FSLIC had owned in Chicago since 1983. This was 1989! I asked, "why do we own this stuff? Why do we still own it six years later?" I was given a story, I tucked it away, and I decided that I needed to find out more.

After licking my wounds and trying to heal the verbal bruises inflicted by Phil Donohue, I went back to the agency and started finding out more about our asset disposition process. We weren't doing deals anymore in the spring of 1989. That had been taken out of our hands. We were just putting sick thrifts into conservatorships at that point, and the RTC was going to do all the deals. So, it was now time to find out about asset disposition.

I learned that for a piece of acquired real estate, it looked like we did the right thing. After acquiring it, we would get an appraisal. Then a sales person would have some flexibility. He or she could go below the appraisal and sell at a price as low as 90 percent of the appraisal. So far, so good. But why, six years later hadn't we sold this particular piece of property?

Then I realized that our procedures weren't flexible enough. The appraisal might not have been an accurate appraisal at the time, or the market might have fallen away between the time that the appraisal was done and when real estate was really being marketed. So, I asked, "what happens next?" Well, after awhile we would get another appraisal, but often we would go back to the same appraiser, and that appraiser might be reluctant to change the appraisal value because that might indicate that he or she had made a mistake the first time around. And so, we would get stuck with these problems of unsold and poorly managed real estate.

It was then that I had my first and only insight with respect to asset disposal. I realized that since we were bad managers of this stuff, we shouldn't be holding onto it. What we needed to do was to forget about going back for appraisals. Instead we should set some kind of time limits: perhaps six months for a single-family residence and nine months for a multi-family residence, and a year for some kinds of commercial property. If we hadn't sold a piece of property within the time limits, then we should start dropping the price. Give the sales person flexibility down to 80 percent. If three months after that we still hadn't sold it, drop the floor to 70 percent. Just keep dropping the price until the property is sold.

At that point, I started working with the staff of the agency: sitting down in their offices, talking to them, trying to plant the seeds of this idea—of giving the sales people a reasonable chance to sell a piece of property, but if it didn't sell, just keep dropping the floor price until it did.

I realized that this idea wouldn't take hold immediately. But, I was extremely pleased when I read in the newspapers about a year and a half later that Bill Seidman announced that exactly this plan—of periodically dropping the floor price—was going to be put into place. Of course, a lot of the newspapers described Bill's plan as a fire sale, as giving the properties away. They didn't understand it. I think that is an indication of just how much damage the "dead hand" of historically based, backward-looking accounting has done, of how much influence it still has on the way most of the world perceives things, rather than thinking in terms of markets and current market prices. But, I was very pleased that Bill stuck to the plan, which helped move the real estate.

Back to my points. Besides being a poor manager of assets, the agency was a poor seller of assets. It was difficult to acquire high-quality expertise at civil service salaries and the absence of commissions, bonuses, etc. Government salary structures limited greatly what we could do. Again, that is not meant to be a criticism of the men and women we had on the staff. They did very well. But, they had their limitations, and the salary structure—the absence of commissions, the absence of bonuses, and similar incentives that would be natural in a private-sector setting—clearly put limitations on what we could do.

The incentive structure was a major problem. Our inability to provide financing was a problem. And, when I got to the agency in 1986, the one effort that had been made to try to deal with these personnel problems, expertise problems and incentive problems—the Federal Asset Disposition Association (FADA)—was in the process of foundering and basically turned out to be not very useful, because of political and bureaucratic insensitivities on the part of the leadership of the FADA.

I look back on all of this and I conclude that selling real estate is inevitably going to be a problem in this kind of environment. It is just too easy to be criticized regardless of the strategy pursued. Sandra just mentioned all the ways that a government staff person can get criticized in carrying out a transaction. Either you've sold too cheap and somebody else is making huge profits, or you've held it too long and the market has fallen away and why didn't you sell sooner? It is a large problem. It leads to an unfortunate but realistic conclusion: the management and sales of real estate in a political fish bowl ain't easy. I have a lot of respect for the men and women of the FSLIC and then the RTC who, despite all these problems, managed to do quite a credible job.

Thank you very much.

Hubert Bell, Jr., Attorney/CPA
The Law Offices of Hubert Bell, Jr.

I'm pleased to be here today and participate in this symposium. As Sandra indicated, I will discuss those assets that generally do not appear on the books of the failed institution. Rather, they represent intangible-like assets of a receivership estate. When the FDIC or FSLIC closed an institution, it succeeded to a number of rights, titles, privileges, and claims that are generally referred to as professional liability claims. These assets, or claims under civil law, are pursued since any recoveries are used to help offset the losses that may have been caused by the misconduct of directors, officers, accountants, or appraisers who provided services for the institution.

Professional liability claims can be quite complex and contentious, and generally require a number of years to pursue before any recovery is achieved by the receiver. I also will discuss today my involvement in that process—the conversion process—that is the identification and conversion of those assets into dollars. I will also talk about what happened in Texas and some of the problems that the industry faced there during the crisis years. I plan to spend most of the time, however, talking about the conversion process and prosecution of director and officer liability cases on behalf of the FDIC and RTC.

I began my career in the banking regulatory industry as an administrative law judge in Texas. At the time, Jim Sexton was the Commissioner. One of my duties or responsibilities was to conduct bank charter hearings on applicants who had filed applications for bank charters. That was at a time when there were investors who still wanted a charter. That changed over time.

We were required to hold a hearing on each charter application. Our procedure was somewhat different than the OCC's. Regardless of whether the application was contested, we were required to conduct a hearing and my job was to conduct those hearings. There were certain standards that had to be met, such as the likelihood of profitability, adequacy of capital, good faith of the applicant, requisite experience, ability and integrity of the applicant to assure success of the institution, and a public necessity must have existed for the new institution.

I have several charts that I want to show you which graphically illustrate how the industry declined and the resulting economic impact of that decline. Chart 1 shows the increase in the number of financial institutions in the state of Texas and how that picture changed over time. It is also important to note that Texas did not have branch banking until 1987. So, all the banks were independent, free-standing, chartered institutions. You can see the increase in charters from 808 state charters and 627 national charters in 1979, to a high of 896 state charters and 1,076 national charters in 1986. As I understand it, the OCC's view on granting bank charters at that time was basically to allow the free market system to work. If an applicant had the necessary capital, the application fee, and was of good character, then the charter was granted. This might account for the lower percentage increase in the number of charters for state banks as compared with national banks during the economic boom times in Texas.

You can also see the decline in the total number of banks over the years from a high of 1,972 in 1986 to the present number of only 840 banks, with nearly an equal number of state and national charters.

Lawyers played a prominent role in assisting the FDIC and RTC in managing the crisis. Lawyers were involved in identifying potential claims, as well as in the process of converting these identified claims to some actual monetary benefit for the receivership estates. The next chart I'll show you illustrates the number of legal matters handled by the FDIC during the crisis years. Chart 2 shows that there was a high of 65,000 matters handled in 1988, with a high average asset value of $43.3 million occurring in 1991. In addition, the professional liability section of the FDIC and RTC was required to use outside counsel extensively during this period.

Now, to move on to the Texas experience. In most communities, certainly in Texas and probably throughout the country, the most paramount, dominant structure in a city is generally the bank building. It would appear that it is the most stable industry in the city, but that generally is not the case. Banks are institutions that are not able to withstand major macroeconomic shocks in our economic system. I will show you the results of a study that sort of reflects that as well. There was a study performed which compared the financial characteristics of banks that failed with those that survived during the height of the problem years. That study revealed that those institutions that survived were those that generally had a higher equity-to-asset ratio and a lower loan-to-asset ratio. So, banking institutions that may appear to be very stable and secure are actually quite sensitive to changes in our system because of these very low and sensitive margins.

The next chart that I want to show you, Chart 3, shows the number of bank failures in Texas during the crisis years. 1986 was the worst year since the Great Depression for the nation's banking system. There were a total of 138 bank failures and 26 of those failures were in Texas, which represented about 18.8 percent of the total. However, the collapse in the real estate market in 1987 and 1988 had an even more pronounced effect on Texas banks. Out of the 184 total bank failures in the nation in 1987, Texas accounted for 50, comprising about 27 percent of the total bank failures.

As the real estate market worsened in the state, so did the number of bank failures. As a result of the real estate problems, total bank failures, again, set a record of 200 for the year 1988, and of that 200, 133 or 56 percent of those institutions were Texas banks.

Also, I have a chart, Chart 4, that shows the same or similar type of results or statistics for savings and loans in the state. In 1988, 205 thrifts failed in the U.S. and 90 (nearly 44 percent) of those failed thrifts were in Texas. Another 127 Texas thrifts failed during 1990 and 1991, representing nearly 23 percent of the total number of thrift failures nationwide during that same two-year period.

Most of the problems in Texas were due to the decline in the oil and gas industry, as well as the collapse in the Texas real estate market which was precipitated to some degree by the Tax Reform Act of 1996. There was considerable over-investment by a number of real estate developers and speculators.

Also during this period, you have to remember that deregulation, certainly in the S&L industry, as well as the phasing out of Regulation Q helped to create an environment that led to the resulting problems.

Now, I'm going to move on to the director and officer liability area. Ultimately, a bank's management and its board of directors and their cumulative decisions are responsible for the success or failure of an institution. Regulators play a role in this, but they certainly are not responsible for the primary success or failure of the bank. Another study was performed of the failures of banks during the crisis period which showed that, out of the banks that were resolved, 90 percent of those institutions had some type of management-driven weaknesses. That seems to be a high percentage, but from my involvement with director and officer liability cases, that is probably not too high. Also, that same study showed that, out of the total number of banks resolved, one-third of those institutions were plagued by fraud or abuse. I would say in Texas, certainly from my experience, the problems caused by insider abuse probably approached the 50 percent level, as opposed to 33 percent.

I recently had the opportunity to talk with both the former banking commissioner of Texas and the current banking commissioner. They both felt that those are fairly accurate numbers.

Directors and officers of financial institutions have three fiduciary duties. First is the duty of care. Second is the duty of loyalty. Third is the duty of obedience. The duty of care requires that directors and officers conduct the business of the bank with prudence and good judgment. It is sort of an ordinary, prudent-man standard.

The duty of loyalty requires that the directors and officers of the institution conduct the affairs of the bank with honesty and integrity, and they are forbidden from engaging in transactions that would place their interest at a higher level than the interests of the bank.

The third duty mentioned, the duty of obedience, is the duty to obey the law.

Some of these standards, over the years, in Texas as well as in other states, were relaxed as state legislatures enacted laws to lower the standard of care required by directors and officers of institutions in an effort to protect them from actions brought by the FDIC and RTC. Some of those states even passed laws that applied only to financial institutions. Texas was one of those states, and not only did Texas pass a law that applied only to financial institutions, they enacted a law that applied only to lawsuits brought by the RTC and FDIC. In addition, they retroactively abolished the cause of action for breach of the basic duty of care, simple negligence, and they made this new standard applicable to cases already pending in Texas.

Needless to say, there were a number of challenges based on constitutional grounds that the law was somewhat discriminatory and should not stand. The Texas legislature in the next session made some changes to that statute before this issue was fully adjudicated.

In wrapping up, I want to show you the final chart, Chart 5, which depicts the results of the activities of the FDIC and RTC during this period. The professional liability recoveries from January 1986 to December 1996 by the FDIC exceeded \$2.5 billion. The costs for outside counsel during that same period was about \$444 million. Also, during that period, the RTC collected over $1.5 billion, with associated costs of $466 million. So, from a return on investment standpoint, I would say that the activities and efforts they put forth were remarkably successful.

Thank you.

David Cooke, Director
Barents Group, L.L.C.

Hello. I'm David Cooke and it's certainly an honor and privilege to be here today. I was delighted when I was asked to be here today and talk a little bit about the RTC experience. I've been gone for six years so it really is an out-of-body experience for me. I'm trying to recall as much as I can. When I was asked to make a presentation by Sandra Thompson and John Bovenzi, "I said, I've been gone for a long time. What specifically would you like me to talk about?" I was told you should talk about some of the issues and concerns that you had. The more I thought about it, the more excited I became. There were a lot of things happening back then. There were funding issues. There were legislative issues. There were debates—don't sell too fast or too slow. There were contracting issues—hire these guys, don't hire those guys. The more I thought about it, the more excited I got. Sandra said, "you know Dave, that is going to fit in really great and I really want you to do it. But, make sure you stay within 10 minutes—preferably 6–7!" So, I will try to go quickly.

From my perspective, the way the RTC began was influenced by a lot of things. It was influenced by the law that created it. It was a complex law. The governance of the RTC was confusing. The political environment was hostile, unforgiving and impatient. I can't help but think back to some of the early testimonies and just how hostile the environment was to members of the savings and loan industry. Just a few years ago, it was a "good life" with Jimmy Stewart, and now the sentiment had changed.

Another factor that influenced the RTC was, of course, the FDIC. The FDIC, I've got to say, was essential and supportive. We could not have done it without them. But, the FDIC had its own capacity problems and to be honest with you, they weren't ready for the workload either. I vividly remember the first RTC board meeting when Danny Wall, former head of the Bank Board said, "you guys don't know what you're getting into." About six or seven days later, I thought, yeah, he's right—what am I doing here?

This reminds me of another story. I had been with the FDIC for years and some of you out there know that. At the time the RTC was being conceived, I was Deputy to Chairman Seidman. He had been interviewing people to take over the top RTC position. One day in July, I asked him, how's it going? He says I'm interviewing this guy and that guy but I'm not really sure they're right. They all seemed pretty impressive to me. He said, you ought to think about taking the job. I thought he was kidding, to be honest with you. I said, yeah right. The next week, he said, well, have you thought about taking the job? Of course, this was quite an honor and I said, can I think about it overnight? So, I went home, thought about it, came in the next morning feeling pretty good. So, I go in to see him and I say, well Bill, do you really think I am the best guy for the job? He says, no I don't, but you know the people, you know the issues and you're here. So, with that word of encouragement…I went to the first board meeting where Danny Wall was saying you don't know what you're getting into. Then I had this Congressman tell me I was going down a slippery slope. So, I began to think this may have been a big career mistake.

The RTC was also influenced by the private sector. We had private sector guys running to and running from the RTC. There were people running to the RTC because they wanted to get work. They wanted to advise us how to sell assets. They wanted to do due diligence. They wanted to help run the back room operations of the thrifts. And, there were people running from the RTC that were afraid they were going to be sued by the RTC. That issue caused a bit of a problem in the early days as well.

Also influencing how the RTC acted were the assets—we had an awful lot of assets that came in very early—and the funding issues.

As far as the law, at first, it looks like a pretty good law. You had to maximize recoveries. You want to minimize the disruption to the marketplace. No fire sales. Use the private sector wherever feasible and close up operations in seven years. I can tell you seven years seems a long way out. So, everything seemed fine.

However, there were some other provisions in the legislation that we really had not dealt with before. There were provisions that said make sure you don't sell to any professional who has caused problems, who has caused a loss. That was a problem because anybody with thrift experience might be sued to get some money back with professional liability suits. So, immediately we had some problems in contracting—who can we contract with.

There were other provisions—give certain preferences to women and minority groups in the contracting arena and in the institution sales and later in some asset sales. At the FDIC, where the core of us came from at the beginning—we didn't have any experience in working those issues and they were very, very politically sensitive. There were also provisions to give preferences to certain low income groups in buying housing—again something we had no experience with whatsoever. So, it made us realize that we had to do some different things.

The law also provided us with what I think is a unique governance structure, which I thought was probably not going to be duplicated again, but it might be. In some countries, believe it or not, a structure like the RTC may be the answer for people looking to absolve themselves of responsibility in the process.

The governance provisions of the RTC legislation attempted to separate policy from operations. We had an oversight board in the early days, a very demanding one which was later revised. It set policies and approved budgets and you had the RTC/FDIC board which ran operations and never the twain shall meet. We also had advisory boards to give us advice. So, the lines of accountability were clearly blurred. There were times when we would go to one board to be told you've got to go talk to the other board, and the other board would say you've got to go back to that board on some very sensitive issues.

In the structure that was set up, we had lots of people involved in the process, giving us advice. There were not as many committed to actually doing it, other than a lot of people we recruited. This reminds me of the story of the difference between involvement and commitment that a colleague once told me. He said, it is like having ham and eggs for breakfast. The chicken is involved but the pig is committed. So, not to refer to us as a bunch of pigs, but we were definitely committed to the process.

The early emphasis in the RTC's establishment, most of the time and attention was just focused on building the staff, the infrastructure and in setting up policies. We had all these issues dealing with contracting and how you run a conservatorship. There were a lot of things consuming a lot of time. It was a big job, which Bill Roelle knows better than anybody here—getting control of all these S&Ls. The FDIC started taking over the conservatorships in early 1989, as Larry White mentioned, the RTC was created on August 9th or 10th. From that day forward—we became really responsible for what happened to those institutions.

There were lots of issues on the basic approach—which was, let's package these institutions up and sell them to healthy banks. We started trying what was known as a whole bank sale where we tried to find some bank that would, at a certain price, take on a lot of the assets except for the really "stinky" assets, as Larry White called them. I think we called them "opportunity" assets. That may have been a difference in the sales strategy between the RTC and the Bank Board.

A lot of time was focused on how are we going to manage all this real estate and these low quality loans, nonperforming, subperforming, potentially nonperforming—all these loans that we felt that we couldn't sell. We found out that we couldn't sell a lot of those loans, even the ones that we thought we could sell.

The political emphasis at that time when we started centered on concerns about the RTC dumping assets and disrupting markets. People would come in and say, my God, you're going to destroy the market in Arizona, you're going to destroy the market in Texas, so make sure you don't do it. We knew the appraisals that were on the books for these assets in the beginning were totally unrealistic. We knew we had to get more realistic—that means we need to lower appraisals on these properties to sell them. We spent lots of time meeting with members of Congress and state and local representatives that were very concerned that we were going to disrupt the financial markets, the asset markets, the credit flow. We always would have some borrower who felt that we were being unreasonable.

Things started to change though. Some of the factors that started to influence that change was that banks took only the best assets. That was despite the fact that we offered them price discounts. We offered them put-back options and generally they would put them back after they had been cherry picked and they would put them back late. I remember we used to get the reports looking at how many assets had been sold. We would originally count things we sold with put-backs as a sale, and then we would keep our fingers crossed that at the expiration of the put period that they would actually keep them and for some assets they did, but for too many of the harder to sell, they didn't.

Well, since we couldn't get the banks to buy them, we needed funding to carry the asset inventory. We had two types of funds that we used to preach about. We had loss funds and what we called working capital. We needed money to carry the assets. If we wanted to get rid of the conservatorship, close it down, sell off the good assets and sell off the deposit liabilities to somebody else, we needed to have funds. We needed to have cash in effect to fund us holding onto the assets in inventory.

The legislation simply did not address that funding need at all. It only talked about loss funds. So, very early on we ran into a brick wall. We couldn't do any more transactions because we couldn't fund the closing. The S&Ls had to be kept in conservatorship longer and longer and longer. I don't remember what the average worked out to, but it was getting pretty long and that meant we had more and more control problems. We had to deal with the liquidity problems of the institutions and we had to regularly preach about what the cost of this delay was. We had some very creative thinkers in our Department of Research that would put together some really convincing numbers.

Eventually things changed when Treasury funding was arranged after about six months. Treasury would lend us money to carry these inventories. The good news was the pace of S&L sales picked up dramatically. That was an exciting time at RTC. Over three months we sold lots of S&Ls. Paul Ramey and Sherwin Koopmans and Bill Roelle were setting off whistles and having contests—it was an exciting time—it was a happy mood. But, people started to get concerned now about all these assets coming in and Treasury borrowings being scored, since it was a budget outlay. They didn't have to go through the appropriations process, but the impact was negative. So, there was growing discontent.

Also, a growing asset inventory meant increasing market interest. Then criticism started to increase about the pace of sales and the way we were handling assets with our standardized asset management and disposition contracts. We knew that we had some problems with incentives in those contracts, and we were in the midst of revising them when due to a policy change decreed by Chairman Seidman, we stopped looking to the asset managers for the disposition phase.

Other things also influenced the change in direction. The oversight board did direct the RTC to experiment with structured transactions and equity participations. They said why don't you try some new things. Interestingly, they had been resistant to do some things, like seller financing. But, they eventually changed that position to where they approved of seller financing and then were asking us why weren't we using it more often than we were.

Another factor of influence was the FDIC chairman. While we were just working on an experiment for the oversight board, he said we should just go ahead and do a big bulk sale. I remember when he called me into his office and he said, Dave, you know, if we only sell a million dollars a day it is going to take like three trillion years to sell them all. Then I said, "that is a good point Bill, but you know we are selling more than a million dollars a day." But the next thing I know we are going to a public meeting, with the oversight board, and Bill is saying, "if we only sold a million dollars a day . . . ." and so now it's in the media. Chairman Seidman says it will take years to get rid of the assets.

So, people were saying you guys were trying to build a bureaucracy—you're going to be here forever. So, immediately we started to switch to become more large-sales oriented.

Some of the things that were done by the RTC that I think were really commendable were the development of the standard sales agreements, due diligence procedures, appraisal guidelines, and instructions to appraisers—many of these things were controversial. Almost every step that seems standard now was a big, agonizing debate at one point. Providing market oriented reps and warrants—who provides the warranty? Is it just going to be the receivership? How far does it go? What are you doing to the government? There was a lot of anxiety over that. Creation of sales centers, the 800 sales lines, which were quickly swamped, publishing calendars of upcoming sales—and lots of other new things were done in the area of asset sales.

Not to exceed my time, I just want to make a couple comments of some things that I thought were particularly memorable to me. At the time, everything was important, but some of the things that I remember about securitization and whether or not to do securitization. Our first securitization transaction was junk bond securities. We went to the board and they approved it. It was the first one. Later, we went back to the board and said, well, we would now like to do securitization of mortgages. The board members were really concerned about their own liability and delayed it several months. But finally, a law was passed that said the board would not have to worry about that liability and it went through. Securitization was very successful—and I believe it worked out very well.

Another big issue that I recall was whether or not we should re-underwrite a lot of these loans. If we re-underwrite the loans, we can make them look better and we can package them better in securitizations. When I left, and I think it ended this way, the decision came down to say we might be opening Pandora's box. There may be truth that a lot of mortgages that were potentially nonperforming that we decided to restructure might have opened up the flood gates for others and we might have done things to the loans that might actually have made them less attractive—so, we decided not to. However, that is an issue and I do a fair amount of international stuff and the re-underwriting of loans is a big issue, particularly when you start dealing with industrial companies and not primary real estate assets.

Another thing, real estate auction, major real estate auctions, auctions of nonperforming assets, I was delighted to see that those things took off and were flying so well. Our first big real estate auction was a major disaster. It didn't go off, as a matter of fact. We ended up in litigation with the auctioneer company. But, because of those mistakes, and that was the nice thing, the people at the RTC were really, maybe we were under a lot of pressure, but we were willing to try just about anything. It wasn't real clear who would tell us we could or couldn't either because it was a confusing structure. So, we would try different things and we would get through stuff a little bit along the way but we would do all right in the final end. I know in the final one they did, the processes really got streamlined and the FDIC has also helped streamline. They've done some of the same procedures so everybody is to be congratulated.

The Derived Investment Value (DIV) was another thing developed by the RTC, with the help of consultants that are, now are competitors of the company that I work for, I won't give them any credit. But there were consultants that helped develop that scheme. And DIV basically analyzed cash flows and resulted in giving values that were much lower, closer to what an investor might consider an asset worth. I remember some of the early transactions—I think it was Tom Horton—I said, Tom, how did you do? He said, great Dave, we got 75 percent of value. I said, that is really great and I'm thinking of appraisal values. He said, no Dave, it is a DIV which is only about 70 percent of the appraisal value or whatever. So, it did work. We let the market speak.

Earlier Larry White mentioned a variation of the Filene's basement sale. I remember that. Bill Seidman actually called it the Filene's basement sale and people did see it as a fire sale. But by then, everybody's attitudes were changing. In the early days of the RTC, we were visited in the chairman's office, even before RTC, by people from Arizona and Texas, and they were coming and saying, please do not sell these assets. Do not destroy the market. Those same people came in about a year later and said, please sell those assets. The market is all clogged up. Nobody wants to buy anything. They all saw this big weight that the government is holding.

Seller financing was an issue that the RTC finally worked out. That was a very, very controversial issue, considering how sparingly it was eventually used. I don't think it was more than just a few billion dollars in the end, but it was so controversial, I think it was one of the major factors why the first president of the oversight board staff decided not to stay, because he was a big supporter that we should provide it.

Certainly, the structured transactions the RTC built, the end-deals and the equity participations, those were really break-throughs. I think the RTC and the FDIC did a tremendous job doing it. Sometimes I find myself in my idle moments thinking back though. You look back on the process because you hear things when you leave—you hear things through people on the private-sector side. You hear things from people in other countries. I guess I don't know—it would be interesting to see—did we go too fast? Did we leave too much on the table, or is the pace more important than the price, because the faster the pace the faster you unclog that clog, but at a price to do it? I still think about it from time to time. I don't know that we would have handled it any differently, really. Maybe just some of the lessons we learned the first year or so we would avoid them.

Anyway, thank you very much.

Ted Samuel, Former Chairman and Chief Executive Officer
Niagara Asset Corporation
Niagara Portfolio Management Corporation

Good afternoon and I'm delighted to be invited to this meeting. I believe my role here is to represent the perspective of the private-sector contractor. I will attempt to discuss briefly some of the concepts and the evolution of the crisis resolution, as opposed to the details.

First, it is very difficult in 1998 on a spring day, with interest rates at 6 percent and the Dow Jones somewhere around 9,000, to portray the climate of 1989. However, 1989 was a much different story.

- Interest rates were very high and had a huge effect on nonperforming assets. High interest rates were incorporated in appraisal capitalization rates as well as in present value rates.
- For many borrowers, particularly in the real estate sector, there was no alternative financing available.
- The country was hostile. I was in Texas—it was really hostile in Texas. I was not from Texas either. There was an attitude of anger and suspicion at both the borrowers and the lenders.
- Confidence in the financial system hung in the balance. It was a crisis in Texas.

The crisis first involved me when I arrived at First RepublicBank. The bank had failed and its problem assets of over $10 billion created a large potential drain on the FDIC fund. There were about 300,000 items under special asset management. There were about 1,000 employees. They were angry employees. They were angry at possibly no longer being employees. They were angry at me because I was from North Carolina—Ohio really.

The crisis we faced in this climate was immediate, material and real. The resolution of the crisis became a riddle which had objectives and constraints.

The objectives were fairly simple to write down. Liquidate large numbers of poorly understood assets quickly and for cash. Those objectives were reinforced by the asset liquidation agreement, under which we worked.

The constraints to asset management fell into several broad categories. First, let's talk about the large numbers—300,000 items, mostly small loans and consumer loans. They presented a certain chaotic element to asset management and administration.

Second—poorly understood assets. Initially, we didn't know what we had. We didn't know what we were attempting to manage or sell. This was perhaps the biggest problem of all. These loans were not made or documented to ever be transferred anywhere. One of my biggest shocks came while walking down the street with Jim Irwin shortly after arriving at the FirstRepublic Special Asset Bank. I was in charge of the real estate problem loan portfolio. I said to Jim, "Okay I'm here—I'd like my list of assets." There was a pause. There was a long pause. He said, well, we don't have one. It took me six months to get a list of assets. I'm sure that was repeated time after time at other institutions and at the RTC.

Third, after a brief period of collections funded by alternative sources, we ran into a logjam as our borrowers could not raise money. Other banks were not lending money. No one was lending money. We needed cash from those assets. The FDIC needed cash. We reached an impasse.

We concluded that in addition to our traditional collection activities, we needed another vehicle to solve the riddle. The traditional methods failed for several reasons. First, the time requirements to resolve large asset volumes were unacceptable. Second, cash collections were difficult, as refinancing was not available for many of our borrowers. Third, fairness and wisdom dictated restructuring debt in many cases as opposed to demanding a cash settlement from our borrowers. Fourth, the market was imperiled by requiring cash for asset sales, particularly real estate owned sales. Fifth, fair market values were not attainable quickly for cash collections or sales. And, sixth, real estate sales took too much time and did not close.

We began to focus on bulk or pooled sales as a solution. In theory, bulk or pooled sales would quickly generate cash, sell large volumes, allow restructurings at the borrower level, and not destroy individual markets. However, several theoretical and practical impediments remained. The first one, which continued, was that we did not know what we were selling.

I'm going to take a minute and talk about something fundamental to the whole process and that is appraisals. Appraisals were crucial requirements for asset resolutions. One of my earlier experiences at the former FirstRepublic was being told that we simply could not get appraisals because there were no more appraisers available. Appraisals tended to come in high on the first go-around because the appraisals were based on prior sales when property values had fallen 30 to 40 percent due to future projections. This required at least a second round of appraisals. One logistical problem with appraisals is the need to give the appraiser good property information. Of course, we didn't have that information. The time requirements for this expanded geometrically. We just slogged our way through the appraisal issues.

In retrospect, I believe some of the information problems we encountered could have been reduced through the judicious use of representations and warranties, particularly in conjunction with bulk sales. In my opinion, buyers will accept the additional work of researching certain asset issues following closing, provided they are protected from what they find. They will accept this work without significantly discounting bid prices. Note that I believe work can be transferred but not risk. If I were to hold up a loan file and told you it contained a first mortgage and asked you to bid on it, you may bid with your implied understanding of what it was. If I said "maybe" it is a first mortgage, your bid would be considerably different. We started with the "maybe" first mortgage.

Fortunately, over the years, we expanded sale representations and warranties which encouraged effective sales. Transferring loan review work through expanded representations and warranties would have significantly sped up the sale process had they been used earlier. As it was, we experienced significant delay in an attempt to avoid representations or warranties which did nothing to remove risk or improve value.

The second remaining problem for loan sales was to satisfy the fair market value requirement. Our global assignment was to recover the highest net present value, but fair market value inevitably crept in. We satisfied the fair market value requirement by demonstrating several things.

First, we demonstrated fairness by subjecting all bidders to the same rules, by providing all bidders with reasonable representations and warranties, by providing relatively affordable small and stratified pools, by providing the same information to all the bidders, and by providing competitive bidding with broad marketing.

Second, we needed to demonstrate, in addition to obtaining appraisals, that sales were at market values. We demonstrated obtaining market values by widely marketing, by advertising sales, by widening the market through providing financing, and by profit-sharing arrangements and equity participations. I am in favor of equity participations because whatever the assets were worth, we shared in those values. Hopefully, values were being enhanced by the buyers' efforts.

In addition, we developed new concepts of net recovery values, such as the Derived Investment Value (DIV), which allowed for realistic valuation. Still, we had an appraisal-timing problem that didn't go away and slowed us down.

Okay, so the theory worked. Bulk sales could meet objectives, but would they work? Would they close? Was there a wide enough and deep enough market?

First, we needed deals to close. We had a good deal of experience with deals that did not close. The reason they did not close was that we did not require prior due diligence. Requiring prior due diligence was key to these programs working. When people bid, they bought. At first, people were reluctant to bid. People may have bid low, but they bought.

The second key element was representations and warranties. We improved the representations and warranties so that the bid risk structures were appropriate to the assets being sold.

The final element was the depth of the market. In short, would we get a price which met our fair market value test? The first deals closed and investors noticed the attractive prices. You can always count on competitive greed. Bidders and prices increased substantially. A viable market was born. Asset sale prices began exceeding our expectations and then our belief. Competitive bidding worked. Reasonably priced funds were raised to fund troubled assets. The crisis, from my standpoint, stabilized.

A by-product of bulk sales is that it changed the temperament of the problem and the crisis. When you're a bank or liquidator and you collect 70 percent of a loan, you feel you've lost no matter how good your collection. You still feel you've lost. In the bulk sale environment, profits are made and it changed the entire temperament. All of a sudden, there is an optimism about workouts and prospects for the future. We saw that happen in Texas. People recognized an opportunity. Then they bid the opportunity up to very competitive levels.

We finished our job and went home and interest rates fell and we were invited to symposiums and lived happily ever after.

Seriously, proper credit must be given to several additional factors. First, I worked under asset liquidation agreements, and those agreements delegated authority through oversight committees. The oversight committees were extremely important to us. I admit when I arrived in Dallas there was a great deal of animosity between my staff and the FDIC staff. This probably resulted from anger and disappointment at being part of a failed bank, with a failed career. Nonetheless, over a period of time, this animosity was largely dispelled to the credit of the oversight committees. They did great work, used common sense, were locally available, and key to the success.

Second, incentives based on cash collections for both the private contractors and their employees played a large role. This kept our focus and our enthusiasm as we worked ourselves out of jobs and careers. It was highly effective down to the lowest employee level. It made my job of managing much, much easier than I told the oversight committee. Never underestimate the value of management by incentives.

To summarize, I would recommend the following in the future: (1) Avoid large numbers of small assets. Make acquiring banks take them and if that is not possible, sell them immediately. The administration of small assets was one of our greatest difficulties; (2) Sell loans in bulk competitive bids with financing and retain a profits interest, particularly in difficult to value transactions; (3) Use firm sale contracts with prior due diligence and representations and warranties; (4) Delegate authority; (5) Provide incentives to servicers; (6) Provide seller financing for all large sales of loans or REO; (7) Place less emphasis on cash collections from primary borrowers, and; (8) Transfer work to investors through representations and warranties.

In closing, what did our efforts accomplish with the bulk sales solution? We broadened recovery methods. We lowered the cost of funds and refinanced billions of dollars of assets. We changed the temperament of collections from losing to winning, and we saved time and expense. Make no mistake, there were mistakes made—I know because I made some. However, criticism that bulk sales, at least the ones we sold, sold cheap, is simply false. The Dow Jones stocks sold cheap. Bonds sold cheap. I believe that the average buyer of our pools would have done approximately as well had they purchased almost any mutual fund in 1990.

Finally, make no mistake, I believe that asset dispositions were handled very well overall. In 1990, I drafted, but did not send, an editorial regarding the difficulties facing the RTC and the FDIC. The opening line was, "Hercules and Solomon on their best day could not resolve the problems confronting the RTC and FDIC to everyone's satisfaction." I still believe that. I also believe that I worked with many outstanding people in both the public and private sectors and I'm proud of our joint success. Thank you.

Diana Reid, Managing Director/Senior Advisor
Credit Suisse First Boston

My name is Diana Reid and I am a managing director with the investment banking firm of Credit Suisse First Boston. I want to thank Sandra for inviting me to join you today. I am honored to be the lone investment banker at this gathering.

Sandra asked me to speak about the variety of roles that Wall Street played in the RTC and FDIC's crisis management. Among the Wall Street firms, there was a wide range of participation in RTC activities. Some Wall Street firms had very little involvement with the RTC crisis management; they decided not to commit the infrastructure, resources, and time; or just didn't have the capability among their product areas. Others had the capability, but decided it was not a long-term product line. Others among the Wall Street firms did commit significant time and resources to the effort. The commitment or the amount of involvement had a wide range of risk appetites. Some firms focused completely on the advisory work and fee-based assignments. Some firms focused on the principal opportunities. Some firms focused on both.

What I'm going to speak about today is what Credit Suisse First Boston did and what we did not do, and how we made those choices.

One personal note I'd like to share is how I got involved with First Boston's effort. Think back to the situation in 1989 and 1990. I've worked at First Boston since 1983, as Sandra noted, and what I focused on was credit risk classes of assets; the newer, more difficult-to-sell ABS (asset backed securities) and MBS (mortgage back securities). So, when the RTC and the FDIC came along with bulk sales, I was asked by my manager to get involved and identify the investors for these assets. At that time, real estate was in the news, not in positive articles such as appear today; but every day there was something else negative about thrift assets or real estate that appeared in the papers. So, my assignment was to find investors for an asset class with a negative taint.

Let me walk you through the evolution of CSFB's involvement in the RTC's asset disposition. The first aspect we got involved in, in the very early years, was advising our institutional clients, major banks and thrifts on their whole bank purchases. We were not initially involved in the government advisory business; we were helping our clients figure out a strategy to purchase some of the banks and thrifts that were for sale. Sometimes we would provide them financing for such acquisitions. We would take some risk, and we would arrange financing for their purchases. In one case, we provided a valuation of all of the assets of a large thrift that a bank was purchasing so that the bank could quickly purchase those assets, value them and securitize them. So, CSFB's first involvement was advising our traditional client base on how to purchase some of the thrifts and banks that were for sale.

The second phase in CSFB's participation was to become an advisor to the RTC on various issues, primarily the bulk sale advisory work. So, before we took any principal risk, we became an advisor and began to understand what the issues were with the assets. What the assets were and what the process of securitization or sale might entail. So, CSFB would receive a fee, which we had competitively submitted and been chosen through an auction process, and we would receive that fee for assisting the RTC in coordinating all of the information gathering, overseeing the due diligence advisors, developing a marketing strategy (which was probably one of the most challenging tasks), figuring out who would be the possible bidders for these assets, putting together an organized book to send out to the potential bidders, working with those bidders on their due diligence, and then running an auction. That was an exciting task—running those auctions. On our first of several bulk sales, I remember sitting with the RTC staff and the CSFB team, being so excited when we would finally receive bids that were at or above the threshold price that the RTC had set. It was terrific to have found multiple investors to bid competitively for the assets in such a different environment.

CSFB completed many advisory assignments. But remember, at that time, we weren't risking any of our own money. We allocated a lot of time, resources, infrastructure, sometimes even some new systems design, and we were receiving a fee for that work. CSFB completed such advisory assignments on residential loans, multi-family loans, commercial property loans, performing loans, and nonperforming loans; for the range that the RTC was managing, we would act as advisor on those bulk sales. Only after we had completed such advisory assignments, assisting the RTC in selling billions of dollars of assets through bulk sales, did CSFB decide that we would also risk some principal and become a bidder in certain bulk sales.

So, then CSFB's role became the investor in certain loans. Sometimes we would securitize them. Other times we would sell them "as-is," maybe in different groupings or individually. Sometimes we would meet with the borrowers and restructure the loans before we then re-offered them to other investors. Sometimes we entered into joint ventures with asset managers who were much more familiar with a certain location, real estate market or property type than we were, to ensure that we didn't make mistakes bidding from New York City on assets that were located in Texas or California.

So, CSFB became bidders for these assets. But, there was a range of risks taken. We profited on many portfolios. We lost money on a few portfolios. At times we underestimated the cost of servicing, modifying or working out the very small loans or residential loans. That was where the most difficulty occurred. But, overall, CSFB saw it as an opportunity to combine our knowledge of asset valuation, risk taking and securitization.

The next step began with the securitization programs. This is really where Wall Street contributed significantly. After all, securitization is our primary business. We at CSFB took a great deal of pride in being a founder and leader of asset-backed and mortgage-backed securities/markets. We knew those markets very well. This was an area that we acted as advisor to the FDIC and the RTC, and also played a leading role as an underwriter of those securities. This was, to me, definitely the most satisfying of all of the projects that I worked on for the RTC. Beginning with residential loans and then to multi-family, and then to commercial, and then to the combination of commercial and multi-family. CSFB participated as advisor on the securitization of nonperforming loans, but not as securities underwriter. We did participate on the equity tranches of some transactions, as principal.

The securitization program was one of the most significant innovations of the RTC and has contributed to today's active and healthy CMBS (commercial mortgage backed securities) market. Its results are still seen in the market today. The RTC forced the securities underwriters to innovate, find new investors, and to create new credit enhancement structures.

The other product that Wall Street broadly participated in was funds. For the nonperforming loans, the equity partnerships, the nonperforming pools in securitizations, many firms established funds. Morgan Stanley, Goldman Sachs, and CSFB were really the dominant players in investing our own money as well as raising third-party funds in limited partnership structures and using those limited partnerships to bid on some of these nonperforming assets. That is a big on-going business today in different types of assets with different types of sellers, but is certainly one of the main legacies of the RTC experience.

"Necessity is the mother of invention" is an apt quote to summarize the RTC experience. Sandra and her staff forced the Wall Street professionals to be creative, to invent new solutions. Three such examples: In an early residential loan securitzation, we were faced with selling several hundred million dollars in loans indexed to the 11th District Cost of Funds index. One of the healthy California thrifts had just attempted to do a much smaller transaction with a similar pool of adjustable rate mortgage; and it had taken them several weeks to clear the market, i.e., find enough investors to purchase all the securities. So, I was, needless to say, a little bit worried about a much larger deal clearing the market. What we created was a "cross-index" feature that proved popular with investors and profitable for the RTC, as well. We issued the bonds using LIBOR and we proved to the rating agencies (and we proved to the RTC who was holding the residual), and to the investors that there was enough cash flow in the transaction to support this feature.

The multi-family securitization of 1991-M5 was the first time we had looked at balloon maturity extensions. If you looked at the underlying asset value of the multi-family properties versus the loan on a property, all the loans were about 100 percent of property value and re-financing was not as liquid as it is today. We came up with an "extension" scenario that gave the investors comfort that the securities would perform well. We gave the rating agencies comfort that the securities could support that rating, and also introduced servicer flexibility so that at the balloon maturity the borrower was not forced into foreclosure.

In commercial real estate transactions, the "excess apply" structure was one that I'm most proud of having helped execute. The RTC kept the residual value and paid off early the highest yielding components of the financing. The structure allowed us to attract new investors to those securitizations.

I'd like to conclude my remarks with a list of what the RTC experience has created in the fixed-income securities market. First and foremost, I believe that traders and the fixed-income departments on Wall Street are more capable today of selling securities with a complex story. There were many trading desks and many firms that did not have the expertise nor take the time to sell securities that had complex stories. The RTC experience pushed us all to develop skills that we would not have otherwise had. So, there is a lot more complexity in structured transactions, which allows issuers to create offerings tailored to their current needs.

Second, there exists today a commercial mortgage-backed securities market. There wasn't one in 1990. The CMBS market really developed because the RTC proved there were investors out there to support it. The CMBS market has provided liquidity to the real estate market, and that liquidity has been a factor behind the real estate recovery of this decade. The RTC created the early CMBS market, forced the setting of standards of due diligence and focused the rating agencies on this market.

Third, the street today is more willing to take principal risk for assets that can be placed into securitizations. There are more firms today willing to look at unusual assets and commit their own capital.

Fourth, the enhancement of systems and financial modeling is not one that most people recognize. But very advanced financial engineering was required to model many of the RTC transactions which introduced new structural twists, new asset types, and new credit enhancement methods. I remember when we were structuring 1991-M5, one weekend in the financial engineering room we had 15 computer programmers who had been working 12 to 16 hour days for about three weeks to upgrade the systems so that we could model, provide analysis, answer investor questions, and value the residual that the RTC would retain on this transaction. We believed we had one of the best systems on the street before M5, but we still had to enhance and improve that system. Most of the Wall Street firms have vastly improved financial engineering models today if they were involved in the RTC process.

Thompson: Before we start the question and answer period, I would like to pose a question to any one of the panelists who would care to address it. That is that there is a lot of debate about whole loan sales or the government selling assets while retaining an equity interest. Do you think the government should retain an equity interest in asset sales?

Samuel: I believe the answer depends on the type of assets being sold. If the assets are well understood with a defined market providing full market value, then sell without equity participation. In cases of poorly understood assets or difficult to value assets then equity participation is beneficial.

Thompson: David Cooke, why didn't the government sell assets using government guarantees?

Cooke: That was an issue of some discussion. The feeling was if you could put a full faith and credit guarantee behind an asset, you could sell anything. So, what's the point. Actually there were some asset categories where at one time we thought it might make sense because the market was being irrational. But, as the opponents to that approach said, and thinking about it, I think they're right—if we slap the full faith and credit of the U.S., we don't really need you to go around and try to sell it. So, it was decided not to. But again, some of the representations and warranties, especially some of the early reps and warranties that went on some of the early securitization deals, I recall, seemed to be getting awful close to a full faith guarantee because reps given by the RTC were, in effect, backed by full faith and credit. But I think the whole view was very cautious not to do anything to prolong the government's involvement in those assets, and I think it was probably for the best.

White: The names of the programs might have been a little different, the particular twists might have been a little different, but the same fundamental problems were present. David, you had the advantage of more development in capital markets, better technology; you could do stuff that we weren't capable of. But, on the issue of guarantees or financing, basically there was a strong sentiment in the FSLIC that said, let's just get rid of this stuff. We don't want it coming back to us. We want it out of here. That was a very strong sentiment.

Thompson: Based on your remarks on progress that we had with FADA, do you think we would have been better served in just hiring a private contractor to just sell everything, as opposed to trying to sell it ourselves?

White: There is no right answer to that. It's all an issue of monitoring, of structuring contracts, of incentives. In principle, by having the private sector rather than the public sector, you are not subject to the limitations of salaries, of not being able to offer bonuses, of not being able to hire the necessary expertise at the government civil service rates. On the other hand, if you get the contract wrong with a private-sector contractor, they're going to take advantage of it. If you provide too rich an incentive to manage rather than to sell, they'll manage the hell out of those assets and they won't sell them. If you provide not enough incentive for management, they'll dump stuff that ought to be managed before it's sold. So, getting those contract terms right is terrifically important and terrifically difficult. There is no good or right answer.

I think the FADA was a creative effort to try to bring private-sector expertise, salaries, and incentives into the tent while still retaining a decent amount of oversight and control on the part of the federal agency. But, as I said, it fell apart because of inadequate sensitivities to the bureaucratic niceties of the government sector, the unfamiliarity of the private-sector people in trying to deal with the public sector.

Smith: I'm Ed Smith with Banc One Mortgage Capital Markets, and I have a question for Mr. Bell, if you will. If you measure recoveries of these claims in terms of actual cash dollars as opposed to judgment amounts, how would you compare that with the cost of seeking those recoveries?

Bell: I'm not sure if I have the statistics to completely answer your question, but I think most of those recoveries that were reflected on the chart would be actual dollar recoveries, either from proceeds from insurance companies or actual cash settlements with the defendants in the case, and not simply judgments.

Kroener: Bill Kroener, General Counsel of the FDIC. The long-term, ten-year numbers, total costs on total recoveries, are just about four to one recoveries as against cost. That is for both the RTC and the FDIC for the PLS program as a whole. We track these numbers fairly carefully and regularly and that is the overall number for the ten-year period. Obviously, there are amplitudes within the period.

Thompson: Any more questions?

Cooke: Maybe I could ask a question on that issue, if you don't mind. I'm just not sure how something turned out. When I was at the RTC, we used to say, we have 100,000 pieces of litigation and some of it was claims against people that borrowed money. It was all varieties. But if you looked at the dollar amounts, some of them were very small. And, there was a consideration about why don't we just go and auction off all these claims. And I remember, this was a very difficult thing to do. I'm not talking about loan judgments, and stuff like that. I'm talking about litigation cases, small dollar cases.

But, it was something like, as I recall, 75 percent of the number was less than $25,000 in claims. I thought, why can't we just get rid of that? Did anybody ever do that? I left in 1992. Or, do we still have 100,000 small claims?

Smith: I'm Jack Smith, Deputy General Counsel for the FDIC. That was a public policy issue that came up from time-to-time and the resolution was you can't take those restitution orders, which are $2 billion outstanding, and you can't take those PLS claims and auction them off to the public because there is a concept of public prosecution in those kinds of claims. So you can't just discount them. Sometimes, a particular defendant, for example, Don Dixon, went bankrupt and he lost a lot of money for us, as you will recall. People thought, well, we'll just auction off his claim because he's never going to have any money again. But, believe it or not Don Dixon has come back and he is making money down in Florida and we think we're going to get a million dollars out of him there. So, you don't just give up on those kinds of claims.

Bell: If I could add to that—I would think with the uncertainty of litigation, it would be fairly difficult to market those types of claims because there are a number of defenses that the defendants would use in defense of the action that would be brought. One defense would be bankruptcy, another would be the statute of limitations, mitigation of damages, and other issues that could make the actual litigation very risky for a purchaser of those type of claims.

Cooke: It was yesterday and was an economic issue at the time, it seemed like. Small things, get rid of them as fast as you can. We always would—I know the legal divisions would always work to do a cost-benefit analysis. What is the probability of getting it. It seemed to me that the majority of the claims just made it where it made sense to go forward. That is probably unfair because it had probably been just the ones I saw. It seemed the probability of winning and the probability of getting anything in judgment—it would work out that the amount of the expected recovery was always enough for the expected cost.

Crocker: Don Crocker. Is it fair to say that the receiver's powers that were given under FIRREA had a significant impact that increased the recoveries that the RTC and the FDIC achieved during the four- or five-year period of the crisis?

Cooke: I would think it had to have a positive impact on recoveries. I don't know what it did in a more broad concept. If you're talking about the receivership powers—the superpowers—the special powers to deal with the burdensome contracts, and there were others, proved to be very helpful to have. But, there are questions and I don't know if anybody focuses on them any more about the fairness of it. Was the government given too much power? Some of my friends at the FDIC tell me that there are some, even within the FDIC, that wonder about how powerful should a receivership be? I don't know. You probably have a view on that. What do you think?

Comment: Lots of people besides the taxpayers and the receiver's powers had a huge adverse impact on third parties to the benefit of the funds and that no longer would be supported by a court under due process or condemnation or a variety of other legal theories and that is why these current lawsuits on the Supreme Court have been authorized on the net worth issue—the regulatory net worth issue—which is important because there is no longer a war so there is no longer authority to be using war powers.

White: And there were also long-run incentive issues. Do individuals and institutions change their contracting arrangements because of the possibility that, when a receiver comes in, he or she will take harsh measures?

Cooke: The RTC, its job was to maximize recoveries and it had these special powers. What we find ourselves doing is using those powers to the absolute maximum because they would say, hey look, we are supposed to maximize recoveries and I guess the most memorable one was an irate call I got from a Senator from New York about the position on rent control being taken by the RTC. I don't know where that ended up. To be honest with you, I've been gone for a number of years and I haven't really followed it. But from the RTC standpoint, our job was to try to get as much as we could, and as many powers as Congress gave us, we were inclined to use. I don't remember anybody saying, well, gee, I don't think we should use it. It was more or less, well, we ought to use it because we've got it. Because if we don't, people will say, why aren't you using it? But you're right. Maybe times have changed.

In other countries that you go in and you talk about the scope of powers given the FDIC and the RTC, and basically some people you're just cutting out the of court process and it is something that in some of the markets I go in, they just can't conceive cutting out the judicial process as much. It is a hard sell because we do have a due process here in our own structure.

Thompson: Ted, we've spoke in quite extensive terms about securitizations and equity partnerships, but quite honestly, the failed bank assets were really cleaner and the FDIC used a lot of different disposition strategies to try to sell assets. They sold them individually. They used bulk sales. Can you talk a little bit about what you did as an asset liquidation manager for Goldome in particular?

Samuel: I can try. We employed everything from individual asset sales to bulk sales of large quantities of assets. We also managed 34 Goldome subsidiaries that ranged from insurance companies to Goldome Credit Corporation, a major secondary finance lender. We employed the most practical approach at the moment for the issue. In the subsidiaries, we were the board of directors. Speed is essential in dealing with operating companies. The subsidiaries were sold off, one-by-one, in separate transactions.

When we received a homogenous group of assets with decent data, we sold them in the secondary market. In one case, they were quickly turned around and securitized. That sale and securitization paved the way for later securitizations.

We considered securitizing those assets ourselves, but frankly the process and the representations and warranties needed to securitize were farther than we chose to go. In retrospect, I think we left a little money on the table, maybe 4–5 percent of the transaction. But, it was a very good transaction for us and it had some very difficult issues for the eventual purchaser.

McFarland: My name is Beverly McFarland and I'm with the Beverly Group. I would like to address a question to Ms. Thompson and Mr. White. Of all of the methodologies used to dispose of assets around the United States, which do you feel, perhaps some research has been accomplished, had the highest net yield? Securitization, auctions, direct sales by the sales center, bulk sales, the SAMDA contractors, and how did the SAMDA contractors come out?

White: I'm the wrong guy. I don't have those answers. Often the assets are such different types that the different channels must be used. I'm not sure how we would even address the issue and provide you with the answer. But, I'm the wrong guy.

Thompson: I'm the wrong girl. No, actually there were different sales strategies that were used for different types of assets, and different methods worked best depending on the market. Whole loan sales worked really well at certain points in time for residential mortgage loans. Securitization works well when you have a certain dollar threshold because there are expenses that are associated with each type of transaction. We've looked or tried to look at the SAMDA contracts and also the SAMA, ALA and RALA contracts, and it really is an evolutionary concept and all of these methods worked well for what they were supposed to do. As we learned and as we grew, we refined these methods to try to get to the point where we are today. So, it is really hard for me to put in context which worked best because you're looking at different points in time and different asset categories. So, I think they all worked well and I think the government benefited from the mistakes that were made because we refined the strategies that were used to sell assets over the years.

Reid: Just to add one point to your question, perhaps to help you re-think the question you're asking. Each time CSFB acted as an underwriter on a securitization, one of the last tasks we would perform before offering it to investors was to review the information and present to the RTC the indicative pricing of what that pool would sell for if we were to sell it "as-is," as whole loans with no credit enhancement, instead of in a securitization. Usually that is a fairly complex analysis, but there are two elements to it that I think really are important to add in when you're comparing what you would get for selling a pool of whole loans and what you get through a securitization. It is not only the cash raised on the day of closing, because on a whole loan sale, that is all the cash you're going to see. That is the total amount of cash you will see out of that sale. Typically in the RTC transactions, the RTC held on to a residual interest, not an equity participation like some of the later deals, but a residual interest. If the assets performed better than the expectations (or base case) then there would be money left over at the end of the transaction and that would go back to the RTC. So, when you are comparing purely a bulk sale with a securitization, you have to look at both the cash raised on the day you closed, as well as the total cash to the RTC after considering the residual interest.

Meyer: Jim Meyer from the FDIC. Ted, as you reached the end of your contracts with the FDIC, etc., what were some of the challenges you faced as you reached the end and did your incentive structures hold, and what advice do you have for us as we clean up the bottom of the barrel, basically?

Samuel: I'm delighted to say that at the end of our contract, we had almost nothing left. Our incentive contract had a sliding scale which started at one percent and went to about 15–20 percent. That provided great incentive for us to resolve almost everything.

I assume there are other cases when there are many assets left. In those cases, I think the FDIC should either extend the servicing agreement to facilitate final collections or bulk sales or transfer the assets to a consolidating servicer.

Gilbert: Gary Gilbert, America's Community Bankers. This is for anyone on the panel who would like to respond. I was wondering if there are any unique problems in disposing either through a securitization process or otherwise, small business loans, particularly those that are not collateralized or poorly collateralized?

Reid: From a securitization standpoint, I believe there was one securitization done quite a few years ago by Chrysler Finance. The statement of how difficult it is to determine the long-term repayment probability of small business loans is that that transaction was a split-rated transaction, which in securitization indicates that the rating agencies do not agree on what the repayment to bond holders will be. Small business loans are a difficult asset class to value because you can view them purely as corporate loans to corporations that are not in the Fortune 500 or you can view them as business loans where it is also a real estate venture, in effect, because they are occupying the entire building and running a business out of it. So, in the case of foreclosure/non-payment, if the small business fails, the lender is left with a property and a business. Can you find an alternative buyer or use for the property to re-coup your loan?

Samuel: I think small business loans are among the most difficult to collect. They are particularly difficult if the collection objective is fast cash. They generally have no collateral. They fit very well in financed bulk sales with an equity participation which gives buyers of those packages time to work with the small business people over a longer period of time.

Question: In the Texas situation, how pervasive was fraud where you found that assets were basically worth nothing and you couldn't collect anything at all?

Bell: In general or with respect to insider deals and pursuing claims related to professional misconduct—I'm asking for clarification of your question.

Question: How much of it was really, when you actually went in there, did you find that the assets were fraudulent and they had been made either by people who were dishonest or borrowers who were dishonest, and the assets themselves were worth nothing?

Bell: Okay, I follow your question. Very few of the cases that we prosecuted for the FDIC and RTC involved actual fraud, that is those cases that I directly participated in. We saw a number of cases where there was substantial insider abuse and favorable treatment given to insiders, but not very many cases where there were sham transactions or where a director received some benefit and actually provided nothing in return. We didn't see very many of those type cases. But, I have seen studies that indicate in about one-third of the cases overall, and I assume those include S&Ls and commercial banks as well, where they saw some fraud that was about one-third. Also in Texas I've heard reports that fraud may have risen to the level of at least 50 percent.

Thompson: I think we're just about ready to take a break so that we can be back at 4:00 p.m. to hear our featured speaker, John Heimann. I want to thank my panelists very much and thank you all for participating.

Featured Speaker

Introduction

John Bovenzi, Director
Division of Resolutions and Receiverships, FDIC

I would like to introduce our afternoon speaker, and my understanding is that after his remarks he is willing to take some questions. Let me introduce John Heimann, who is the Chairman of Global Financial Institutions for Merrill Lynch & Company, a member of the firm's Office of the Chairman and Executive Management Committee. Mr. Heimann came to Merrill Lynch in 1984 as Vice Chairman of Merrill Lynch Capital Markets. He served as Chairman for the Executive Committee for Merrill Lynch European/Middle East from 1988 to 1990, and became Chairman of Global Financial Institutions in 1991. He served as U.S. Comptroller of the Currency from 1977 to 1981 and as a member of the FDIC's board of directors. You'll notice if you look later at his biography in your program that John Heimann has accomplished quite a lot. I won't go through all of it, but it's impressive and suffice to say we are very pleased that he was willing to take time from his busy schedule to be with us today. So, would you please join me in welcoming John Heimann.

John G. Heimann
Chairman, Global Financial Institutions
Merrill Lynch & Company

Thank you very much. I am an investment banker that morphed into a supervisor. I was first Superintendent of the Banks of New York State and then came to Washington as Comptroller of the Currency to return to the investment banking industry. So, the best introduction I've ever received was from Alan Greenspan who said, this is John Heimann—he's a poacher, turned gamekeeper, turned poacher. I wish that fate for all of you—I really do.

I'm really very pleased to be with you today at this symposium. When I was asked to join you, the organizers gave me the wonderful brief to "talk about anything that interests me." That is generous, but it does cause one to reflect and think about what would you really want to say to so sophisticated and knowledgeable an audience? I decided I would discard those matters which would be a regurgitation of comments made by myself and others on a number of well-worthwhile subjects such as Glass-Steagall. What will Congress do? Will it make any difference and how did we ever get into this ridiculous situation with a Congress struggling with self-interested turf battles while the financial intermediary system in the United States and the rest of the world steams ahead and redesigns itself?

I suspect that the future will be filled with very learned doctorate theses, dissecting the history of Glass-Steagall, from its hurried enactment to its protracted reform. Since I have been an active participant in this issue, having first testified for the repeal of Glass-Steagall as New York State Superintendent of Banks 23 years ago (I must have been very persuasive right?) I will leave objective dissection of this issue in the hands of interested academics of the future.

Nor will I address in the body of my talk the future of the financial services industry. Anyone with eyes, ears, and common sense can easily determine the future shape of the financial services industry. It has been apparent for the past decade and I have again written and spoken to the subject so many times that I thought I would spare myself, and others, a repetition of the obvious. Nor will I dwell on the suitability of deposit insurance. It is thoroughly apparent that deposit insurance is a key, if not the key element, in any banking system. To debate its importance is questionable use of valuable time. Deposit insurance is a bedrock for stability. In a positive sense, we know that from the U.S. experience, and in a negative sense, we know that from the Asian experience. Yes, of course, there is room for debate on the extent of coverage under deposit insurance, and yes, there is room for debate whether deposit insurance should be privately funded or supported in the final analysis by an implicit government guarantee. Unquestionably, there is need for far more debate on the issue of moral hazard and its flip side, too big to fail, than has taken place to date.

But, I shall pass on all of that, even though I have strong views on these related subjects, not only as it affects the United States' financial system, but also how it impacts the international activities of the International Monetary Fund. On these subjects during question and answer, if you want to bring them up, that is fine with me.

But, in light of the globalization of the financial services industry, which combines banking, securities, and in many countries, insurance, and the recent spate of mergers in the United States and elsewhere, for example, Nations Bank and Bank of America, which we were involved in, Bank One/MBD which I was involved in, CIBC/Toronto Dominion Bank in Canada, Credito Italiano and Unicredito in Italy.

I just thought I would like to talk about the future of the structure, not of the industry, but of the system that supervises the industry in its broadest sense—the financial regulators. Now, I know that this is a complicated subject. It is one that is bound to raise considerable controversy. But, I thought it would be unfair of me to come down here without setting the cat amongst the pigeons, and when I say cat amongst the pigeons, that's what I mean. I don't mean every man for himself as the elephant said to the chickens. I mean cat amongst the pigeons—to discuss this subject.

It has been discussed, by the way, on an international basis by the Group of 30 study, which many of you may have seen, of which I co-chaired on financial supervision and national limitations. The subtitle of that study is "The Inherent Contradiction of National Supervision of Global Firms and Global Markets." Any of you who haven't seen that study, if you will give me your card after this is over, I would be delighted to send it to you because it is a first rate piece of work. I know that is immodest, but that is what the FT said. That is the Financial Times and the Wall Street Journal. But, it is really worth your reading if your concerned in this area of activity.

Now, financial supervision is predicated upon the correct belief that the real economy should be isolated from the repercussions of systemic failure in the financial intermediary system. I will always use that phrase. I don't mean the banking system. I don't mean the securities system. I don't mean insurance. I mean the financial intermediary system. Those institutions that intermediate the savings of the nation and put them to productive use.

Financial crises, particularly those that occur in the banking system, have dramatic economic consequences in the societies which they intermediate. Innocent savers, small businesses and others are perversely affected through no fault of their own. The financial supervisors' main task, therefore, is to prevent the unintended consequences of financial institutional failure. And, they do that through the supervision and regulation of individual institutions which, taken together, make up the financial intermediary system. That is not to say that financial institutions cannot disappear. A dynamic system that constantly evolves to meet the needs of the customers or clients will always include those who cannot adjust or those who make poor judgments. When that occurs, and it always does, but when that occurs, these institutions must be and inevitably are weeded out. That is not only permissible, it is desirable. But, the process of disappearance must be managed to prevent the problem of one institution being transmitted to others.

As a sidebar, and we won't discuss this at any length now, but one need only look at what has happened in the Japanese financial system to understand how not to manage this type of problem.

But, before tackling the issue of supervisory instruction, there are three principles that need to be observed. Number one is independence. Banking supervision, in fact all financial supervision, must be independent and not subject to the passing political whims and fancies of the legislative and executive body. By that I mean the financial supervisory structure should be so designed that the supervisor can take actions he or she deems necessary in the public interest, free from parochial, political pressures. Supervisors' powers are great—I heard a bit of that before when I was listening. In the granting of charters, they bestow economic advantage. Conversely, in the closure of an institution, they take away economic advantage. To be independent, the supervisory agency must be free of undue short term influence from either the administration or the Congress. Therefore, the supervisory agency should not rely upon the appropriations process for its funding. Furthermore, the person or persons who run that supervisory agency should receive term appointments and be subject to rule only through a Congressional process. These twin requirements keep the supervisor free of direct Congressional and Executive Branch pressure. That is the case today for the banking regulatory agencies, but not for some of the others. But, of course, it is understood that the agency must be responsive to the parliamentary body that created it and that is done through Congressional oversight.

In my view, the model for the United States today is the newly-created Financial Services Authority in the United Kingdom which combines all the functions of the financial regulatory powers covering banks, building societies (we call them thrifts), securities activities and insurance. Even though it is totally independent, the linkage between the FSA and the central bank is strong and reciprocal, as it should be since the central bank is responsible for the provision of liquidity without which financial crises could easily blossom. In my view, the FSA is the prototype for the entire world.

My second principle is integration. As the recent announcement of Citicorp and Travelers highlights and others around the globe, the melding of banking, securities and insurance is the design of the future. This structure exists in most European nations. With the disappearance of Article 65 in Japan—that is their Glass-Steagall law which has disappeared—we will continue to seek commingling of banking and securities activities in that country. In fact, with the broad exemptions granted under Section 20 by the Federal Reserve, the amalgamation of banking and securities activities in the United States is broadly operative. Therefore, considering those realities of now and in the future, we must expect that we will see more and more of these activities housed in one operating entity. It hardly makes sense to have a variety of different supervisors involved in overseeing that operation.

As it stands today, we have three national banking supervisory agencies—the Federal Reserve, the Office of the Comptroller of the Currency and the FDIC. Thrifts are regulated by the Office of Thrift Supervision; credit unions by the National Credit Union Administration. On top of this, there are 50 state banking supervisors. In the world of securities, we find the Securities Exchange Commission. We have the Commodities Futures Trading Commission. And of course, when it comes to insurance, there is no national supervision, as that is vested in the 50 state insurance commissioners.

Now, how do we integrate all of this into an efficient and effective supervisory system which simultaneously permits innovation and forward movement? To me the answer is obvious—it's the same answer that has propelled the U.S. banking system forward since the founding days of the republic, and it's the dual banking system which clearly must be protected for those states which are willing to appropriate the necessary resources to properly supervise state-chartered institutions.

So, integration means bringing together all of the activities that modern financial institutions offer to the public, and under the supervisory umbrella of one entity. Obviously, today's supervisory bodies have very special areas of expertise developed over the years. To use these talents effectively, many have argued for functional regulation, a concept with which I am in total agreement. To do otherwise I think would be foolish. In H.R.10, this concept is promulgated. But that still leaves the issue of the lead supervisor who always sees the whole and works closely with the functional regulators.

Regardless of the specifics of the present bill, it is my contention that the supervisory structure in the United States needs a major overhaul so that it brings together the various banking and securities regulators in one body. Insurance should be a part of this, but until there is some Congressionally-authorized role for national insurance company supervisors, this will have to remain outside the new structure.

We should create a financial services supervisory body which would preserve functional regulation, and simultaneously, would permit state-chartered institutions to flourish.

The third point is integrity, and by integrity I mean the process which combines independence and integration, and that is critical.

In short, the overseer of the diversified financial enterprise should be capable of viewing the totality of operations from a safety and soundness viewpoint and it should not be subject to undue political pressures. Additionally, it means the integrity of the process by which it makes its judgment, and that its goals and responsibilities are clearly stated and understandable to the public.

In recent months, we have witnessed some unseemly squabbles amongst the regulators, over what can charitably be called turf. It is understandable that private interests will engage in adversarial politics in consideration of their economic self-interest. However, it is hard to justify self-interest for agencies of the government responsible to the people. These battles do not serve the public interest and undoubtedly will continue until the supervisory system is rationalized. In light of the rapid globalization of finance, delay in resolving our dilemma will prove to be as expensive as it is unnecessary.

One of the major arguments against a single federal regulator is that it would put too much power in a single regulatory body, that it would stifle innovation, and that it would be slow to move as it would become exceedingly bureaucratic. Many of these concerns would be solved, as I pointed out before, if we not only preserve but increasingly support a strong and effective dual banking system. My experience in New York State and then from my years here is that many of the real innovations that have taken place in banking did, in fact, start at the state level. They were not created in Washington, but they were created in one of the states by an imaginative superintendent or commissioner with the support of the banking community in that state.

So, my proposal fundamentally is to create a federal financial commission which would combine the banking supervisory activities of the Federal Reserve, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, and the National Credit Union Administration. Additionally, the Securities and Exchange Commission and the Commodities Futures Trading

Commission would also be members. Each existing agency would continue its functional responsibility in order to preserve their expertise and to avoid unnecessary duplication. The commission's board would consist of the heads of the agencies named above, slightly overweighted in favor of the Fed, which would have two board members for a total of nine. There is a legitimate argument on the part of the Fed that they have to know what is going on in the financial system as part of their duties and responsibilities as the central bank.

In addition, there would be two public members appointed for a five-year term, one of whom would be the chairman and both appointed by the President with the advice and consent of the Senate. The commission would then have 11 voting members, and as noted before, it would be funded by fees charged to the regulated institutions to keep it free from the day-to-day hassle with the appropriations process, though obviously the commission would be responsive to federal legislative oversight.

However, I know that is the perfect plan. But, I think it is a step too far. I know it has been right for years, but it's not going to work obviously—too many turf battles involved here. But yet we still need to do something. So, if Congress does not see in its wisdom to create a federal commission, then it seems to me that an acceptable alternative would be for the commission to be part of the Federal Reserve which is independent, according to the standards I set forth previously. In that case, the Fed would need only one member of the board on the commission and public members would be reduced to one, the chairman of the board, for a total commission membership of nine. The state superintendents of banks would relate directly to the commission through the FDIC. The FDIC would remain the insurer of the system as it is today, but its structure would need to be adjusted so that it can more directly represent the states. This could be accomplished by a restructuring of the FDIC board to include one or more state representatives. Importantly, it should be noted that the existing structure of all agencies would remain as they are today, that is, there would be no change in the governance structure in the Fed or the SEC, the FDIC, the CFTC and so forth. The governance does not affect those agencies that have a single person regulator such as the OCC and the OTS.

Now, I realize that bringing all of these agencies together would be difficult. Winston Churchill said don't argue the difficulties—they argue themselves. But, it seems to me that we must, in the United States, adapt our system to the growing reality of international financial competition. We have to do that in a way which takes care of the unique situation of the United States in terms of the spread of our financial system. It is unlike any other nation and therefore we have to adjust accordingly. Nevertheless, that should not be the excuse for doing nothing. That merely says we have to be imaginative in its design. I think that we can do that. I don't think we want to wait for circumstances to force us to change because whenever that happens, it is usually the result of crisis which costs the taxpayers a heck of a lot of money.

So, with that I would like to close my remarks and open it up to questions, except to say one thing. I want to take this opportunity—this is totally off the subject—but I want to take this opportunity to commend in this audience Skip Hove. The reason I want to do that is, I think he is one of the unsung heroes of financial supervision in the United States. He has been Acting Chairman of the FDIC—I'm not sure he's here so I'm not saying this for his benefit in his presence. He has been Acting Chairman of the FDIC three times and I don't think he's ever gotten the credit he deserves for the extraordinary job he's done standing in for one of the great agencies that was left leaderless. I just wanted to say Skip Hove is a treasure and we're all lucky that he is here.

Question: With either your new financial organization or the current regulators, what types of qualitative performance standards would you be applying to see if they're successful, especially in light of the Government Performance Results Act?

Heimann: That is a very good question. I think financial supervision has to change quite dramatically from where it's been in the past 20 years. When you have a giant organization that you have to oversee, and to make sure they are not getting themselves into financial difficulty, whatever that means, you can't do it the old fashioned way. It can no longer be examined as looking at loan files or questioning transactions. There is only one way you can oversee an organization of 50,000 to 100,000 people with a couple of hundred billion dollars in assets, with offices and activities in 40 nations, 50 nations, 80 nations—I don't know how many. How are you going to do that? You are all professionals—how are you going to do that? Are you going to put one guy in the head office—is he going to do it? No. Are you going to send in 10,000 examiners? We don't have 10,000 examiners. Are you going to send in 10,000 examiners to look at that and take a snapshot, and what good is a snapshot. When you can change your balance sheet in nanoseconds, so to speak, if you're so inclined, by pressing buttons on a computer and increasing your risks substantially through the use of just trading derivatives, etc., what good is a balance sheet analysis?

So, the whole form of supervisory oversight will have to change if it is to be effective in the future. It's going to have to combine very great knowledge, of not just banking per se. What is a bank today? Banking in the traditional sense—certainly capital markets—the banking system has been disintermediated by the capital markets. The banks all want to be in the capital market. I don't blame them for that one bit. So, you need people who understand traditional commercial banking, capital markets activities, and obviously insurance would be another element of it.

I wonder what happened to Daiwa? When the examiners from Japan came to New York to look at Daiwa, it was the banking examiners who came from the banking bureau. They didn't know beans about securities and of course the problem was in the securities side of Daiwa. Would it have been curtailed or controlled if it had been the securities guys from the securities bureau of the Ministry of Finance? I don't know. But it seems to me it would have been far more logical if those two sets of talents had been combined when they looked at Daiwa. The point in all this is you have to combine the talents.

So, the next question is are you going to have every agency duplicate things? Is the Fed now going to have a whole bunch of capital markets people? Is the FDIC going to have a whole bunch of capital markets people? Is the SEC now going to have a whole bunch of bank examiners and the costs for all of that? That doesn't make any sense. It is not fair to the public. It is simply unfair to the consumer, if nobody else.

So, how are we going to measure it? I think we're going to measure it by a number of ways going into the future. Obviously—I'm going to have to divert for a minute. We do have a dual banking system in the United States, but it is not what everybody calls the dual banking system. When in my remarks I was talking about state supervision and federal supervision—we have a dual banking system in the United States which are the big banks and the little banks. We have had that dual banking system for many years. The rules of the game are different. I happen to be a strong supporter of the community banking system and I think it has enormous value in this country and some of the community bankers are the smartest bankers around by far. But, having said that, you can examine and supervise a bank of $100 million or $500 million, or up to a billion quite differently than one that is $250 billion or greater than that.

So, we do have a dual banking system and we're going to have to adjust. That is why I feel so strongly about the state superintendents and state banking commissions. We have to adjust our systems so that there is an entity on a national level that can look at the big multinational problem and then you have the capacity simultaneously to deal with the domestic institutions.

How will it be measured? Well, more and more it's going to be measured by disclosure, transparency and by the markets themselves. As the systems grow, the markets are going to be the most severe judges of these institutions in terms of their share price. They have been in the past, but I don't think people have appreciated that so much. If you had looked at outfits like Franklin National or First Pennsylvania, just to name a few at different periods of time, Continental Illinois—all the different periods of time, you'll see their share prices were declining, long before the problem became a public problem. And, so in my view, for the larger institutions it's transparency and disclosure. More and more, I think the banking supervisors have begun to understand that following the share prices of these institutions is a wonderful early warning signal and pay attention to what the broad public is saying about a financial institution. How will it be measured? I think that is how it will be measured. That will be the reality of it.

This also brings up the other question about too big to fail, and I don't know if you want to get into that and I'll pass on that. But, I would have to say that of course there are institutions that are too big to fail. Why are we kidding ourselves? Can you imagine what would happen to the financial system of the world if you name the institution—I don't want to pick any one out—but forget the United States—if the Deutsche Bank closed its doors. They must be involved with financial institutions everywhere in the globe, as are our larger banks. So, it is not an issue of too big to fail.

We in the United States have found an answer to that and importantly the FDIC had a really lead role in finding that answer. It first happened with First Pennsylvania and then it went on—Continental Illinois, etc. We have designed a neutron bomb to take care of financial institutions that have been badly managed. We wipe out the shareholders. We sue the members of the board and management. But, the building still stands. It still continues to function. So, too big to fail is a meaningless phrase if the shareholders are wiped out and management is changed. So, I think we have to revise our lexicon when we discuss these subjects.

Finally, I would say yes, institutions must disappear. As I said in my remarks, there will be numbers of institutions that simply are sufficiently badly managed that they will come on hard times and they deserve to be wiped out. That doesn't mean just closing it down, but certainly the shareholders, the board of directors, the managers, etc. have to pay the penalty for their mismanagement. So, I think that is another system that will be very effective.

Question: Mr. Heimann, you've concentrated your remarks on how to reform the federal regulatory system. What would you do to improve market discipline in the system? You spoke a little bit about disclosure and transparency and touched on too big to fail. Is that your answer, or is there more we could do?

Heimann: I think that is a good question. Market discipline—that is something that is broached about by everyone. What is market discipline? There can be no market discipline without full information being made public. You just can't have market discipline without that. How is the market going to know?

One other thing about deposit insurance—I remembered this debate while I was here. That was we should rely on market discipline—we don't need deposit insurance. I have this picture of a hundred million Americans sitting around staring at half-baked balance sheets of banks, trying to understand whether the bank was strong or weak, and in many of the banks, they are so small they put out material once a year or twice a year. This just doesn't make any sense. We're not going to have market discipline in those cases.

We have market discipline where you have security analysts following the individual institutions. They issue reports and there is full information. I think part of the answer is market discipline certainly. But there has to be full information, which raises the most important question that people don't like to talk about—what about CAMEL ratings? Should they be made public? Isn't that a way for the public to find out? Isn't that a way to have market discipline? Shouldn't they know that the supervisors have looked at ABC institution and given it a four—because if it's a five it's not a problem—they're gone. But, giving them a four? What will that do? It is the same basic theory as having a variable rate deposit insurance. That is all part of market discipline in the broadest sense of the word.

I happen to believe, after all of this time that I've been around this system, and that has been a long time it seems like, that the CAMEL ratings should be made public. That is the way to create market discipline.

Now you say, that is a terrible thing to do—look at the problems you cause the regulators because up until now they could put any rating they want on it and they can't get sued or blamed for a run. But, I think that creates discipline and it creates discipline not only in the financial system but it creates a certain kind of discipline amongst the financial regulatory organizations, that they have to defend the ratings.

This brings me to another subject. I don't know how many people fundamentally get to the concept that all supervisory, certainly on loans and credit, questions are subjective.

They are not objective. But, as anyone knows if you're looking at a loan, it depends on the assumptions you apply to that loan. If it's a building in downtown Washington and you assume that the U.S. economy is going to grow by 2.5 percent in real terms, your valuation of that building in downtown Washington will be somewhat different than if you assume it will be a one percent negative growth in real terms. Therefore, the heart of supervision is subjective.

Question: Are the Japanese authorities moving in any way toward a solution?

Heimann: Well, I'm a great admirer of the Japanese and I think they've done a fantastic job since the end of World War II, and they surely have done that. There is a cultural question here that the Japanese government really has to deal with. There are a couple cultural questions. Number one, when they were recovering from the ravages of the war in the Pacific, the Japanese authorities felt it was their responsibility, and quite correctly so, to protect their industry, and the Ministry of Trade and Industry and the Ministry of Finance saw it as their primary responsibility to help build these indigenous corporations and financial institutions and they did a terrific job. There is no question about it. And Japan became a true economic power in the world, second only to the United States today, and assuming that the European Monetary Union (EMU) works as they think it will, Europe will be one of the three economic giants and powers of the world.

The problem, as I've seen it, and I've expressed this concern for the last five to ten years was that for whatever reason, the bureaucrats, and you can use that word in Japan with much more meaning than you can in the United States and we use it in the United States a lot, but in Japan the bureaucrats have enormous power and influence. They continue to protect the system and manage it in a way that we would never dream of in the United States. So, the financial system, if you look at it, was protected for many years on the philosophy of the lowest common denominator. It was considered anathema in Japan that a financial institution should fail or close, or disappear. Therefore, their rules and regulations and the standards they have set were the lowest common denominator—not those that were necessarily correct, but those which when implemented would not cause the disappearance or the failure of one of their financial institutions. Japanese are like Americans—they've got good bankers and they've got bad bankers. We have the same thing—good bankers and bad bankers. But, it was part of the Japanese cultural philosophy to protect everyone—it was called the convoy effect.

Unfortunately, that is still, in many ways, in action. It is true the Japanese authorities have closed a bank and they have closed a securities company—Yamaichi. Yet, with the money that the Diet granted for support of the banks, they put $100 million into every one of the banks, regardless of what was weak and what was strong. The reason they did that is they said if you put it into bank "A" and not to bank "B," the public would assume that bank "A" was in trouble and they would cause a run on the bank.

I'm a great believer in deposit insurance. That solves a lot of these kinds of problems. Nevertheless, the Japanese have a way to go in terms of structuring their financial system so it's not only competitive, but it is competitive in the world arena and it should be because it is a very historically strong economy and people are savers and hard workers, and they deserve a financial system which does represent the best of their country rather than some hangover from the past, which is no longer effective.

Will they get it right in the long run? The answer is yes, because they are very smart. Their political system is vastly different from ours. I think they'll get it right in the long run, but they're going to have to go through this kind of turmoil and concern as it affects their people. You will notice in the paper today that Japan just had the largest jump in unemployment in the last 10–12 years. The publicly announced unemployment numbers in Japan are not real because they have sort of make-do employment, so the unemployment numbers are actually higher than the 4.6 percent that they announced today. Our analysts in Japan say it is about 7.2 percent.

The Japanese also—the problem is for 50 years people were trained and taxed to save. Interest was tax-free. Consumption was taxed. That helped build the nation. No question about it. But, today what they need is consumption because retail sales are falling off the cliff. They really have to get their economy going again and they can't export their way out of the problems. They're going to have to do it through domestic consumption. That means changes in the tax laws which have been proposed. But, once again, there is a problem because they proposed temporary tax relief—not permanent tax relief. Savers, people who are sitting there seeing the economy in the doldrums, seeing people getting laid off for the first time in the post-World War II period, and getting 0.2 percent on their savings—they're not about to start spending a lot of money unless they think the tax cut is something they will have for a long period of time. I think Japan will come out of it. It still has a way to go, and I don't understand the politics of that country well enough to know how they're going to resolve the issue. But, for the good of the Japanese people and for the good of Asia and for the good of the world, I hope they do.

Question: Returning to your comment before about making CAMEL ratings public. What do you think of the private sector attempts at emulating a rating system—do you think that is a suitable substitute for market discipline?

Heimann: Well, you mean the rating agencies?

Question: Yes, and those people that do ratings on banks and thrifts using call report data.

Heimann: They don't have the insight that the supervisors do. What is the great strength of the supervisory system? Are the bank examiners smarter than everybody—no. They are as smart as everybody in a cross-section of the public. They have something that nobody else has—that is, they go into a series of banks and they can compare. They can see what is happening inside of those institutions. They can see who is doing a good job and who's not. They can see whose risk controls work better than others. It is very hard for outsiders to see that. You see it in the end when things go awry, but until they go awry, it is very hard to see that.

For example, you know that there was a study done called the Derivatives Policy Group Report that was done for the SEC and the CFTC of which I was co-chairman. At the beginning we went around with 50 banks and asked who had independent risk management, and 50 hands went up in the air. Everybody had independent risk management. So, you started to poke at it, and what did they mean by independent? Of course, some were really independent and others reported to the CFO, who had a treasury department that was a profit center. That is not independent. I won't go through all of those war stories, but you have to be able to get inside. No one can do that like the bank examiners.

I'm not suggesting that the confidential sections of bank examination reports be made public. I don't mean that at all. I'm just talking about the ratings. Obviously, it wouldn't make sense to publish all the ratings tomorrow. I think you would have to prepare the public to understand what they meant. So, this would be a process that would take place over years.

As far as the rating agencies are concerned, Asia proved yet, once again, that the rating agencies are a lagging indicator.

If there are no other questions, let me once again thank you for doing me the honor of having me visit with you today. Again, anyone who wants the Group of 30 Report, and I do recommend it to you, should just give me their card.

Thank you very much.

DAY 2

Managing the Crisis: The FDIC and RTC Experience April 29–30, 1998

Introduction

Kate McDermott
Symposium Hostess

It is my distinct pleasure this morning to introduce to you Gail Patelunas. Gail is the Deputy Director of Asset Management for the FDIC's Division of Resolutions and Receiverships. Gail joined the FDIC in 1990 to work on resolving failed financial institutions. As one of the initial members of the former Division of Resolutions, she gained increasing responsibility and became acting director of the Division of Resolutions for the year prior to its merger into the Division of Resolutions and Receiverships. Prior to joining the FDIC, Gail Patelunas worked as a financial analyst with the Board of Governors of the Federal Reserve, Division of Banking Supervision and Regulation. Gail was also a bank stock analyst for Kidder Peabody and a senior manager in KPMG Peat Marwick's bank consulting group.

Ladies and gentlemen, Gail Patelunas.

Welcoming Remarks

Gail Patelunas, Deputy Director, Asset Management
Division of Resolutions and Receiverships, FDIC

Thanks, Kate.

Well, I just want to summarize what we listened to yesterday and some of the things that we heard. We heard a wide variety and array of views and perspectives and also history on the resolution of the banking crisis of the 1980s and early 1990s. This ranged from the general resolution techniques to more specific asset disposition methods and problems. We also heard some suggestions for future activities and improvements on those techniques which was very good.

Judging from some of the comments we heard yesterday, I suggest that we have a whole other symposium on the cost test. That seems to be a very controversial issue.

Looking back and listening to the comments that I heard yesterday, our efforts seemed to center on maximizing our flexibility and innovation in dealing with the failures in a very constraining environment, both legally and economically. The techniques used to address the resolutions and the failures evolved through trial and error and also as the economic conditions changed and the pace of the failures picked up, and in the FDIC and the private sector, the capabilities changed in absorbing the amount of assets that were thrown off by the failing banks.

Going forward, one of the FDIC's challenges will be to develop a readiness to deal innovatively with potential problems in a continually evolving banking industry which is marked by consolidation unprecedented in size and product diversification. Like Joe Neeley said yesterday, uncertainty is the greatest risk of battle and that will certainly be true for the FDIC in the future.

I was at a financial analyst seminar recently in New York where part of the discussion focused on why banks typically trade at a discount to the market and whether or not this phenomenon is likely to change permanently, given the bank's record earnings, their good credit quality and the stable interest rates. One participant put it very bluntly and very succinctly, and he said, banks speculate on debt with other people's money. This not only explains the reason for a traditional trading discount, but that banks are in a cyclical business and continue to be tied to the economy in the cyclicality. The FDIC must use this information and be ready for the uncertainties that the future brings. In that effort, seminars like this are very useful.

Today, we will hear about the banking crises in other countries and we'll also solicit ideas for future readiness.

The first panel this morning will discuss banking crises in other countries. The moderator is Tom Rose, Senior Deputy Director of the Division of Resolutions and Receiverships. Tom began his FDIC career in 1982 in the Legal Division where he gained progressively increasing responsibilities and was appointed deputy general counsel for the liquidation branch in 1985. Mr. Rose worked closely with the resolution staff, developing policies relating to closed bank and thrift operations and legal issues. In mid-1996, Mr. Rose was appointed senior deputy director of the Division of Resolutions and Receiverships, where he oversees the general operations of the division. Mr. Rose has an undergraduate degree in Political Science from Villanova University and a law degree from Villanova University.

Please join me in welcoming Mr. Rose and his panel.

PANEL 3

Managing Bank Crises in Other Countries

Thomas Rose, Senior Deputy Director
Division of Resolutions and Receiverships, FDIC

Thank you, Gail. Once again I'll join in welcoming all of you to the second day of the symposium. Yesterday, the panels discussed the U.S. bank and thrift failures of the 1980s and the 1990s. As noted yesterday, one of the most successful resolutions is prevention. Forecasting and addressing the problems early on normally will result in fewer failures and reduced cost. Prevention, however, is not always possible, especially if there is a currency crisis or other external influencing factors. Absent the prevention, the development of resolution strategies sufficiently flexible to adapt to a changing economy are critical to resolving troubled institutions.

The techniques used to address the enormous volume of assets resulting from failures in the U.S. were as varied as their results. I believe the ability to be creative and flexible will be seen for years to come as a key to resolving any bank crisis.

The United States has not been alone in dealing with troubled banks and thrifts. Over the same time period, many other countries such as Argentina, Bolivia, Brazil, Chile, Peru, Venezuela, Mexico, Finland—and the list goes on and on—have all dealt with or are currently dealing with problem financial institutions.

Troubled institutions throughout the world have created challenges for financial systems worldwide. Governments have implemented a variety of resolution strategies ranging from forbearance to open bank assistance to liquidation. Generally, these strategies have been used as a tool to maintaining or restoring public confidence and financial stability. Today, we have a distinguished panel who will address resolution strategies used by other countries. You will see that the spectrum of resolution processes has been varied. You will note similarities as well as differences in the process used in the United States.

As we proceed with the discussion, it should become very clear that no two banking failures or crises are the same. Likewise, no two countries are the same. What worked in one country may serve as a possible solution for another, but should be viewed more as a building block to crafting the right solution rather than the solution itself. Resolving failing financial institutions must be viewed in the broadest of contexts, especially in developing nations, where a banking crisis can easily become a debt crisis.

Many factors must be considered when attempting to resolve banking problems. A review of the laws, the culture, the existence or non-existence of deposit insurance, the expected cost, the economy, as well as the political environment, and finally, the potential long-term impact, are all critical, essential elements to crafting the right solution.

The concentration of banking in a few institutions may also impact the resolution process. As was seen with the rescue package of Credit Lyonnaise, it may suggest that the reality of too big to fail has already been proven. At the same time, the resolution of Credit Lyonnaise attempted to address the moral hazard by forcing a downsizing of that institution in the rest of Europe; therefore, making it not overly competitive with the other institutions in Europe, not giving it an advantage. In France, it was left such that the other French banks feel that they've been placed at a competitive disadvantage.

As suggested by our featured speaker yesterday, what do the mega mergers in the U.S. suggest for our future? Can we afford to ignore the banking problems of other countries? Economies continue to grow more interdependent, failures on an individual basis may only impact the local economy. On the other hand, a large number of failures or the failure of a mega institution may, in fact, have fall-out in a number of countries. Today's discussion will focus on past crises and current events, starting with the Scandinavian experience. We will then move to Eastern Europe and the issues confronted by emerging nations, followed by a discussion of the Japanese government's response to recent banking problems and the potential impact on the rest of southeast Asia, as well as the world.

Let us welcome this morning's panel. To my left is Arne Berggren. Mr. Berggren traveled a great distance to be with us today, coming from an assignment in South Korea via his home in Stockholm. He is President of Eusticon and serves as a consulting advisor to banking authorities in a number of countries, as well as to The World Bank and the International Monetary Fund. Earlier in his career, Mr. Berggren was Special Advisor to the Swedish Ministry of Finance, and in that capacity, he assisted extensively with measures taken to strengthen the Swedish banking system.

To Mr. Berggren's left is Bill Roelle. No stranger to us. Bill is currently Managing Director of Business Development for General Electric Capital Corporation. Immediately prior to assuming that position he served as an advisor to the Polish government in addressing bank privatization. Earlier in his career, he was employed at the FDIC in a number of different positions. He also served as Chief Financial Officer and Director of Resolutions and Operations for the Resolution Trust Corporation.

To Mr. Roelle's left is also no stranger to us—a former FDIC chairman, Bill Seidman. Mr. Seidman is currently a commentator on CNBC TV, publisher of Bank

Director magazine, and a worldwide consultant on banking issues. While at the FDIC, he oversaw the birth of the Resolution Trust Corporation and served as its first chairman. He was responsible for many of the asset disposition and resolution strategies used by the FDIC in the late 1980s. He has had a varied career, including serving as vice chairman and chief financial officer of Phelps Dodge Corporation, managing partner of the accounting firm of Seidman & Seidman, educator and a member of the White House staff of President Ford as assistant for economic affairs.

I would like to thank the panelists for taking time from their busy schedules to be with us today. At the conclusion of the presentation today, as in yesterday, there will be an opportunity for questions. I would encourage all of you to be active participants in this discussion. The worldwide financial news of the past six months clearly suggests that this should be an interesting and lively discussion.

Let me introduce our first panelist, Mr. Berggren.

Arne Berggren
International Banking Consultant

Good morning. First, I would like to say how glad and honored I am to be here. I am impressed by the failed bank resolution processes that you have developed and by what you have accomplished in resolving your banking crisis. I also think you have a lot of experience that many countries will benefit from in the future.

However, while there are many similarities, it is critical to note that there are also important differences between a banking crisis in the United States and a banking crisis in smaller countries. First of all, the American economy is the largest in the world and is "closed" in the sense that it is not as exposed to problems in other countries. Smaller countries have more "open" economies, as they are more reliant on foreign trade, and are therefore more exposed to problems in other countries. These economies can be rather volatile, as they typically are also more reliant on foreign sources for investment. As a result, banking problems in these countries can quickly develop into severe systemic problems. Moreover, the economic and political differences between countries make it important to adjust the responses and techniques to fit the unique circumstances.

What I will do today is to go through the Scandinavian banking crises. First, I will try to show you some similarities between the three Scandinavian countries. I will then move to the Swedish case. I am most familiar with that case since I engineered most of the Swedish strategies and processes.

If you look at most countries that have lived through a banking crisis, especially the more developed countries, you will see a scary pattern that very often starts with deregulation of the domestic credit market and/or the current account. It seems to be a rule of nature that deregulation is often followed by an over-expansion of the economy—a boom period. This boom lasts for a while and oftentimes results in a crash.

Let's look at the banking crises in Scandinavia. Each crisis happened at different times due to the different structures of their economies. The Norwegian economy is based on oil. You are very familiar with what can happen in that type of situation. When the price of oil fell in the early 1980s, it had a dramatic effect on Norway's terms of trade, and this eventually had a negative effect on their banking system. Finland and Sweden, in a sense, benefited from Norway's problems and were able to "postpone" their bank problems for a couple of years. Finland had extensive trade relations with their Soviet neighbor, and their banking crisis became serious when the Soviet Union fell apart. The Swedish banking crisis started with the bursting of our real estate bubble. The most difficult period of the Swedish banking crisis came after a period of currency unrest (when George Soros became a household name, even in Europe).

So what we have noticed is that a country will have a period of deregulation and experience an over-expansion of their economy, which oftentimes ends in a crash. I think that you have seen that cycle at work in many states and areas within the U.S.

Let's go back to the mid-1980s to look at the development of the Swedish economy. The combination of strong economic growth coupled with the deregulation of the domestic credit markets eventually generated a banking environment that was the equivalent of an economic hothouse. The deregulation enabled a rapid credit expansion by bankers that did not fully understand the risks involved. Prior to deregulation, those bankers were in a sense required to go to the central bank once a week and ask for money to lend—but when everything was deregulated they were looking for new markets and to increase market share. At the same time, we had a system with high marginal taxes and interest income was tax-deductible. As a result, a very high leverage ratio was built into the Swedish economy.

During the period of expansion (until 1989–1990) real estate prices rose 25 percent per annum. There was also a wave of leveraged buyouts. The ratio of credit to Gross Domestic Product (GDP) rose from 90 percent to 140 percent in just two years.

I would like to point out an important difference between the American banking system and the European banking systems. In Europe, the normal ratio of banking assets to GDP is around 100 percent. In America, it is around 50 percent. The banking systems are more important in Europe since their capital markets are less developed.

The expansion lasted until around 1989–1990 when an international recession, a tax reform, and some other events led to a dramatic downward adjustment in asset values. Real estate prices fell 50 percent, stock prices fell, and practically everything lost value in a very short period of time. That was later followed by a currency crisis that led to a 30 percent depreciation of the currency. That caused another wave of business failures. This demonstrates how quickly things can evolve in an open economy.

A period of ad hoc measures was instituted when the banking crisis first began to appear. We were initially approaching the situation bank-by-bank until it became clear that the entire banking system was fragile. We eventually instituted a general guarantee—which I will discuss later.

So, that was the macroeconomic situation. Let's now look at the structure of the system. The finance companies were the first financial institutions that were hit by the crisis. These institutions were one of the results of the regulations existing prior to 1985. They could not take deposits. They issued CDs. They often borrowed short term and lended long term.

We also had a wave of mergers in the banking system as all institutions were hunting for dominance, for market share, and were trying to cut costs. By 1992, we had only 17 commercial banks in the country and the six largest banks accounted for 75 percent of our banking system. As we developed our strategies to address the banking crisis, it was clear that we could not liquidate them all.

Other considerations had to do with the structure of the economy. Sweden has quite a few multi-national corporations. Maybe 90 percent of their sales are outside the country and are in other currencies. The structure of the Swedish economy is like a cocktail glass in that we have several extremely large multinational corporations, a few mid-sized companies, and many small business organizations. One result is that approximately 40 percent of bank loans are in foreign currencies. This is a short description of the situation at that time.

So what did we do? It was clear that the failing finance companies were nonsystemic so they were handled by the supervisory authorities in a normal court liquidation process or in negotiations between creditors. The Swedish banking system was, in relative terms, well capitalized before the crisis. It looked strong and we thought that we could weather the storm. But our financial problems did not end there. We had our first bank failures in 1991, and those were large bank failures. The consequence was that the Swedish Ministry of Finance got directly involved.

We did not have a deposit insurance system in Sweden, which was good in my opinion. Those large failing banks were all systemic and taxpayers' money was necessary in order to solve their problems. That meant that we had to go to the Parliament with a bill each time a bank had a problem and explain why it was necessary to do certain things. However, the condition of the system was not improving. It was increasingly clear that the system was fragile. At the Ministry of Finance a few of us started to develop a worst-case scenario. That was important in that it helped us to form a political consensus among the decision-makers in the Ministry of Finance, the Central Bank, and the office of the Prime Minister, as well as the political opposition.

The crisis continued. We had to make a big quick fix for Nordbanken. However, it was soon clear that the quick fix was not enough. So we decided to nationalize the bank and recapitalize it. Nordbanken was very large, as its asset base equaled 23 percent of GDP. The initial cost of recapitalizing Nordbanken equaled 3 percent of GDP. A few years later we were able turn it around at a profit for the taxpayers and that transaction, more or less, paid for the banking crisis.

The restructuring of Nordbanken was really important in that it served as a showcase for the rest of our work. It demonstrated the government's determination to address and resolve the crisis and it helped us to gain respect. If you are operating in a small open economy and are dependent on the international capital markets, you need to explain to American pension fund managers, to Japanese pension fund managers, to Standard & Poor's, to Moody's, and to others what your country is up to. The intended audience was not the depositors, because they already trusted us, it was the international capital market.

So what do you do in a situation like the one in Nordbanken? You need to develop a strategy, a set of actions, and determine how to pay for it. The interests of the shareholders, depositors, creditors, management, employees, and the taxpayers were all at stake. We approached the problem as a commercial undertaking and determined how we could maximize profits to the government or minimize cost. We studied Nordbanken's operations to determine how we could improve efficiency and the management of various asset types. It was clear that there was a potential for improving the core banking operation, to cut costs and unprofitable lines of business, and to refocus the organization. We felt that a successful approach would be to act as an aggressive equity investor focused on profit maximization. That would be the only way to recover some or all of the taxpayers' expenditures.

Nordbanken was refocused to retail and we decided to skip the large corporate segment altogether. The large and complex nonperforming loans, and what we called nonstrategic assets, were removed from the franchise. As you can see, we were more involved in the organization and management of the restructuring of the bank than governments often are in situations like this.

It was also really clear that we needed to explain to the politicians that we had suffered a loss, that we were less rich than we had previously thought, and that the necessary expenditures to restore confidence in the system could be a sunk cost. However, a portion of those expenditures could actually be viewed as an investment and as a way to get our money back. It was clear that we needed to recapitalize the bank to a decent level to restore confidence. The best-managed and capitalized banks in the country were used as benchmarks for the recapitalization.

Our goal was to re-privatize the bank in a reasonable amount of time and thereby recover our initial investment. That would allow us to achieve our primary goal, which was to minimize the final cost to the taxpayers.

An asset management corporation called Securum AB was established and the large bad assets were transferred to that entity from the bank. The government provided the required equity. Once that was accomplished the restructured Nordbanken had a balance sheet that was more transparent and its operations more focused, and we were able to start the bank and the asset sales process.

Just a few words about the asset sales process. We used different approaches to asset disposition, both organizationally and strategically, depending on the type and the size of the assets. Securum is just one example. Most of Securum's assets were linked to larger real estate and industrial companies—such as the chemical industry for example. Our scope was international. We had assets in the United Kingdom and in Germany, we had assets in Atlanta and in New York. We had golf courses in Spain and France and in similar places.

Anyway, the idea we wanted to get across was that we did not mind becoming an owner of the underlying assets. The message was that we wanted to work out the loans effectively and that Securum's mission was to get its money back. In many cases that meant that companies were taken over and run by Securum. We took over the companies, restructured and merged them into more logical industrial groups, made them profitable, and then exited the investments by floating them on the stock exchange or by negotiated sales.

The reason for this approach instead of direct sales of nonperforming loans was that Sweden is a small country with less developed capital markets. We couldn't securitize, since our capital market was not deep enough. So we needed another approach and this was the corporate restructuring approach.

We thought that it would take eight to ten years for Securum AB to get rid of the assets, but it actually took only five to six. During the general crisis that followed after the restructuring of Nordbanken, the government set up other types of asset management corporations. Some were independent and others were established as bank subsidiaries. All banks eventually established asset management corporations during the crisis, and those were later spun off to their shareholders.

In 1992 it was clear that the Swedish banking system was falling apart and we were forced to issue a general guarantee, i.e., the state guaranteed that all banks would meet all their commitments on a timely basis. Everything was guaranteed apart from the stockholders' interests. Moreover, the parliament gave the administration a "carte blanche" to do whatever was necessary to safeguard the payment system. That meant that we no longer had to go to parliament seeking approval for individual measures and to get funding—we could use as much money as was needed to accomplish our objectives, i.e., to restore confidence in accordance with the principles set out in the bill.

We said that the support system would be in place as long as it was needed. However, we wanted to shorten that period since we realized that the pricing mechanism would be disturbed as long as the guarantee was in place. We managed to clearly communicate that message as we could see that all short-term bank papers were priced the same, while there were differences between longer-term bank papers. It was clear those investors understood that the support system was a temporary measure.

The individual decisions were all based on a few principles during the crisis. However, certain principles were more critical than others. I think the commercial principle was one—to run the operation as a business and to maximize profits for the real owners, i.e., the taxpayers. Another was to focus on minimizing final costs rather than short-term government expenditures.

We established the Bank Support Process with this in mind. First, we decided what kind of banking system we wanted, or would most likely end up having, in the future. We then developed our analytical framework. This framework was used to decide which banks we had to close or merge, which business lines to get out of, and which banks had the greatest potential for profit improvement. We ran through a lot of financial valuations, risk analyses, and reviews of strategic options for each of the institutions that applied for support. We wanted to preserve local competition—we did not want a community to have only one local bank branch.

This is what we did to alleviate our banking crisis. We had to do all of this since there were no market prices at the time. How can you value stock, real estate, loans, etc., when there is no market? You have to value it anyway. You need to develop assumptions and you need to develop an analytical framework that treats everyone equal. You need to be able to delegate this framework into your system, and you have to control the methodologies and other things crucial for making this process work. For example, by using this framework we were able to individually value 25,000 pieces of real estate in just four to five months.

To conclude, when you are faced with a systemic banking crisis like the one we had, the most important thing is to develop a worst-case scenario and to be certain that you have the management capacity to handle it. It is also quite important that you base your restructuring efforts on facts, and not on wishes, in order to shorten the workout period.

You may think that our approach was extreme. I have not seen it used in any country other than Sweden. However, I think it made it possible for us to shorten the period of intervention to two years and we were able to remove the guarantee since the situation had returned to normal by then. We had initially used around 7 percent of GDP. But we actually recovered most of that when we were able to sell our stakes in the intervened institutions. As a result, the final cost was 0.5 percent of GDP.

Thank you.

Bill Roelle, Head of Operations, Financial Services Group
GE Capital

Good morning. I want to speak a little bit today about managing the crisis in Eastern Europe. Could we have the first slide please?

Slide BR-1

I'll focus on the Polish experience because I'm most familiar with that, and I think it would be safe to say that you can assume for most of the Visiguard countries that the Polish experience is fairly representative. It is just a larger country and they have more banks, but the process and the problems are the same.

Let me point out before I start this that they started off in a crisis when they came out from under the Iron Curtain. Their banking system was essentially non-existent as we know it and it was in crisis from almost day one because virtually all their banks, by our standards, were insolvent.

Slide BR-2

If you look at the legislative framework, in 1989 the Polish banking system had been transformed from a collection of highly specialized state-owned banks to financial services institutions or universal banks. These banks were taken out from under the National Bank of Poland which was their mono-bank. They were commercialized which was to say they were taken out and made stock institutions, of which the state owned all the stock. So, they were still essentially state-owned banks, but they were partitioned. As you see, the National Bank of Poland Act created a monetary policy arm, a bank regulation and supervisory arm, and it split up the National Bank of Poland.

The monetary policy arm has done a reasonably good job. The Polish economy has had real growth the last three years, averaging slightly over six percent. However, the monetary policy arm is highly politicized and very much influenced by the IMF and The World Bank. Poland continues to want to enter the European economy. They want in NATO and they are highly influenced and they have to maintain many of the strictures that are placed upon them by the IMF and The World Bank and that often conflicts with their domestic policy issues.

Regulation and supervision—I'll tell you a little bit more about that on the next slide.

The Banking Act really established or tried to establish, and I'm using the word here—"de-monopolization." You might call it restructuring. But what they really set out to do is they understood that they had a monopoly and it was a mono-bank and they had to do something about that. So, they split it up, as I told you. But, the split up was rather more form over substance.

They also created the power for the Bank Privatization Act to be housed with the Ministry of Finance, which has also had its difficulties and was highly politicized and I'll tell you a little bit more about that in the next slide.

The Deposit Insurance Act was created. It is very similar to ours. They've done some things that we probably, in hindsight, would have done. They've kept the amount of deposits that are insured to a very reasonable limit. They've been careful not to go too far too quickly. But, there are differences and some of them are significant and debilitating.

Slide BR-3

I'll give you a quick overview of the banking sector today. If you look at that, what is in the private sector is 38 percent of the gross assets. Privatization—these are institutions that are teed up to be privatized, represent 8 percent. You have 5 percent in co-ops and you have virtually half of their entire system in what are called specialized banks. I'll tell you a little bit about each of those.

The footings in the banking system are around $70 billion. If you look at the number of banks in each of those categories, there are 76 banks in the private sector. There are two banks teed up to be privatized. There are seven banks in the specialized category, and there are 1,600 co-ops, most of which are insolvent.

Slide BR-4

The opportunities are substantial and we should remember that although they started out in crisis, the Poles didn't realize they were in crisis. They weren't valuing or measuring their banking system exactly the way we would. They saw, coming out from the Iron Curtain, and joining the free nations with a market driven economy as a huge opportunity, in spite of the crisis that we might see as regulators, supervisors, and folks who had worked in and around bank problems in the United States for the last 20 years.

They have a stable government and they are very much market driven. Perhaps too stable. The reason I say that is that their governments, since they came out from under the Iron Curtain, have been largely coalition governments—very fractured. The coalitions get together and form a government and because of the special interest inside the coalitions, you may have a very right-wing coalition that wants to drive ahead with privatization of the entire sector, not only the banking sector but the industrial sector. On the other side of the coalition, but within the coalition, you will have the ex-communist party who are ostensibly democratic, want to go slow, do not want to disturb the power settings that were already in existence, and do not want to have the economy move too quickly until they are fairly certain that, if one were to be skeptical, they were substantially in place to inherit the wealth of the new economy. If one wanted to be more objective, they really do believe that the socialist system still has many positive attributes and they don't want to become completely a capitalist system.

They get a lot of help from the international community. One place they've gotten a great deal of help is from the Polish Bank Privatization Fund which was anchored by the United States. We put up close to $400 million. England put up about $150 million. The Japanese put up roughly $2 or $3 million. Australians put in some money. Altogether, the fund represented about $600 million dollars. This fund was put together to help the Polish government recapitalize their banks and the way they did it is the Polish government issued bonds and put the bonds in the bank. So, they recapitalized the bank by creating instruments that they gave to the banks, essentially. The problem was, how were they going to, in effect, deal with that hit on their budget.

So, the western governments got together, built this fund, and this fund is currently being used to amortize this debt that the Polish government took on in order to recapitalize their banks. It is basically set up as a defeasance program.

They've had strong real growth. They are growing at roughly over 6 percent, as I said, and that is helping a great deal. The EBRD is also taking an active role in the reconstruction of the banking system. They don't do it directly. They're very careful about not becoming owners, owners in the sense of being directors and managers of the bank. But, as the Poles take their banks to the private sector and to the stock market, the EBRD usually takes a standby position in an IPO investment. So, in effect, if they go to market and the IPO is 80–85 percent successful, the EBRD will step up for the remaining 15 percent. They will become a passive stockholder with the expectation that there will be a take-out within five years.

There is substantial foreign interest in Polish banking. It is an interesting fact that Poles don't trust us and probably with good cause. They understand that their banking system is near and dear to their economic growth. They need us. They need foreign investment, and they need foreign know-how, but the Poles' history, their thousand-year history suggests to them that many of their neighbors are not always kindly disposed towards them and one of the old sayings in Poland is that first they invaded us with tanks, and now they're invading us with their money. Probably true.

They also, in terms of foreign investment, they do not know how to deal with it. Along with the investment comes very active participation, as you would expect. The foreigners who invest in Polish banks want to move the banks along much faster in terms of what the Poles are willing to do, or even can do, given their coalition government. What you find is that a foreign investor will come in. It's not unusual to have a bank in Poland have something in the neighborhood of a billion dollars in assets and maybe 5,000 employees, which would be unheard of here. They may have 200 or 300 branches in these banks that were spun off from the National Bank of Poland, each one operates like a unit bank. It's very reminiscent of Texas. So, you have the headquarters bank, which is usually located in one of the major cities, usually Warsaw, a few in Krakow and then Gdansk, but largely in Warsaw. Then they have branches all over the country operating as unit banks. They have their own P&Ls. They give very limited information to their headquarters bank. It would be almost impossible for them to roll up any significant information in less than two weeks, and often it takes a month to find out what their financial position is.

In short, it's a difficult situation. They have a good and a well-organized stock market, patterned very much like ours. The problem with that is it's very young, it's highly volatile and 50 percent of the stocks in their market are banking stocks. So, as they privatize more banks it makes it difficult for the next generation of IPOs because the market is not balanced and there are entirely too many bank stocks.

Slide BR-5

Now, the challenges are significant. The deposit insurance, those of you here and particularly my colleagues at the FDIC will find this interesting. The deposit insurance responsibility is split among three agencies: the Treasury, the Ministry of Finance, and the National Bank of Poland. Then they have a staff called the Deposit Insurance Staff. Now, for those of you who have gone through the last 20 years at the FDIC with me, can you imagine what it would have taken for us to do some of the things that we needed to do in the banking crisis and the thrift crisis if we had a board compiled of this group of people who all had good intentions but different agendas? So, the deposit insurance responsibility in Poland is going to be a difficult proposition, I believe, for them to figure out how they're going to handle the crisis when they have the money to do so.

As I indicated, the coalition government is slow to act. They are also reflective of the constituency in their coalition. There is high difficulty in doing anything that strikes as somehow undermining the social program that is in place there. As a side note, one thinks of our social security program and how much we have to worry about that. Over 25 percent of the Polish GDP goes to their social programs. So, they have a huge social program, high unemployment, and many people in retirement at age 50. So, it is a huge problem and those people do know how to vote.

The government has been inconsistent and confusing in its privatization efforts. They started out doing IPOs. The last IPO they did almost failed, then they switched to creating a Phoenix. We had great difficulty convincing them that was a bad idea, but they thought they could take all of their bad banks, put them together into one huge bank and somehow create gold out of lead.

They really did think that they knew more about market allocation than the market. I've tried to persuade them that generally if you could get the market to resolve your problem, even though the market was young and still forming, that it would be a better result than trying to engineer a solution themselves. However, they have had many fits and starts. They had a recent transaction where they put a bank up for sale under a competitive bidding process, much like we would do a failed bank transaction. They had very competitive bids. One from a German bank, one from a Dutch bank, and the winner was a Korean bank. They promptly took those bids into the inner sanctum and they came out with no winner and they did not privatize that bank. So, they disappointed their foreign investors. The foreign investors spent a lot of money doing due diligence, involving themselves in the process, stepping up to bid, and then the government changes its mind. So, they have had a difficult process in trying to gain some equilibrium in going forward.

The legal infrastructure is not conducive to safe and sound banking practices. Mortgage liens are not centrally recorded, if recorded. Many properties were confiscated by the communist government and the German occupation forces before them, and there is a lot of litigation in the courts about who owns property and therefore getting a mortgage and getting a free and clear title to a piece of land is quite difficult.

There are no UCC filings. There is no UCC program. It is difficult, therefore, to put any kind of a lien on rolling stock or anything that one might want to repossess if one could repossess. There are no credit bureaus. The banks now exchange information among themselves and largely it is that informal system that represents their credit bureau system.

Slide BR-6

I'll show you a typical Polish bank that is in that private group that is going to be privatized. This is PBK. If you look at the amount of cash and due, it is substantial. Loans—substantial, but I'll explain that in the next slide. Securities—those are government securities. No investments by and large. Small fixed assets and other assets.

Slide BR-7

If you look at the loans, you'll see that consumer loans are minimum. Consumerism, the average consumer loan in the Polish banks, and it is not average—average is a bad measure here—the average Polish citizen owes about $182, which is roughly 50 percent of their monthly disposable income. So, they're not heavily in debt yet. If you look at commercial loans, you will see up there I think it says about 28 percent are in what are called government-directed loans. These are loans that are ostensibly guaranteed by the government. They are loans that were directed to state-owned enterprise. Most of these loans, if you were to go in and examine these banks, look at the state-owned enterprise and then look at the value of the loan, most of them would be classified as loss.

The reason that they are carried on their books and that they are current is because they are fully guaranteed by the government.

Slide BR-8

You look at the reserves. They don't have much in the way of classification. Below standard is reasonably small. Doubtful—very small. They only started using doubtful as a measure after they started working with largely folks from the U.S. over at the National Bank of Poland. You'll see at the bottom there it says lost. I had a lot of trouble with my Polish colleagues. I kept saying make that loss, and they kept wanting to change it to lost. I kept saying, no, no, it's loss. They said, no, but we've lost it. So, finally I just gave up and left it as lost. What you also find is they don't recognize classifications hardly at all until the judgment day, and then it goes immediately to loss.

Slide BR-9

If you look at their liabilities, "due to" is not substantial; deposits are very substantial. The Poles have virtually all of their money in banks, but it is not in any kind of accounts that you would recognize. I will tell you a little bit about that later. Their other liabilities are relatively small.

Slide BR-10

If you look at the deposit breakdown, individual deposits are reasonable. They do not think of a deposit as a transactional deposit, even though you'll see that some are current and some are term. Their current deposits are largely deposits that are put in that can be withdrawn on demand. There are very few checking accounts in Poland. These are just savings accounts that you can go to and have immediate withdrawal privileges. This is very painful as it usually takes you 35–40 minutes to go in and do a bank transaction in Poland.

Corporations and non-government—again, split. Some are term. Some are current. About 60/40. The current deposits are largely deposits that are in for a short period of time and would represent working capital or would represent compensating balances that are held for purposes of some lending that is going on.

In summary, if you take what's going on in Poland and you expand it to the other Visiguard countries which are Hungary, Czech Republic, Slovakia—they are largely in the same boat. They all had mono-banks. When their mono-banks converted, they split out to specialized banks and to these so-called commercialized banks, and they have all attacked the problem roughly the same way. Hungary and the Czech Republic privatized much quicker. They got their hands around the problem ostensibly and got the banks in the private sector. They have regretted it to a certain extent. Many of those banks were not adequately capitalized. They are having to re-visit a number of those transactions, and where they were good transactions, the banks have not fared extraordinarily well because of the difficulty in getting the population to engage itself with the banking sector. In Poland, they've gone slower. They've made fewer mistakes, but they have not privatized.

A side on the specialized banks—the ones that represent 40 percent of the assets—there are only seven banks there. Those banks are gargantuan—they're huge. Literally among the seven banks there are probably somewhere in the neighborhood of 2,500 branches. Three of those specialized banks, three of the largest—one is called Vigized—that is an agricultural bank. The other is PKLSA, which was a foreign investment bank. And then they have PKLBP, which was their mortgage bank. All three of those banks, by our standards, under our examination, would be insolvent. The government has recapitalized them and even under the recapitalization going forward, it is problematic how they are going to deal with those problems because all of the loans they hold are old agricultural cooperative loans, many of which don't exist any longer. The mortgage loans are to co-ops. There is no equity in these loans. The co-ops themselves are hard to split up. There is no actual ownership interest in the co-ops. You cannot evict. There are a number of legalistic problems associated with these loans that make them uncollectible.

So, they have a big struggle. They are going to have to work on those big specialized banks and they're going to have to solve that problem. My confidence is that they will. They're going to do a good job. It's going to take a long time. If their economy keeps growing, they'll make it.

One thing that I would point out as well in one of the slides, the bank management, the young managers, the people that have studied western economics and finance are very capable. They are extremely capable. They need leadership. The old entrenched senior management and directors in these banks came from the old communist system. They are not good bankers by our standards. They understand the system extraordinarily well. They know how to negotiate and operate within their old system. They have great difficulty dealing with the new reality of a privatized system where the banks are supposed to allocate credit and direct capital flows to the most needy. They want to continue to do the direction by feel-good old relationships. They would still want to put money into some of the state-owned enterprises where they have high connections and high confidence in their friends that are in those state-owned enterprises.

Overcoming that is a large struggle for the National Bank of Poland. I think, under their new supervision program that they are rolling out in the next year or so, they will come to grips with this. But, if you can imagine, if countries like the Visiguard countries have lived under a form of government where the banking system was nothing but a check writer to state-owned enterprises and simply an allocative mechanism that was determined by a central committee, to one day drop that Iron Curtain and say, now, we're going to split up the mono-bank into commercialized banks and go forth and do commercial banking—it was a tall order. Almost impossible but they're doing well and they will succeed—I think. It will take time, again, and I think the one last thing I would say is that they are getting a lot of advice from people like me and some of you out there. Most of it is good. Some of it is bad. They're overwhelmed with advice. Probably one of the nicest things we could do is back off, give them help when they ask for help, and otherwise let them try to learn and sort out their problems. They are overwhelmed with advice.

Thank you very much, I appreciate it.

L. William Seidman, Chief Commentator
CNBC-TV

It is a great pleasure to be back at the FDIC. To be here and listen to board member Neeley eloquently describe what most of you went through in the past is a real pleasure, and it's just an honor to be here with the old FDIC and RTC heros—Bovenzi, Cooke, Glassman, Stone, Roelle, Rose—those are all the people who really pulled us through. I'm amazed as I go around the world that everybody knows the RTC but not too many people know the FDIC. I have to point out to them that the RTC cost the government $100 billion which the taxpayers paid, but the FDIC has never cost the taxpayer a penny. So, the real hero in this ought to really be the FDIC who weathered more failures than the RTC handled.

My assignment is to tell you about the countries that I've been to. That includes Saudi Arabia, Russia, Japan and just beginning with China.

Let me start with Saudi Arabia. Their challenge is they have so much money they have trouble knowing what to do with it. The second challenge is that they have what is called Muslim banking which makes paying/charging interest illegal. Now, if interest is illegal, I want all of you great bank supervisors and those who value banks to go into the bank and determine the condition of the bank when every deal is based on a purchase and sale, even though it may be figured like interest. It is an exciting way of banking and it's a challenge to do, and if you have as much money as they have, you can do that. But, my role there is merely to help them spend their money. That is not all bad.

Let me say this about Russia, 90 percent of what you heard from Bill Roelle about Poland applies to the Russian system. In fact, the Russian system reminds me of this story they tell over there. Ivan asked his mother—mother, why have I got the biggest feet in the third grade? Is it because my dad was communist? She says, no son, it's because you're 19.

Well, the fact of the matter is, Russia is a huge country, but it has a banking system that is in the third grade. It is just really beginning and the biggest difference between what you've heard from Bill Roelle about Poland and Russia is that Russia has started a lot of new independent banks which are truly trying to be banks in the same sense as we have in our country. The difference is that they're very small and, if you took a look at the United States in 1870, you would get a pretty good picture of their banks today. They are small. Their longest loan is 90 days. A lot of what they do is really just foreign exchange. I went into one small bank and there were three or four of the tougher looking Russians sitting around with AK47s and I said, I know that crime is awful around here, but do you need to have a real army here to defend this small of a bank? They said, well, they are not here to defend the bank, those are the people who collect our loans. That is essentially the way banking was done earlier in our country. So, the Russian banking system is just beginning to develop.

I was there for The World Bank and we had $2 billion to spend, and if you want to really be treated royally, just wander through Russia with $2 billion that you can provide them. I got so full of caviar that I couldn't look at a fish egg again. We ultimately ended up with a program that took 200 selected banks around the country, small banks that were developing, and tried to bring their people over here and train them, capitalize them, and turn them into real banks. That program is actually working fairly well. They are developing a whole new system of banks outside of the kind you heard about from Roelle, the old Russian communist banks. So, that is all I'll say about Russia.

I'm a TV broadcaster and I'm used to three minute pitches, so I can't go on for too long on one subject or I'll ruin my status as a TV man.

Let me go on to Japan which, of course, is far more important to us—the second largest economy in the world. I think what Japan proves is what I have found everywhere I've gone in the world, that while many things are the same, many things are different. When you go to these countries, one of the first things you try to do is sort out what is the same and what is different. Certainly, Japan is a good place to do that. I've been going there ever since I left the FDIC and it kind of reminds me of the bad news/worse news stories. A doctor calls up his patient and says, I have bad news for you and worse news for you. You have only 24 hours to live. The patient says, oh, that's terrible. What could be worse news? The doctor says, I've been trying to get you since yesterday. That is pretty much where the Japanese banking system is. They've been getting bad news and every year it gets worse.

If you looked at their system, you could see many things that were comparable to problems we had, particularly in the S&L industry. First, they had a real estate boom. Their banks had huge conflicts of interest with borrowers. They had poor to no supervision. The Japanese were the original inventors of "not on my watch" and would do anything to push it off until the next guy is in office. They tried to deal with it by, in effect, having strong institutions take over weak institutions. So, all of you will recognize their situation was comparable to what we saw, particularly in our S&L mess.

But, there were major differences, and are major differences. First, they don't have any holding company structures and in many ways, that makes taking over a bank if it has failed, much easier. If you remember the bridge bank mechanism to handle failures. If there were no holding companies, it would be very easy to take over an organization of any size. You simply would change the ownership of the bank. You wouldn't have the kind of problems you have with holding companies. So, that makes it much easier. But, the thing that makes it much harder in Japan is that 40–50 percent of the capital of the banks is ownership of other bank stocks. So, to the extent that you fail a bank and make the stock worthless, it reverberates throughout the system because other banks lose capital. In that way, their problem is much, and I mean much, more difficult than the problems that we had.

They have fewer institutions than we have and that, of course, makes it somewhat easier, although I will say, Arne, that I was consulted by the Swedish group in 1990 and when I looked over the situation I said, well, you have five or six big banks and they're all busted—that is too tough for me—go get somebody else to handle it. They were really in the soup.

Above all, the Japanese culture is much different than ours and when I began going there, their basic approach was that time will correct this, that prices are depressed—that this is just a cycle and over time this will take care of itself. Well, as all of us who have been in the business know, if on the asset side of the balance sheet you have 15–20 percent of assets that are producing no income, and on the liability side you're paying for holding those assets, then it is unlikely that time is going to cure that in any period. Of course, the only reason the Japanese banking system is actually operating today is due to their central bank reducing the short-term interest rates to a half of one percent so that the banks can borrow from the central bank at a half of one percent and lend it to us at 5–6 percent. That spread is the income that has essentially been keeping the banking system alive in Japan. Without that, there would have been a crisis which would have demanded an overall correction immediately.

"Too big to fail" is something that doesn't worry the Japanese. As soon as they had their problem, they guaranteed all bank deposits in all banks. That is the way they are operating today. It is almost amusing to hear people discuss, is too big to fail really alive and well? In every country in the world that has had major problems it is not only alive and well, but we're in the position now that Korea is too big to fail and Indonesia is too big to fail. We, and the IMF and others are out saving banking systems all over the world because they're too big to fail and they'll jeopardize the world's financial system. So, too big to fail—the Japanese have no problem with that. They have already guaranteed all bank accounts, all deposits in all banks and they're right in step with the rest of the world.

For many years we have been telling them that what they were doing to meet their problems was not really going to work. You couldn't keep those interest rates down there forever. As long as you have a banking system that didn't work, you weren't going to have an economy that recovered. Finally they had runs on some banks. Much as we found at the FDIC, it really moves you into action when a big bank has a run on it. The Japanese have not done anything with an insolvent bank—any bank, unless there has been a "run" on the bank. Only at that time have they taken action and so far that has involved three or four institutions, a large credit union, and one relatively large bank.

So, as far as the kind of action that we talk about and you study here, you don't need to spend a lot of time in Japan because the net result of what they've done is to subsidize their banks through monetary policy. They really haven't taken any action in the past.

Now, all that is being changed. They decided they would have a "Big Bang," like the big bang they had in London, and free their markets, and put their system on what they call world standards of banking. So, what have they done? They've created a new independent supervisory institution which is not under the Ministry of Finance. It reports to the Prime Minister. It is independent, and the law requires it to use international banking standards and to institute "prompt corrective action." Well, they marched up to that requirement and took a look, and the first thing they did was defer it for a year because if you took prompt corrective action using international accounting standards, you would maybe have only one or two solvent banks. The size of their banking problems, no one knows for sure because they have not had an independent bank supervisory group. You've heard about several bank supervisors who are now being indicted. The Japanese have a very small on-site type of supervision that clearly wasn't effective. For an advanced country they have some of the weakest and least computerized banking and supervisory systems. So, the answer is they don't really know today how badly off they are. They know that it's bad. They've admitted to $600 billion of nonperforming loans. But, they have had pretty much the same experience that we had with the S&Ls which was if they reported that their loss was $50 million, when we liquidated it, it was $150 million. I believe, they are going to find when they get this new supervisory agency going, that their problem is much larger than they so far have acknowledged.

So, how are they going to handle this? Well, they looked at what we did in the United States and they decided they would take it all. They would set up an FDIC which they called the Deposit Insurance Corporation of Japan. They set up an RTC which would handle assets, and they would set up an RFC, which we used during the Great Depression to refinance all of our banks. The RFC would handle any preferred stocks in banks that were "well run" and had some capital, even though they were undercapitalized.

That is approximately the situation a few months ago when I was there. They passed the legislation and the first thing they did was say, well the RFC investments looks like the way we ought to go first, so we'll start putting money in the weaker banks to boost their capital. This is where the Japanese culture comes in. They said, we can't put capital into just the problem banks—if, for example, the Fuji Bank comes in and wants this capital and the Mitsubishi Bank doesn't, that will make a distinction between the two and it will label Fuji Banks as weak. So, what has happened? All the major banks have come in and the government has put preferred stock in all of them—good, bad and indifferent. So, the government is now providing what we call open bank assistance to all the major banks "whether they need it or not." They've said, we can't have any distinction because if you did there would be a run on those banks labeled weak and the system would be in trouble.

They've also started to dispose of assets. The sales have been by the banks themselves dealing with all our old friends at Bankers Trust and Goldman Sachs and all the rest. The government agencies, which have $230 billion in funding, have not yet, as far as I can see, done anything in that regard. I'm going over there again in another month and maybe by that time they will have started to move in that direction.

They are looking at commercial real estate securitization. We will have to see whether having talked the talk, whether they are really actually going to walk the walk. So far, it is not too encouraging.

One of the key questions is, why the Japanese government is not more concerned about their economic problems? They've been in a non-growth economy for seven years now. Their GDP growth is zero to one percent, and you would think that if something like that was going on in this country, there would be a revolution. The fact of the matter is in Japan, the average Japanese citizen may be better off than he was seven years ago. They have had full employment since by the nature of their system they don't fire people, and they don't cut anybody's wages. Since they have experienced deflation in effect, the average person in Japan is living as well or better than he did in the past. As a matter of fact, the crash in real estate prices has allowed lots of Japanese to now live somewhere closer to their work than a two-hour commute by train to Tokyo. So, they have a word over there that describes why the Japanese aren't doing anything—it's something like nooroomaya, and it sort of means, I'm in a lukewarm bath and it's cold outside—I don't think I'll get out. There is no political will to do any of the tough things that we were required to do. Yet, it is obvious that they can't continue. Many of their banks are not capitalized at world standards and their credit ratings have been lowered. Eventually they will have to do something if they want their economy to recover.

When you go over there and talk with the average person in Japan and ask them why they are not yelling for the heads of their politicians, and they all say, "things are not bad. I have my job. My pay is good. I'm not going to be fired. I'm saving money for my old age. I don't trust the politicians. I'd rather let things go the way they are." So, we'll see what happens. The key to it is that they are in the world economy and slowly the world is impressing on them the costs of having a system that isn't up to world standards.

Thank you.

Rose: I have a couple of questions that I was going to ask, but I would like to, at this point, defer to the rest of you, the participants. Does anyone have a question they would like to ask of the panel?

Question: This is for Mr. Berggren. Will the Euro, the whole method of changing Europe and their economic union, effectively convert European countries into closed economies, more like the United States, and cause some of the problems that you experienced to not occur in such a dramatic fashion?

Berggren: You have many mergers going on in Europe right now. It is not only between banks and insurance companies, it is going on all over the place. You have the same thing going on here. So, I think you will continue to have lots of mergers going on in Europe. I think it will be a fragile situation in a way. I think any future problems would not come to a situation with many small banks, as you had in the U.S. I think it will be with the larger banks. But, of course the macroeconomic shocks will be less because the whole European economy in a sense will be closed as the American situation.

Milton Joseph: For the whole panel, in the United States we obviously have really adequate disclosure for people who want to look at banks in terms of call reports. Is there anything going on to standardize accounting and disclosure among international banks in these countries?

Seidman: Well, the Japanese system as they have now announced it would move them into full disclosure using international standards for their banking system. So, if they actually put into effect what they said they're going to put into effect, that would be a very important change to improve transparency. But, they haven't done it yet and based on their past record, we'll have to wait and see whether they actually do.

Roelle: In Poland and the Visiguard countries, they have adopted international accounting standards. They have difficulty making the transformation from the current accounting system, which was French inspired, difficult to figure out, and done substantially differently than most of you all would recognize, in particular, the way they handle reserves and some other things in the accounting statement. However, the Polish National Bank, and I think it's true of Hungary and the Czech Republic, have all adopted international accounting standards. So, you will eventually see that all of their balance sheet and income statements will look the same. But, I think it is probably a year or so away before that happens.

Berggren: Although some countries claim to be adopting international accounting standards, if you have a close look at it, maybe they are not really international accounting standards. There are also other problems. In many countries, you don't require consolidation of industry groups. So, you can have a lot of funny stuff going on in accounts outside the bank balance sheet and that takes some time to figure out. You can also have very weak accounting professionals in the country. Many of the local accounting companies do not apply the American or European standard of accounting. So, there are a lot of questions and difficulties when you try to go to a foreign country and assess the situation.

John Quinn, FDIC: This question is for Bill Seidman. You mentioned that you're starting to work in China. I was wondering if you've been able to identify any models that the Chinese government is interested in pursuing with respect to privatizing their banking sector, supervision, regulation, or deposit insurance?

Seidman: As I said, they're just getting started. The central committee has ordered that the banking system become a sound banking system in terms of world standards and they've got all the problems of a communist state which has made huge loans to government industries and they are looking now at starting, not by privatizing the system, but by actually taking out the bad loans, taking out the security on the bad loans, and selling it in a securitized method, mainly with foreign capital. That is where they are at the moment. Then actually privatizing the banks—they do have private banks in China now and they supposedly, Price Waterhouse has been over there for I don't know how many years trying to help them set up a system. So, the first step is going to be to try to take the bad assets out and after that, apparently they're going to try to privatize some of the larger banks. But, they haven't done any of this yet. So, it is all in the talk stage.

Don McKinley, FDIC: To Bill Roelle and Bill Seidman, maybe you can describe what opportunities, if any, there are for European banks or U.S. domestic financial services industries to operate in countries like Japan or over in eastern Europe in terms of making consumer loans or taking deposits and basically interacting with their economies?

Roelle: In eastern Europe and in Poland, as I indicated, you have a lot of foreign interest. I think there are difficulties however. One is, as I mentioned, virtually all of the Polish banks are unit banks. Each branch is a unit bank. They do not have very sophisticated computer systems. They do not operate in a check environment. It is still a cash based economy. There is heavy consumer demand as they come out from the Iron Curtain and as real wages and disposable income have increased. The Poles, for example, the Polish automobile sector was the fifth largest in terms of sales in Europe in 1996 and was almost the fourth largest in 1997. That shows a lot of pent-up demand. The answer is yes—there is a lot of opportunity for foreign investment in Poland. There is a lot of opportunity in consumer lending. I think until they get some of their infrastructure fixed so that you can have liens on cars that will be centrally registered, so that you can actually repossess the property if necessary, that it is going to go slow. Any foreign investor is going to have to put a huge investment in terms of computer systems and technology into the Polish banks. The Poles want to sell these banks. They view them as crown jewels so they want a high premium. So, if you're looking at the premium you have to pay the Polish government to get the bank and then the investment you have to make in it and the kind of returns that your investors are probably going to want, your stockholders or shareholders, it's a tough proposition. But, there is a lot of opportunity.

Question: I have a question for Mr. Seidman on Japan. You mentioned that some of the companies bidding to be the initial buyers are American companies. What are some of the obstacles and challenges they are facing for acquiring portfolios in Japan and what kind of competition do you see for them by either other Japanese companies who want to get into the business, or perhaps other countries?

Seidman: Right now the biggest challenge is to get the product. The government has not yet put any product on the market, so it all has to be negotiated from the private banks. That is, at least so far it has, just really gotten started in the last few months. So, it is just getting underway. I think longer term there will be lots of opportunities for people to bid for assets much in the way they did here. So far, there hasn't been, as far as I know, Japanese bidders for what is essentially nonperforming real estate. So, it is pretty much in the same state as it was at the RTC when Bill Roelle took it over and got it going. They are just establishing the market. They hadn't allowed securitization or any of those things up until these new laws were passed. So, there will be a lot of opportunities, I believe, in the future.

Bert Ely: For Bill Seidman with regard to Japan. Bill, my sense is that things have continued to roll along as they have in Japan because the Japanese government is running some very substantial budget deficits, and its ratio of government debt to GDP is starting to reach very high levels. I heard someone refer to Japan recently as the Italy of Asia in that regard. How much longer is Japan going to be able to keep doing that? Is it possible that it will break the back there, that their debt levels will get just too high, and in that regard, I believe I read recently that one of the major credit rating agencies, either Moodys or S&P, put Japan on credit watch. What are some of the longer-term implications of that, not only for the Japanese government debt, but also for private sector debt in Japan?

Seidman: I think Japan is on a road that if they don't change, eventually will lead to real financial chaos because they won't be able to maintain this full employment. Some, like the chairman of Sony, have already said that if they don't do something very soon, the average citizen is going to feel the problems that they have. So, they have to change because as I said in my remarks, the world is not going to accept them as a sound player in the financial markets unless they do something. On the other hand, they have larger savings than any other nation in the world. Their pool of capital is tremendous so that I don't think this is a near-term problem. It is a long-term problem, which is just beginning to show up. I would guess that before it really starts to become a major problem for them, they will do something. They are living today on exports and the rest of the world is not going to live with them trying to maintain their economy solely on exports and running huge surpluses in a balance of trade. So, they will have to change, but because of the tremendous reserves they have, they can run quite a while without it.

Question: There has been a lot of talk today about some of the similarities and differences in the methods in which various countries have dealt with problem institutions. There has also been a number of people calling for a uniform system on resolutions worldwide. Do you have any feelings, any of you on the panel, any comments with regard to a uniform system of resolution?

Seidman: I have to go and make a broadcast now. Time, tide and broadcast wait for no man. So, I have to leave, but I would just say that what impresses me is that uniform resolutions of banking problems, we don't have them in this country and I can't imagine having them in the world.

Berg: My name is Dick Berg, and I'm with First National Bank of Ordway, Colorado. We've heard that the European banks do not have or have not taken any real action on the year 2000 problem. Do you have any comment on that?

Roelle: I don't think that is accurate. We spend a lot of time discussing, in addition to all the other things that I had talked to you today, about that. The Polish government, for example, and I know from my current affiliation with our activities in Europe, there is truly a huge amount of investment in time being spent on the year 2000. So, I can't speak for every European bank, but I can certainly speak for most of the U.S. interests in Europe. We're spending a huge amount of money and time on the year 2000 issues, as well as Euro issues. It may be that some of the European banks are not paying attention, but I doubt it.

Berggren: Actually, I'm not familiar with what is happening, but I know how much focus we have on it in many of the Scandinavian countries. I think the conversion to the Euro (currency) is what people are most concerned about. They need to have systems to handle that. A related issue is for the countries that will not join. Sweden is one of those countries. We will have to have parallel systems.

Rose: Thank you all very much. We appreciate your participation in today's panel. Thank you in the audience for being active participants. We are going to have a short break now until 11:15. Thank you.

PANEL 4

Reflections and Looking Ahead

Introduction

Gail Patelunas, Deputy Director, Asset Management
Division of Resolutions and Receiverships, FDIC

In our second panel this morning, we're going to be looking at future events and what some of the future events might hold in the resolutions arena. Moderating this panel is Mitchell Glassman, who is a Deputy Director in the Division of Resolutions and Receiverships. Mitchell joined the FDIC in 1975 as a liquidator-at-large. He's worked on failures in Kansas, Illinois, California and Florida. In looking at his biography, one of the things that I noticed was that Mitchell was a liquidator-in-charge at the failure of the Metropolitan Bank & Trust in Tampa, Florida, which failed in 1982. If you can remember back to 1982, that was the largest failure to date and it was $250 million in total assets. So, that puts it all in perspective. In 1983, Mr. Glassman moved to Dallas to establish a liquidation office, and in 1984, he became the Deputy Regional Director of that regional office. In 1993, he moved to Washington, D.C. and became the Deputy Director in the then Division of Liquidation. He currently serves as the Deputy Director for the Operations Branch of this division. Mr. Glassman holds a business degree from the University of Missouri, and is a graduate of the Stonier Graduate School of Banking. Please join me in welcoming Mr. Glassman and his panel.

Mitchell Glassman, Deputy Director, Operations
Division of Resolutions and Receiverships, FDIC

Thank you, Gail. The subject of this final panel of our symposium is to not only reflect upon the FDIC and RTC's most difficult challenges, but also their accomplishments during the past period of financial turmoil in the U.S. banking and thrift industry. As a long-term employee of FDIC who was deeply involved in resolving and managing the bank crisis, I've been looking forward to not only moderating this panel, but also to listen and learn from our panelists and guests, for we have to go on. There is a future.

Oliver Wendell Holmes once said that if you want to understand what is happening today or try to decide what will happen tomorrow, try looking back.

During the last day and a half, we have heard discussions relative to bank and thrift resolution strategies and methods, asset disposition and marketing strategies and techniques, application of deposit insurance and failed institutions, and also we heard at the luncheon from Director Neeley who mentioned that it wasn't just the FDIC and RTC corporate experience, but it was also a personal one for those who fought the battle. I have to admit that I'm one who fits in this category. The historic study of the bank and thrift crisis brought back many reflections for me. I would just like to share one very quickly.

You're not going to find this in the study or find this in any anecdotal information that may be provided later on, but it has to do with a small bank in east Texas. Again, it was like many other banks that we had dealt with. What was unique about this bank is that we were walking in and we had a closing crew, and this closing crew was on its fourth closing in six weeks, so they were tired, but the adrenaline was there, and they were ready to go to work. When we were walking into this bank, which was on a Friday at 6:00 p.m., we noticed an elderly gentleman, and in east Texas, it is not unusual to have people out on the street. But, this gentleman was obviously a rancher who had been in the community. He stayed outside for most of the weekend. We were very concerned and I asked the employees inside if everything was okay—was there anything we could do for him to reassure him that everything was going to be okay. They told us that his name was Jake and that he was a long-term community leader and that two weeks before, he had just deposited money in the bank and the money came from a failed S&L. So, Jake was worried obviously and had an anxious look on his face. But, he stayed there. He was able to peer through the windows and he watched our team work. At that time, we didn't have an assuming bank. There was a re-bidding process going and the FDIC always has to be prepared, as claim agents, to be paying deposit insurance. So, he saw this activity and we were working through the night.

Come Monday—good news. We did have an assuming bank. Jake came in, cashed his $20 check, and came over and said hello to the assuming bank, but he also came over to me and basically said thanks. Thanks for being there. When I asked why he stayed out there all night, he related the story that 50 years prior to that there was another institution in that bank—this was in the early 30s—and he said that bank was suspended. It was suspended. It was before deposit insurance. He said what made him feel good in looking through that window is that when the bank was suspended the last time, there was no activity, no work. The bank shut down and nobody came. So, it made him feel good.

So, not only did he thank the FDIC for being there, but he wanted to thank all those people and those entities who brought you here. For me, that really hit home because in his unique way, he sensed that the FDIC did not just appear at the bank to handle the crisis in his small community just out of the blue. Even though he witnessed first hand what FDIC was doing and the bank people that were there, a well-rehearsed militaristic type of way of getting the job done, he knew that there was something else to it.

I think what Jake really sensed, but really had no way of knowing, was that the FDIC and RTC had many employees who were passionately dedicated to the mission of maintaining public confidence and ensuring stability. In essence, as we heard from Director Neeley and what a lot of you will see in the literature is that we try to make the bank closing a non-event for the public, especially for the depositor, especially for Jake.

In addition, I don't want to forget that it wasn't just the FDIC employees that helped. It was all the bank and thrift employees who joined in with FDIC and RTC, who stayed on those Friday nights and weekends and worked with us side-by-side because they also had a sense of what it meant to protect depositors and to get the bank reopened. And for all of them who not only worked in our bridge banks and our conservatorships, but those who stayed and actually helped us do the payoffs, those I, also, do not want to forget.

It is for history and the study that we have recorded the FDIC and RTC experiences in managing the crisis. But, it should also be noted that our agencies' historic experiences in resolving and managing the massive numbers of bank and thrift failures in the United States, with our desire to maintain the public confidence in the financial system, would be incomplete without recognizing the enormous efforts of other significant parties and participants. One only has to look at our agenda and look at the participants in our symposium as to the variety of backgrounds of those who were participants in our efforts.

The private sector, the ones who provided the capital to purchase the banks and thrifts, and to refinance the borrowers, and to fund the asset purchases and all the contractor support, not only for those who managed the assets and helped at the closings, but also those who left their own employment in the private sector to help the FDIC and RTC in their efforts.

From the academic and media communities who studied, reviewed, and provided a perpetual comment of the economic and moral impact of the RTC and FDIC policies and procedures.

Last but not least, should we not forget the role of our federal government and our democratic form of government which allowed the U.S. financial crisis to not only be dealt with openly and directly through discussion and comment, but that provided funding so that action could be taken and of course lots of oversight that served as a check and balance.

As the country and financial sector moves forward into the new millennium, it is important that we reflect on our past and to learn the important lessons from our collective experiences. For the future does not hold any guarantees. Nobody ever indicated there is never going to be a guarantee that there will never be another bank failure or that the U.S. financial markets will never ever be in chaos. To help us reflect on this subject and to give us their insights, I'm very pleased to have with me three distinguished panelists—Jonathan Fiechter, Dr. Paul Horvitz, and Jack Ryan.

Jonathan Fiechter serves as a Director of the Special Financial Operations for The World Bank. Prior to this position, he was Director of Financial Sector Development of The World Bank, which provided policy advice and technical assistance to client countries seeking assistance. Mr. Fiechter joined The World Bank from the Office of Thrift Supervision and while at the OTS, Mr. Fiechter held a series of progressively responsible positions, including serving as head of the agency from 1992 to 1996. Mr. Fiechter began his professional career at the U.S. Department of Treasury as an international economist in 1972, and in 1978 he joined the Office of the Comptroller of the Currency. Mr. Fiechter has also served as a Director of the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the Neighborhood Investment Corporation, and is Chairman of the Financial Examination Counsel. Welcome Mr. Fiechter.

Dr. Paul Horvitz has been a Professor of Banking and Finance at the University of Houston since 1977. He received a B.A. degree from the University of Chicago, an MBA degree from Boston University, and in 1958, he received his Ph.D. in Economics from MIT. From 1957 to 1966, Dr. Horvitz worked for the Federal Reserve Bank, the OCC, and in 1967, he joined the FDIC as an Assistant Director of Research, becoming its Director of Research in 1969 and Deputy to the Chairman for Policy in 1976. Dr. Horvitz has authored and edited several books and numerous articles on banking and finance in professional and trade journals, and he is currently co-editor of the Journal of Financial Services Research. From 1983 to 1989, he was a Public Interest Director at the Federal Home Loan Bank of Dallas. Mr. Horvitz is a charter member and remains a member of the Shadow Financial Regulatory Committee. He was a Director of Pulse EFT from 1990 to 1996, and is a current Director of Bank United.

Jack Ryan is the Regional Director of the Office of Thrift Supervision, southeast region. The southeast region in Atlanta, which is also known as the Atlanta Regional Office of OTS, is responsible for 265 thrift institutions with aggregate total assets of more than $61 billion. During 1994 and 1995, Mr. Ryan was on leave of absence from the OTS and served as the Acting CEO of RTC. Before being appointed the Regional Director, Mr. Ryan served as Senior Executive Vice President and Chief Regulatory Officer of the Federal Home Loan Bank of Boston. He also served as the Acting President for a period of seven months in 1989. Mr. Ryan spent 25 years as a commercial bank and bank holding company regulator for the Federal Reserve System and for eight years Mr. Ryan served as Director of the Division of Bank Supervision and Regulation for the Federal Reserve Board in Washington, reporting directly to the board during the terms of Chairman Burns, Miller, and Volker.

I would like to note that at the end we will take questions, and I will ask since this is the last symposium panel, this is your last chance, so we expect a lot of questions to come from you. Without any further ado, I would like to ask Jonathan Fiechter to please start us off.

Jonathan Fiechter, Director, Special Financial Operations
The World Bank

Thank you, Mitchell. It is great to be back. I also think the topic, managing crisis, is an excellent one. Often regulatory conferences such as this focus on how to prevent banking failures, and I think we probably spend too little time on how to manage them once they're upon us. So, I commend the FDIC for this effort.

I would agree with Mitchell that our objective ought to be to try to make bank failures a non-event, that arguably the better we are at managing bank failures in an effective and efficient fashion, and at minimum cost to the taxpayer, the more likely we are to embrace the notion that a healthy banking system that includes risk-takers will have the occasional failure. Our objectives should not be to prevent all bank failures.

Today, I want to touch upon three topics. First, I want to review the lessons that I learned in my time, at the Comptroller of the Currency and Office of Thrift Supervision starting in 1982 with Penn Square and going through the 90s with the thrift industry. Secondly, I'd like to touch upon some lessons related to the resolution process. And then third, conclude with a comment on the future and particularly the application of prompt corrective action, and what that might hold for us going forward.

In terms of the lessons of the 80s and 90s, first and foremost, I think that it is unlikely that any of the supervisory agencies are ever going to be able to predict and prevent major banking problems in the financial sector. They appear to arise almost like clockwork—the REIT problems, LDC, energy sector, the ag bank problem and the thrift industry. So, I think we're going to have to live with systemic crises. Everyone has a bit of myopia, so I think we're going to hold conferences like this long into the future.

Secondly, and this is related—agencies are going to be forced to operate with imperfect information for a variety of reasons, including lack of adequate resources. Predicting bank failures is always going to be more of an art rather than a science.

Third, supervisory agencies will make mistakes. Hopefully Congress will accept this and be reasonable in their natural tendency to second-guess agency decisions. When you've got major problems, swift action is often better than studying an issue and holding off making decisions for fear that a mistake will be made.

Fourth, I think that supervisory agencies in the future, as in the past, will always be tempted to take steps to avoid closing banks, to avoid a loss of credibility and to prevent criticism. Unfortunately, in our system, when a bank fails, particularly a major bank, it is often viewed as a failure on the part of the supervisor—where were they, why didn't they prevent it? In going back to my earlier comments, it would be wonderful if one day we got to the point where we just accept that failures will occur—it's part of a natural process, particularly in a market system.

Fifth, I think agencies have to assume that often, banking problems will turn out to be worse than initial estimates. Bill Seidman has said that when he took on the role of head of the RTC, he assumed the thrift problem was a golf ball, but it turned out to be a watermelon. When I joined the Federal Home Loan Bank Board in 1987, we were talking about a problem that was in the $5 to $10 billion range—that is late 1987. I think the estimate now for the cost of the thrift problem is around $150 billion, not including the interest payment. So, we were off by many multiples.

Based on at least the experience I had with the thrifts, I think once a systemic problem occurs, agencies are much better off if they get their best estimate of the size of the problem out in the public, publicize the heck out of how big the problem is, and bring the public along. I don't recall the banking agencies taking the same approach. At the OTS, we had press conferences every three months where we said, here are the number of 4 and 5 rated thrifts; here are the number of 3 rated thrifts; this is what their losses are. We inundated the public with information. In terms of the experience of the OTS, and part of our objective was to rebuild credibility, I think it was very successful.

Another obvious lesson is that postponing addressing problems raises the cost. Arguably, the thrift problem was a problem of the late 70s and yet it wasn't until the late 80s that we tackled it. And in the intervening decade, the cost of dealing with the problem rose dramatically.

Another thing that may be obvious but became quite apparent again in dealing with the thrift industry, where such a large block of a particular sector was in trouble, was that allowing non-viable thrifts to continue to conduct business really hurt everyone in the area. It was phenomenal how earnings of surviving thrifts improved as what were then called "zombies" were closed down. Having institutions with no return on equity constraints, and who could underprice loans and overpay for deposits—not only were they obviously raising additional costs vis-a-vis the FDIC or FSLIC, but they hurt everyone else in the local marketplace.

Another lesson—agencies really have to fight the temptation to come up with quick fixes. It has to be accepted that fixing a broken banking system is a very difficult process. The old Federal Home Loan Bank Board tried a whole bunch of quick fixes, most of which ended up making problems worse rather than better.

In terms of the process, as I just mentioned, I think it has to be recognized that dealing with failed institutions is much more complicated, particularly when you have major organizations, than one thinks at first glance. Again, I think that the effort that went into putting this conference together, really looking at techniques, has a tremendous payoff over the long run. One of the silver linings of creating the RTC was that at least within the U.S., it created a second opportunity for smart individuals to come together and figure out how to tackle failed institutions. Interestingly there were differences in the approach taken by the RTC versus the FDIC, and I think it was great that when the RTC was folded into the FDIC, a lot of effort was taken looking at which agency had the better approach.

Once a problem is acknowledged, once you've taken over an institution, the quicker you get it back into private hands, the better. I think that with the RTC (and I don't think there was much of a choice), the extended conservatorships of institutions that were taken over by the RTC, ultimately raised the cost of the final resolution. Certainly some of the Bank Board's efforts, of merging weak institutions (what was called the

Southwest Plan), in hindsight turned out not to have been a great success. In that respect, to the extent one has the capacity, simply taking the institution over and getting the good assets back into private hands as quickly as possible is the way to go.

Another lesson we learned in the mid-90s in the thrift industry was that political support for what you're doing is fleeting. Political support is very strong when the problem is first made public. We identified our poster boys who were primary culprits to generate public support for the effort—the Mr. Keatings of the world. But that lasts 24–36 months, and then you begin to have hearings on, are you being too tough, why are you doing this to these people who in fact, never intended to do wrong and simply didn't understand their obligation as a bank or thrift director. So, as strong as the political support may be in the midst of the crisis, one needs to take advantage of it, and not take for granted that it will be there over the long term.

In terms of the resolution process, and I don't want to get into what Jack Ryan might say after me, the more orderly and predictable the process is, with absolute transparency, the better it will go and the more likely you are to retain political support for the process. Resolutions are necessarily complex. There is lots of money involved. But I think one clear lesson between the way the FDIC and the RTC handled 747 failed institutions versus what the Bank Board went through with the thrift resolutions in 1988, relates to openness and transparency. The Bank Board chose to move very quickly to resolve institutions to take advantage of some tax provisions but they acted in secret. In hindsight, a more open and orderly process, even when you've got lots of institutions, is a much better approach.

Something that the RTC did, more so than the FDIC, was getting the private sector involved in the solution in the beginning. As I recall, it was a statutory mandate of the RTC that they use the private-sector to the greatest extent possible. Notwithstanding some of the difficulties of using the private sector (e.g., how much was charged for xeroxing), this private sector involvement was quite successful. We brought in outside expertise and when you are faced with major tasks of the type faced by the RTC, that is a worthwhile lesson to remember.

Auctions of assets from failed institutions—and this is something that at The World Bank we run into in a lot of countries—when you start selling assets, the early birds really do get some pretty good deals. People are unfamiliar with the processes when you first begin selling assets. There are some very good deals and some good assets and some great profits can be made by the people coming in early. We have to accept the fact that for the market to work, you have to have an attractive profit up front. That's what brings lots of bidders for subsequent auctions.

The difficulty we're facing overseas is that those initial bidders tend to be foreigners and that makes it particularly difficult for the countries to have the foreigners picking up assets at very low costs. The presence of foreigners is even more difficult than simply the fact that the private sector is coming in and making money.

I saw Jim Montgomery (Former Chairman of Great Western Bank) here—I don't know whether he is still here or not, but one of the lessons in terms of the way the SAIF was funded was that explicitly imposing the costs of resolution on the remaining open institutions turns these institutions into ultra-conservatives. During the early part of the thrift crisis, you did not have the U.S. League out there rooting for the Bank Board to close more institutions. Rather it argued the regulators were being far too harsh. It argued we were overestimating the size of the problem. "Forebear and in a couple of years they'll turn around," was the position taken by the thrift industry trade group.

As the SAIF premiums began to rise, however, and particularly as the process of shifting the cost of resolving the thrifts to the SAIF was occurring, at OTS we began getting calls from the industry saying, go back, look again, make certain there is no one out there among our thrift institutions that is unsafe and unsound. It was the thrift industry that became the biggest fan of ensuring that you had a healthy industry because they began to say, if you at OTS make a mistake, if an institution closes and costs the SAIF $100 million, that's our money. It was an interesting turn of events.

In terms of the next crisis, whenever that may be, two things have struck me. First, the number of people in the audience who I had worked with who were very experienced in this business, have retired and gone on to other and better things. I think that is true across-the-board. All of the banking agencies have experienced a fairly major drain of experienced staff. I certainly worry that three or four years down the pike when we run into this problem again, I hope a lot of the lessons will not have to be re-learned by staff who were not part of dealing with the problems of the past.

Secondly, we now have prompt corrective action. I'm not quite certain how these old lessons will apply in this new world. Certainly we were able to manage the thrift resolution process much more smoothly because of our ability to deal with these institutions in an orderly fashion. We had a long list of problem institutions. We closed those institutions in close coordination with the RTC in an orderly fashion to avoid indigestion. With prompt corrective action, if one has a systemic problem of the type we had with the ag banks where you had a collapse in farm real estate prices and all of a sudden there are a whole bunch of institutions that are not able to meet the various capital requirements, I'm not quite certain what kind of flexibility we will have. We may find ourselves in the same boat that the FDIC found itself in early 1989, when they took on a couple hundred thrifts pre-RTC legislation, and you had a major case of indigestion.

I think prompt corrective action is great on an institution-by-institution basis because it creates tremendous incentives for owners to deal with problems early. But, if we run into a systemic problem, I worry about the ability of the FDIC and the banking agencies to deal with such a problem.

This is particularly worrisome with the addition of risked-based deposit insurance premiums. When institutions run into trouble under the risk-based premium system, their after-tax costs start going up rapidly as their earnings are falling. So, risk-based insurance premiums can contribute to a rapid drop in capital.

Thank you very much.

Paul Horvitz, Professor of Banking and Finance
University of Houston

I am impressed with much of what I have read and heard here about the FDIC/RTC resolution process. Over time, and as a result of its own analyses and a push from FDICIA, the FDIC has developed the ability to handle failures efficiently and effectively. I want to focus my comments on one aspect of the process that has been solely within the province of the lawyers, but in which I believe that economists have something to contribute. I am referring to FDIC and RTC efforts to recover losses due to the actions of those with special responsibilities for bank soundness—accountants, lawyers, directors and management. Obviously, I am not going to give legal advice. My comments relate to the economics of the professional liability issue, and to public policy considerations.

When I was at the FDIC bank failures were rare events. Even in those days, there were incompetent and inattentive auditors, lawyers, bankers and directors. But the competitive and financial environment was such that bad luck or modest doses of incompetence were not sufficient to cause a bank to fail. A failure was generally the result of some sort of wrong-doing—fraud or self-dealing. It was routine in such cases to sue those responsible, and there was almost always an insurance company providing at least a potentially deep pocket. It is true that FDIC recoveries from bonding companies during that time were modest, but that is a different issue. I believe that those efforts at recovery of FDIC losses on grounds of professional liability were appropriate and reasonable.

The situation in the 1980s and 1990s is a different order. The FDIC and RTC have recovered $5 billion as a result of its pursuit of professional liability. That is not a number that can be easily dismissed, although most of that money came from a very small number of large firms. Nevertheless, the FDIC/RTC process has been badly conceived and poorly applied. I do not believe that those responsible for FDIC losses should be let off the hook, but the process of determining who is responsible was badly tainted—tainted by political and financial considerations at the expense of justice. For those who would question my credentials here, let me note that justice is not a concept that belongs solely to the realm of the lawyers. As an economist, I wish I had better data with which to explore this issue. Much of what I have to say is anecdotal, but it derives from my own experience as an expert witness in a fair number of cases. I have been retained as an expert by both the FDIC/RTC and defendants in this type of litigation (though only rarely in the same case).

It is important to distinguish criminal from civil actions. People who violate criminal laws should be prosecuted, whether they are rich or poor, and whether or not their violations caused losses to the FDIC. As an economist, I have little to say about the criminal prosecution of violators of banking law. But criminal prosecution should not be part of an extortion scheme or a protection racket. It has been frequently alleged, though I have no personal knowledge of this, that defendants in civil cases have inferred that refusal to cooperate with the FDIC could increase the likelihood of criminal prosecution. I am sure that we can all agree that any threats or promises by FDIC lawyers about criminal action as a means of gaining settlements in civil cases are not authorized and not consistent with FDIC policy. In fact, the *RTC Guide for Outside Counsel* states that "As a matter of policy, the settlement of civil litigation on behalf of the RTC may not, expressly or by implication, be related to or conditioned upon the disposition of any criminal charges or recommendations…."

My focus is on civil actions. These involve economic as well as legal judgments. Suing on the basis of professional liability involves three major components: a determination that the subject has done something wrong; that wrong has caused a loss to the FDIC; and the subject has assets that can satisfy a judgment against him. This last point is clearly important in civil actions. There is no point in winning a judgment that cannot be collected, but this consideration has frequently led to suits against outside directors while management directly responsible for actions costly to the FDIC escaped any legal action. It also led to suits against wealthy directors for actions that passed as "business judgments" for many of their poorer colleagues at other failed banks and thrifts. This inequity bothers me less if the actions or inaction of the wealthy directors caused losses. I am bothered by suits against those with deep pockets and only a tangential connection with the cause of the losses.

Bank and thrift failures in the 1980s and 1990s were different from those of my experience with the FDIC in the 1960s and 1970s. The economic environment was much more hostile. Many thrift institutions, run by competent managers in accord with traditional policies, failed in the early 1980s as a result of high interest rates. It would not have been appropriate for the FDIC or FSLIC to take legal action against management and directors of these institutions, and they didn't.

Later on in the 1980s, many thrift institutions run by managers who had been considered competent shifted their operations in the direction of assets involving significant credit risk, such as commercial real estate and construction loans. This shift was in accord with the thrust of DIDMCA and Garn-St Germain, and with the advice being given by consultants and regulators that thrift institutions should include such assets in their portfolio because they generally have adjustable rates and higher yields. Managements whose banks became insolvent because of losses on these assets have been subject to professional liability suits by the FDIC. Why do they deserve such action, when those who incurred similar losses from interest rate risk did not?

What has been the objective of FDIC and RTC professional liability suits? Based on my experience, I would say that the objective is to obtain the maximum amount of money possible from those connected with the failed institution. That is not good public policy. At risk of appearing naïve to this group, I would argue that the objective should be to collect an amount commensurate with the losses these people caused. The distinction is simple: the cost of litigation, particularly litigation with the government, is so great that many subjects of suits by the FDIC or RTC agreed to pay some amount even if they were not responsible for losses. I have seen cases without substantive merit in which the RTC made exorbitant damage claims based on rather outlandish theories. Because the defendant can not be sure that a court will reject the outlandish theory and the exorbitant amount, he may be willing to settle the suit. Whatever the merits of such legal tactics by private parties, it is unseemly when done by the government.

Such tactics do not seem to be in accord with stated FDIC policy. The FDIC's Historical Study states the "the collection process for PL claims is conducted in as consistent and as fair a manner as possible. Potential claims are carefully investigated after every bank and thrift failure. All potential claims are subject to multi-layered review by the FDIC's attorneys and investigators before a final decision on whether and how to proceed….At the FDIC the final decision whether to file suit typically rests with the Board of Directors….No claim is pursued unless it meets both components of a two-part test. First, the claim must be sound on the merits, with the receiver more than likely to succeed in any litigation necessary to collect on the claim. Second, any necessary litigation must likely be cost effective…." This is a good statement of policy.

The RTC policy was that "the Legal Division seeks to avoid extreme advocacy positions and coercive, delaying or obstructive tactics that are not likely to have a substantive impact on the outcome of litigation." I would interpret this statement positively as well, though it seems to suggest that extreme, coercive, delaying, and obstructive tactics are fine if they will affect the outcome. The problem is that these policy statements did not control the way the process worked. In practice, a number of cases with little merit have been pursued.

How do cases without merit get filed? In many cases the RTC (though not the FDIC) hired outside law firms to investigate potential professional liability claims and make a recommendation to the RTC. If the law firm recommended that no action be taken, it obviously was paid for its investigatory efforts. If, on the other hand, it recommended that the RTC pursue the case, the law firm was almost certain to be hired to handle the case (they know more about it than anyone else), and will earn very substantial fees. It is beyond even my naïveté to believe that the RTC always received objective advice. This was a low-risk strategy for the RTC, because cases with no merit rarely led to a loss for the RTC. In those cases, the law firm ultimately recommended a settlement sufficient to cover the legal costs. Because of the costs of a trial, the defendant was usually willing to settle on this basis.

The economic issue that most concerns me is the crucial linkage between actions taken by defendants and the losses. This is most frequently the place in which FDIC PL claims go astray. The FDIC/RTC cases I have been involved in invariably involve real losses suffered by a failed bank or thrift, allegations of mistakes, negligence or wrongdoing by some professionals, and a failure to connect the alleged acts with the losses. Many losses have been blamed on the lack of, or poor quality of, appraisals. If a $5 million loan results in a $3 million loss, and the appraisal was not done in accordance with the regulations, this does not mean that the loss would have been avoided if the appraisal had been up to snuff. In any case, the burden should be on the plaintiff to demonstrate that the inadequacy of the appraisal was responsible for the loss. That is simply not done in the cases I have seen.

Suppose that a loan is made on a development project. The loan approval requires that a soil test be done, but management neglects to do so. Suppose the loan defaults for reasons that have nothing to do with the soil. Is that negligence by management? Probably it is. Is it the cause of a loss? No. Have the FDIC and RTC tried to collect from those responsible for the failure to get the test done? Yes.

Suits against auditors frequently suffer from this problem. Auditors did poor work in many savings and loan audits. But before the FDIC should be able to win a case against the auditor, it should be required to show that the audit flaws led to the losses. I was an expert witness in a case for the RTC in which there was evidence that the auditors had not insisted on appropriate reserves against some troubled commercial real estate loans. My testimony was to be to the effect that directors appropriately rely on the work of outside auditors, and that if the audit had indicated that increased reserves were necessary, and that earnings were overstated, the Board might well have changed its policies on real estate lending. Note that the auditors should not be held responsible for the losses on the loans they messed up on, because those loans were already on the books and the funds out the door. But losses on loans made after the audit might have been avoided if the audit had been done well. The FDIC must have reason to believe that is the case before it brings suit. It should not be able simply to assert that losses on loans made after a poorly-done audit were caused by the poor audit.

A similar problem of causation arises in some suits against lawyers. Law firms, like accounting firms, are prime targets for FDIC action because they usually have assets and insurance. Some of the cases I have seen indicate a real stretch by the FDIC to argue attorney responsibility for losses. In some cases, lawyers whose only role was to prepare closing documents for loans that ultimately went bad, were charged with responsibility for the credit quality of the loan. Do we really want lawyers to insist on reviewing an entire loan proposal and analysis before agreeing to prepare the closing documents? My experience suggests that lawyers will not do this for free.

At the same time that I was working for the FDIC on the case against the auditors, I was serving as an expert witness for the directors of a failed thrift that involved similar issues. I was actually giving the same testimony in both cases—that directors appropriately put heavy reliance on independent auditors. But in the second case the RTC was arguing that directors have a responsibility for seeing that appropriate loan loss reserves are maintained, and that they cannot rely on outside auditors. This position runs counter to current FDIC policy, as stated in a recent speech by FDIC General Counsel William F. Kroener, III, that "a corporate director is entitled to rely on reports, opinions, information, and statements of the corporation's officers, legal counsel, accountants, employees, and committees…." But even if there were no FDIC policy on this matter, I don't think the FDIC should argue both sides of an issue of this sort. I am not making a legal argument. I don't know whether there is any ethical or legal problem for a lawyer making an argument when he knows that his client is maintaining the exact opposite position in another courtroom. As a matter of public policy, the government shouldn't do that.

Many of the cases in which I have been retained involve matters of corporate governance. I believe that the FDIC has overreached in many of its suits against bank and thrift directors. Despite all of the books and articles written for directors that attempt to alert them to their responsibilities (all written by lawyers), they do not provide good, workable advice for real-life situations. The Board of Directors must set policies, and take reasonable steps to assure that policies are being followed. It is reasonable for directors to rely on outside auditors and on management. If loan policy requires current financial statements of borrowers, and management indicates that the policy is being followed, I do not expect directors to examine loan files to verify the presence of the financials.

More important, the directors are in their positions to represent stockholders. Their obligation is to do what is best for the stockholders. At least that is what we are teaching students in corporate finance courses. Directors have no fiduciary duty to protect creditors (including insurers), and if they can benefit stockholders by screwing creditors, that is what they should do. Creditors expect this, and have adequate means to protect themselves. That clearly applies to the FDIC. Obviously, directors must comply with law and regulation, but they have no obligation to disadvantage stockholders to benefit creditors (including depositors). This issue becomes significant, of course, when a bank is in a very weak financial condition. Directors of an insolvent bank may rationally decide to take extraordinary risks, on grounds that normal operations will not allow them to return to solvency. This is what Dan Brumbaugh has called "gambling for resurrection," and others have referred to as throwing the "Hail Mary" pass. These strategies may be better for stockholders than patiently waiting for the coming of the Messiah, because the odds are high that the examiners will come first. I recognize, of course, that this is not always the case. In the early 1980s, those thrift managers who simply prayed for lower interest rates came out better than those who took more activist strategies. The "business judgment" rule should apply to adoption of high risk strategies as well as to specific transactions, if they are carefully considered and adopted in a rational business-like manner.

I have seen several cases in which the FDIC has seemed to lack an understanding of the timing of losses. It is unreasonable to attempt to hold a director responsible for losses incurred on loans made before the director joined the Board, even if the recognition of the losses occurs during his term. This is so obvious a point that I would not bother to mention it, except that the FDIC has brought suits in such situations.

A related issue concerns workouts of problem loans, or loans made to facilitate the sale of REO. Bankers have always recognized that different considerations and loan terms are appropriate in dealing with these assets—assets that are already on the books—than with loans being originated. Suppose a bank makes a prudent loan of $10 million to enable the borrower to acquire an apartment project. As a result of economic and real estate declines, the loan defaults and the bank forecloses on the project, which is now worth only $8 million. It is not necessarily unsound to lend a new borrower $10 million on favorable terms to acquire the property from the bank, simply because the loan is greater than the current appraisal. Similarly, even if a bank has an explicit loan policy against cash-flow mortgages, or loans made without personal liability, it is often reasonable to make exceptions in workout situations. Again, this is obvious, but the FDIC and RTC often have included claims related to losses on such loans. These claims generally ignore the fact that the losses would be there even if the workout loans, or loans to facilitate, were not made.

I have a more serious charge to make against FDIC/RTC behavior in some of these professional liability suits. Many of these cases involve testimony by examiners or other supervisory personnel of the FDIC or OTS. I have seen several cases in which government employees have given untruthful deposition testimony. I do not know whether the lawyers were aware of this or not. I interpret this as a fear by current government employees that their careers will suffer if their testimony undermines the government's case. Any banker who has met with FDIC examiners, and is impressed with their knowledge and confidence, would be amazed to read depositions in which these capable people claim to know nothing about banking or bank supervision, claim a lack of knowledge of agency policies and procedures, and disavow the significance of examination findings that bankers take seriously. In a number of instances the inability of examiners and supervisory personnel to recall facts about specific cases—even when the case is the largest bank failure they have ever been involved with—is beyond belief. It is also surprising how often witnesses from the regulatory agencies turned out to occupy that unique position in the hierarchy of the agency so low that all significant decisions were made by their subordinates, which they simply rubber-stamped, yet were so low in the organization that all significant decisions were made by their superiors.

Let me be clear about my criticism of FDIC handling of professional liability cases. Many failed banks and thrifts suffered losses because of the negligence or wrong-doing of managers, directors, accountants, lawyers, or appraisers. It is reasonable for the FDIC to pursue suits against the people responsible. That is not the issue. My point is that the RTC (and to some extent the FDIC) filed and pursued such suits virtually indiscriminately in most cases of failure. The reason is obvious. The FDIC, RTC, and OTS feared Congressional criticism that they were too easy on the S&L crooks. Rather than explain to a Congressional Committee just why a bank failed, and how the regulators missed picking up the problem early enough, it is easier to blame it on professional negligence and file a suit. The attitude seemed to be "let's sue them all, and let the courts sort them out." After all, a loss in court can be blamed on the judges or the juries, but the agencies cannot be criticized for failing to make every effort to recover its losses. Some of the actions taken by the agencies have been so egregious, that it cannot be believed that they didn't understand the situation. It is much more likely that the explanation lies in the lack of political courage. This desire to avoid responsibility exists at lower levels in the organization as well. I quoted earlier from the FDIC's Historical Study about the FDIC's "multi-layered review." Think about how this would work in practice. An examiner or investigator or lawyer recommends that a PL action be filed. This recommendation is reviewed by the next layer of management. The supervisor will never be criticized for going along with the recommendation, even if the case is a loser in court. However, a decision to reverse the recommendation, and not take action, might be damaging to one's career, particularly if it turns out that the subject of the proposed PL suit is truly a bad guy, or if the losses from a particular failure turn out to be very great.

Some limited evidence on this issue can be found in the Annual Report of the Professional Liability Section for 1997, which notes that following an invitation in a speech to bankers made by the FDIC General Counsel, defense counsel in more than 20 cases contacted the General Counsel to report that their settlement proposals were not receiving appropriate attention at lower levels. The Annual Report notes that "This high level focus and involvement enhanced the settlement process in a number of cases that were the subject of these communications." That is fine, of course, for those whose cases were settled, but what about those who faced similar problems before the General Counsel's invitation and intervention? By 1997 the number of outstanding cases may have been small enough to make the General Counsel's involvement feasible, but that was not the case earlier.

I recognize that there is no simple way of determining which actions of professionals warrant legal action and which don't. I have found, however, that self-dealing is a pretty good criterion to use. This goes to basic corporate governance issues. The primary obligations owed by directors are a duty of care and a duty of loyalty. Self-dealing clearly raises flags about the duty of loyalty, except that bank directors are expected to generate business for the bank (often, that is why they are on the board). But lack of self-dealing is a reasonable indication that the director is not taking personal advantage of his position. My experience suggests that the FDIC does not give this sufficient weight. That is, I think it should be hard to make a negligence case against a bank director for loans that turn out badly when that director has not received any personal benefit from the loan.

A poor record of success in the courts would provide support for the criticisms I am making here. The absence of such evidence does not mean I am wrong, because the FDIC has the ability to drop cases, or accept nominal settlements, when it believes that the outcome at trial will be adverse. It is interesting to note that the FDIC's Historical Study does not cite any statistics on its record in court, despite a plethora of other statistical data. Virtually none of the cases I have worked on has gone to trial, so I have no personal knowledge of such results. I have read occasional stories of a judge blasting the FDIC, but I don't know how common such results are. The FDIC has an obligation to present this data in its Historical Study. I am surprised at the lack of such data in the Historical Study or in the FDIC's Annual Reports of the Professional Liability Section. An economist would routinely expect to see data on the results of cases that have gone to trial, and hence are uninfluenced by the willingness of defendants to pay money to avoid or end a lawsuit.

The Chapter on Professional Liability Claims refers several times to "developing legal doctrines," and "evolving standards of liability for director and officer claims." This is probably a matter for the lawyers, but it seems questionable to me. It appears that much litigation represented attempts by the FDIC to change the legal standards, or at least to establish that the standards for bank officers and directors should be different than those that apply to corporate officials generally. Apart from the legal aspects of that, I don't see the economic logic of a higher standard for bank officers and directors. The FDIC is better able to protect itself than the ordinary creditor or stockholder. Yet at one time the Director of the Office of Thrift Supervision argued that thrift institution directors owe a fiduciary duty to the federal deposit insurance system. Without opining on the law, I cannot see any economic basis for such a position. Yet, as far as I know, that position has never been disavowed by the OTS or FDIC.

I have put this discussion in terms of RTC and FDIC, though I recognize that these criticisms are more applicable to RTC than to FDIC. In view of the history of the organizations and the closeness of their operations, I think it is reasonable to combine them for this purpose. In any case, if there were substantive differences, the FDIC had the opportunity to impose its (presumably) more appropriate standards when it took over the RTC caseload at the sunset of the RTC. It is not clear how many RTC cases were dropped for lack of merit. If the FDIC believes that its behavior has been better than the RTC, it should be able to cite a significant number of such cases. A rather damning comment on this issue is found in a 1997 speech to the Assembly for Bank Directors by then-FDIC Chairman Ricki Helfer. Chairman Helfer stated (I think proudly) that "In one instance the FDIC refused to bring a case that had been authorized…by the RTC, and decided to forego a $200,000 settlement offer that was on the table because the case lacked merit." If there truly is only one such case, then the FDIC cannot claim that its standards differ significantly from those used by the RTC.

I am sure that the FDIC has heard these criticisms from defendants and their counsel. I am not an advocate for defendants in general or for those who have retained me. I hope that criticism of this sort can spark a reconsideration of its position by the FDIC. Incidentally, responses that demonstrate that the FDIC has the legal authority to take every action and every position that it has taken in professional liability matters are not really relevant. What is relevant is an indication that FDIC actions constitute good public policy. Respect for government is in short supply today. The IRS presents an example of how arbitrary actions by an agency, even though consistent with its mission of collecting taxes, can go too far, resulting in loss of public respect and, ultimately, adverse Congressional action.

Jack Ryan, Acting Executive Director of Supervision
Office of Thrift Supervision

It's somehow fitting that I bring up the end here, having performed that function before.

I was listening earlier and heard all those bouquets being thrown at the RTC, but Dr. Horvitz has brought us back to reality and it feels like we've been transported back into 1994 and 1995.

I, for one, am pleased to talk about the RTC and the resolution process in the past tense, not because it wasn't a challenging and rewarding experience, it clearly was. And, not because I didn't have the opportunity to work with some very talented and dedicated people, because I did. But, mainly, because it is a whole lot more fun and interesting in hindsight than it was when the RTC was being criticized from every quarter.

There are so many issues that should be addressed in a forum such as this, and I have time to touch only on a few. I will try not to duplicate what has already been discussed concerning the various resolution techniques, some that worked and some that didn't. Instead, I will focus on the RTC as a resolution concept.

Although not entirely germane to the topic of this symposium, it is important to put some of the issues in an historical perspective. In the early 1980s, the thrift industry was caught in the fight against inflation with a portfolio of long-term fixed mortgages financed with short-term interest sensitive funds. When market interest rates rose to historically high levels, operating losses in the S&L industry escalated, and failures threatened to wipe out the FSLIC Fund. Instead of facing up to the problem at that time, the decision was made to prop up insolvent S&Ls through the use of regulatory forbearance and let them grow out of the problem. The result was a much bigger problem that threatened the economy.

The first lesson we should take away from this experience is perhaps the most difficult one in a political environment; i.e., admitting there is a problem for which existing systems do not provide viable solutions. We did not do that. The other lesson learned is that the solution has to be real and has to be fashioned in a way that does not double the bet. We did not do that either and we paid the price.

In late 1988 and early 1989, when it became obvious that the financial crisis was going to take extraordinary steps, the concept of the Resolution Trust Corporation was announced. I must confess my initial reaction to the RTC part of that proposal was negative. It just didn't make sense to take assets that were under active management by the private sector and turn them over to government bureaucrats for disposition. This seemed to be a sure way to maximize the loss and perpetuate the problem.

I suspect the RTC decision was made because of what was probably a false premise; i.e., that the entire thrift industry was out of control and, therefore, a government solution was the only viable alternative. Except for a handful of rogue institutions, that simply was not the case. However, that decision was not unlike the one regulators make in dealing with troubled institutions. Do they leave management that created the problem in place because they are the most familiar with the assets and are therefore in the best position to deal with them, or do they bring in fresh talent? For reasons of credibility and honesty in the assessment of the problems, it is almost always preferable to opt for new talent and a fresh approach. That was what was done when the RTC was created.

But, how did the RTC avoid the problems that are so often encountered when government agencies are created to deal with a short-term problem and, instead, grow and perpetuate their mission? I don't have a complete answer. Clearly, much of the credit goes to the early management of the RTC and the oversight of Chairman Seidman, who continually pushed for aggressive asset disposition goals. Much of the credit also goes to a very dedicated and professional staff that kept focused on completing the task at hand. The definite statutory sunset of the RTC, coupled with giving the FDIC responsibility for resolving any remaining business, provided an added incentive to complete as much of the work as possible.

As everyone knows, there were no big incentive bonuses for staff and no pot of gold at the end of the rainbow. As a matter of fact, many of the dedicated staff were working hard to put themselves out of a job and the nation owes them a great deal of gratitude.

Finally, I believe that luck and the improving economy brought about by lower rates and the improving real estate market, which in turn was brought about by the RTC's disposition of assets to the private sector, aided in the process. As I'm sure you've heard here today, it was quite an accomplishment. In just six and a half years, the RTC took possession of some 747 failed thrifts, paid off over $200 billion in insured deposits, and sold over $400 billion in assets.

When I was preparing these remarks, I didn't have access to the precise numbers, but taxpayer costs for the RTC were in the neighborhood of $90 billion. The question many have struggled with is whether that cost might have been lower if more of those assets, clearly not all of them, had been left in private hands. Although we will never know whether the cost would have been lower, the answer may well depend on how cost is defined. It is my observation that the private sector tends to hold assets rather than dispose of them at distressed prices, even when the economics of holding is unclear. Their bias tends to tip more toward recovery rates than disposition goals. Moreover, many of the institutions that would have been judged capable of managing those assets were undercapitalized and were distorting the deposit markets by driving up the cost of funds for both banks and thrifts.

I believe that if a significantly larger portion of the assets had been held by government propped up S&Ls, the overhang in the real estate markets would have been extended over a longer period of time and the restoration of a healthy thrift industry would have been delayed. By utilizing all the techniques reported here by the other panels, the RTC removed non-viable institutions from the market and disposed of their assets at the then-prevailing market rates over a fairly short-time horizon. This helped create the environment that led to the sustained period of economic growth that we now enjoy.

The topic of this panel also deals with the future. The RTC developed valuable resolution techniques and we have learned that these techniques have to be dynamic and keep pace with the changing markets. These lessons should help deal with the inevitable future financial crisis. I sincerely hope we have learned enough to avoid problems that would require another RTC. The RTC model may not be the right one for every situation, but it was clearly the ideal one for dealing with the S&L crisis in the U.S.

Thank you very much.

Glassman: I would like to move to the question and answer period and I would like to get started. If I can ask a question, with the rapid changes in the U.S. financial markets and financial U.S. banking system and the role of the global economy, and especially the role of technology in banks, what do you feel banking is going to look like as we get to the new millennium, and what lessons that we have been describing will be able to be applied to them? I'm thinking also of the fact that banks no longer have to have a brick and mortar office anymore. They can just have a web site. How do we take those lessons and apply them to the banks that we may see in the future?

Horvitz: Banking will be different in the future and crises will be different in the future. We never have the luxury of there being exactly the same crisis repeating itself the next time around, so that in a sense, narrow lessons that are learned may not be applicable to the next crisis. I think the way John described the lessons that have been learned have broad applicability. I have a high degree of confidence that the sort of skills that have developed, the approaches that have been taken, and I think the help of the legislation pushing things into a recognition that minimizing cost is the key element, gives me confidence that the next crisis, whether it is the year 2000 problem or some other kind of crisis, that the FDIC is set up to be able to deal with it as well as to be expected.

Fiechter: Just to change your question a little bit, as you describe technology and web sites, I have a view of a basement filled with computers with these blinking lights. Yes, that would be a different type of institution. But, we also have another type of institution, which will also be a challenge—the too big to fail type. There are huge financial organizations being formed in the market and should one of those be closed, it will pose very different challenges than what was faced by the FDIC in the past. I don't know what the biggest liquidation by the FDIC ever was, but I don't know how you find a partner for a $250 billion bank. I suspect that Paul is right that there will be some new challenges going forward should one of these mega-banks ever get into trouble.

Ryan: On the subject of too big to fail, I worked very closely on recapitalization of Continental Illinois when it was in financial trouble. Since then there has been a lot of debate about whether too big to fail is a doctrine to be followed in the United States, given how it undercuts market discipline. I think that "fail" has to be defined. The repercussions of shutting one of these big institutions down and risking the kind of disruptions that could occur in the markets around the world, is a risk that I don't believe policy makers are going to be willing to take. I would assume that wiping out the equity holders' interests and reconstituting the institution through the private sector or through a combination of the private sector and the insurance funds in order to preserve the marketplace, will be something that the policy makers will be driven to regardless of whether they like it or not.

Horvitz: I think what it really means is too big to liquidate is clearly a correct comment for any of these very large institutions, even ones smaller than the mega banks. So, too big to liquidate is clearly part of it. No institution is too big to have stockholders wiped out and one of the parts of the progress that we've made as a result of the last problem is that essentially depositor preference makes it pretty clear that depositors of a mega bank really aren't at risk almost no matter what happens.

John Stone: I have a question for Dr. Horvitz. My name is John Stone—I'm unemployed. Dr. Horvitz, I really appreciated your talk and understood much of what you said of suits being wrongly brought, particularly those involving a director that wasn't even present when the loans were made. But one thing that did puzzle me and like yourself I'm not looking at this from a legalistic standpoint, but when a creditor of a normal corporation, a non-bank corporation, makes a conscious financial decision with its own due diligence and covenants to protect itself, what have you, I agree—directors of that corporation, their prime responsibility is in their stockholders' interests, and that creditor has protected its interest. But, in a financial institution with depositors not as sophisticated and not having the same extent of information available to them, and because of that putting their money into a corporation that has a much higher leverage ratio than a standard corporation, I see a distinct difference, and I think case law said because of that, there is a distinct difference that the directors do have an obligation to depositors much higher than a director would in a non-bank corporation to the creditors. Unless I missed something, is that your premise that they are the same regardless—there is no distinction?

Horvitz: The point is well taken that a depositor in a bank doesn't sit down and negotiate a set of covenants on the operation of the bank prior to the bank accepting the deposit. But, what we have is the regulators or the FDIC taking over that role for the depositor and hence the FDIC is protecting the depositor in doing what a creditor would in a normal situation. Given that, I would say that a director of a bank—and again I'm not opining on what the law is—I'm saying what I think public policy and efficient economics would be—if directors were concerned with a fiduciary duty to stockholders and an obligation obviously to obey the rules and regulations of the regulators. That takes care of the creditor obligation as I see it.

Don McKinley: Looking at the past resolution strategies that we've deployed—forbearance assistance, government intervention in a failed bank by taking over the assets and paying off depositors, and then taking a look at the year 2000 situation, not the large mega-banks but the community banks, and the possibility of those type of technological insolvencies or where a regulator finds that the banks are substantially in unsafe, unsound condition—does the panel have any assessment of what the role of the government ought to be in addressing those types of smaller bank insolvencies, or near insolvencies in terms of resolution strategies? I'm curious as to what that might be.

Ryan: I guess I drew the short straw here. There really isn't any clear answer. We're not really talking in most cases about an insolvency because of the year 2000. We're talking about the inability to conduct business. The issue about whether an institution can be taken over under those circumstances is one that I understand is being researched. But, it would seem to me that if you are a depositor in an institution and you cannot get access to your funds because of the inability of that institution to transact business because of a computer failure and there isn't any opportunity for them to correct that problem over any reasonable period of time, that the FDIC would probably step in and pay off, as it were, the depositors to make them liquid, and then take control of the assets—I would think.

Kolatch: I would like to ask Jack Ryan, as the person who headed the RTC for its final two years, what is your reaction to the claim by Paul Horvitz that it often filed professional liability suits indiscriminately?

Ryan: It seems to me that first of all, I have to look back on many of these suits and recognize that I came from a regulatory role at the OTS. I can tell you that many of the boards of directors of these institutions did not exercise what I would regard as even a low level of meeting their fiduciary responsibility to the institutions. Many of them were simply rubber stamping everything that management brought to them. I don't think that is the kind of board of directors that we want to see in an institution and to the degree that the suits that were brought by the RTC heightened the directors' awareness that they have a responsibility at least to ask reasonable questions and make sure they get a reasonable amount of information in order to fulfill their role as a director, that is a salutary thing in a number of ways. Clearly there are some directors who were sued who maybe shouldn't have been. I don't doubt that for a minute. But, I think we tried, with the information we had at hand, to deal with those people as fairly as we could.

Horvitz: I don't think that people were sued who did a good job as directors. That is not the point I was making. I think most of the people who were sued did fail to do their duty in one sense or another. The problem, however, is their failure was not really what was responsible for the losses and I think it is unreasonable as a civil suit matter to sue people for losses that were not due to their actions or inactions.

Bill Kroener: Just to add some statistics here—I'm Bill Kroener, General Counsel of the FDIC. We did have occasion to look at the professional liability programs pretty hard, particularly after RTC sunset, and we and the RTC both investigate every instance of a bank failure. Looking at the historical record, we end up at the FDIC bringing suits against either the directors or professionals in approximately 20 percent of the bank failures. The comparable RTC numbers were 40 percent. So there were differences. That may have to do with different policies. It may have to do with different behaviors of directors in the two types of institutions. But, I do think one of the things that is arising out of our experience, hopefully for everyone, is that a directorship of a financial institution is not an honorary position from which someone can do nothing. It requires care and attention. But, one of the important things that certainly former Chairman Helfer and I have been speaking out on is that it's very important that financial institutions do have careful, thoughtful directors, and it would be a disservice I think to financial institutions to leave the impression that serving as a director of an insured institution is per se "risky," because I don't believe the statistics bear that out and going forward it is very important to have high-quality directors.

Glassman: Okay. With that I would like to thank our panelists for the discussion and for the insight. And, in conclusion, I would like to ask John Bovenzi if he would come up and officially end our symposium. Thank you very much.

Closing Remarks

John Bovenzi, Director
Division of Resolutions and Receiverships, FDIC

The comments I've received from you over the past day and a half have indicated to me that this has been time well spent. I certainly believe that. I would like to thank our panelists in particular for making the program a success. I think it's been interesting and informative. The panelists have covered a wide range of issues and they've certainly given those of us at the FDIC food for thought as we go forward.

I would like to thank all of you as participants for your questions and your interaction over the last day and a half in helping make this a successful conference.

Finally, I would be neglecting my duties if I didn't mention one other group. Just as one of the objectives in managing a bank failure is to try to make it a non-event for the public, one of the objectives in managing a conference is trying to make things as convenient as possible for all of you so you can sit back and enjoy it. To the extent that has been done and I certainly believe it has been, I'd like to thank in particular Stan Ivie for coordinating the group that has managed the conference, and also Mike Spaid, Jim Gallagher, Bill Phipps, Shelby Heyn-Rigg, Ann Gay and Francine Gage. Also, I don't know all the names of everyone from our Division of Information Resource Management who've been providing the technical support. I understand that the video conferencing and the telecasting have gone very well. I would like to thank all of them as well.

So, if we could end by giving that group a hand, thank you.

APPENDIX A

Biographies

Hubert Bell, Jr.

Mr. Bell graduated with honors from the University of Houston in 1978, earning a Bachelor of Arts in Accounting. While attending the University of Houston, Mr. Bell was an academic scholarship recipient; a regular on the Dean's List; and a member of the following honor societies: Beta Gamma Sigma, Phi Kappa Phi, and Phi Theta Kappa. Following graduation, he successfully completed the Certified Public Accountants Examination and accepted a position with the accounting firm of Arthur Andersen & Co., where he became senior auditor.

Mr. Bell subsequently left the firm to attend the University of Texas School of Law and earned his Juris Doctor in 1983. Since graduation from law school, Mr. Bell has worked for the Texas Railroad Commission and the Texas Banking Department. At the Texas Banking Department, he was directly involved in various banking issues including administrative enforcement actions, bank chartering, determining permissible bank activities, bank closings and administrative hearings, including appeals to district appellate courts.

In late 1988, he established a general civil practice in Austin that is primarily engaged in general business and corporate representation, civil litigation, banking, bankruptcy, commercial and real estate transactions, and director and officer liability matters. He has handled claims exceeding $20 million.

In 1983, Mr. Bell was nominated by the Governor and confirmed by the Texas Senate to serve on the Finance Commission of Texas.

Mr. Bell has written articles on various legal issues and has spoken at seminars sponsored by the University of Texas Law School, Texas Association of Bank Counsel, American Institute of Banking, and the South Texas College of Law. Mr. Bell is a member of the bar of the State of Texas and is admitted to practice in Federal Court in the Western and Southern Districts of Texas. He is a member of the Committee on Admissions of the Supreme Court of Texas, Board of Law Examiners, and the College of the State Bar of Texas.

He is also a member of various professional organizations including the Corporation, Banking and Business Law Section of the State Bar; the American Institute of Certified Public Accountants; Texas Association of Black Counsel; Austin Black Lawyers Association; and others.

Arne Berggren

Arne Berggren is President of Eusticon AB, and is a financial and strategic consulting advisor for the banking authorities in several Asian and European countries, and for several large financial institutions within his native Sweden. Mr. Berggren is an advisor in the area of systemic bank restructuring for the Monetary and Exchange Affairs Department of the International Monetary Fund. As an advisor to The World Bank, Mr. Berggren has also participated in a number of missions to Korea, Thailand, Brazil, Mexico, Lithuania, Russia, Turkey, Bangladesh, the Philippines and Azerbaijan.

While with the Swedish Ministry of Finance (from 1989 to 1993), Mr. Berggren was the special advisor in the area of financial institutions and markets, as well as the in-house investment banker, and was involved in all measures undertaken by the Government to strengthen the Swedish banking system. Mr. Berggren developed the strategy and processes for evaluating the condition of Swedish banks and managed the teams of investment bankers and advisors who were engaged for this project. Mr. Berggren was personally involved with the restructuring of Nordbanken and the creation of the asset management companies of Securum AB and Retriva AB.

While with the Swedish Bank Support Authority (from 1993 to 1995), Mr. Berggren negotiated the sale and/or the financial support packages for problem Swedish banks and also established their in-house workout organization.

Mr. Berggren is also on the Board of Directors for the venture capital company of EntreTech Capital Partners AB.

John F. Bovenzi

John F. Bovenzi is the Director of the Division of Resolutions and Receiverships at the Federal Deposit Insurance Corporation. In this position, he oversees the FDIC's bank and savings and loan closing and receivership management activities. These responsibilities include making payments to insured depositors and disposing of the failed institution's assets. He was appointed to this position in November of 1992 by then-Acting Chairman, Andrew C. "Skip" Hove, Jr.

From 1989 through most of 1992, Mr. Bovenzi served as the Deputy to the Chairman. In that position, he served as an advisor primarily to Chairmen William Seidman and the late William Taylor. Mr. Bovenzi assisted them in administrating and implementing day-to-day operations of the FDIC and the Resolution Trust Corporation. Prior to this appointment, Mr. Bovenzi served for two years as Deputy Director of the FDIC's Division of Research and Statistics. Before that, he was Special Assistant to an FDIC Director, the late C.C. Hope, Jr. Mr. Bovenzi joined the FDIC in 1981 as a financial economist.

Mr. Bovenzi has written and published a number of articles regarding various banking issues, and has given numerous Congressional testimonies regarding the FDIC's activities. Mr. Bovenzi holds a B.A. degree in economics from the University of Massachusetts and MA and Ph.D. degrees in economics from Clark University.

David Cooke

Mr. Cooke is widely recognized within the international financial community as an expert in bank regulation. Before joining Barents as a Director in its Financial Sector Regulatory Practice, he served as an advisor to USAID, the U.S. Treasury Department, The World Bank, and the International Monetary Fund. He has worked with banking systems in the U.S., Central and Eastern Europe, and Latin America. His varied assignments have included advising central banks on problem bank resolution, deposit insurance, asset disposition strategies, bank diagnostics, and financial supervision.

From 1992 to 1995, Mr. Cooke served as President of the Commercial Mortgage Asset Corporation (COMMAC), a company specializing in the securitization of commercial real estate loans originated by commercial banks and other financial institutions.

From 1989 to 1992, Mr. Cooke served as Executive Director of the Resolution Trust Corporation with responsibility for the agency's organization, staffing, and operation. Mr. Cooke oversaw the RTC's takeover of nearly 700 financial institutions and the development of innovative initiatives for managing and disposing of $400 billion in assets.

From 1986 to 1989, Mr. Cooke worked for Chairman L. William Seidman of the Federal Deposit Insurance Corporation, rising to the position of Deputy—serving as senior policy advisor and directing key management committees.

Earlier, Mr. Cooke served the FDIC in a number of capacities, such as Senior Bank Examiner and Chief Bank Analyst responsible for developing and implementing off-site surveillance programs used to monitor all insured banks. He has held senior policy positions responsible for supervisory and corporate policies including positions on risk-based deposit insurance and other deposit reform issues. During the early 1980s he advised the FDIC Chairman on emerging developments in the thrift industry and failure resolution programs.

Mr. Cooke has also served as an adjunct professor specializing in finance and real estate at a number of internationally recognized universities.

Mr. Cooke has a B.S. in business from the University of Maryland and an M.B.A. from George Washington University.

Jonathan Lee Fiechter

Jonathan Lee Fiechter is the Director, Special Financial Operations for The World Bank. Prior to this position, he was the Director of the Financial Sector Development Department of The World Bank. That Department provided policy advice and technical assistance to client countries seeking to strengthen their financial sectors. Mr. Fiechter joined the World Bank from the Office of Thrift Supervision. While at OTS, Mr. Fiechter held a series of progressively responsible positions, including serving as head of the agency from 1992 to 1996.

Mr. Fiechter began his professional career at the U.S. Department of Treasury as an international economist in 1972. In 1978, he joined the Office of the Comptroller of the Currency, the U.S. Agency responsible for supervising national banks, where he was Deputy Comptroller for Economic Research. Mr. Fiechter has also served as a Director of the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, and the Neighborhood Reinvestment Corporation, and as Chairman of the Federal Financial Institutions Examination Council.

Mitchell L. Glassman

Mitchell L. Glassman began his career in banking in 1973. He came to the FDIC in 1975 as a Liquidator-at-Large and was assigned to the Deposit National Bank in Kansas City, Missouri. He later served as a field liquidator of numerous failed banks in Illinois and Wisconsin. In 1978, Mr. Glassman returned to Kansas City as Assistant Liquidator at the Swope Parkway National Bank, Kansas City, Missouri. He served in a similar capacity at the United States National Bank in San Diego, California, the largest bank to have failed during the period. In 1982, he was then assigned to Tampa, Florida as the Liquidator-in-Charge of a large and complex real estate portfolio at the former Metropolitan Bank and Trust Company. In 1983, when the Division of Liquidation decentralized and established six regional offices, Mr. Glassman moved to Dallas, Texas to help establish the new Dallas Regional Office, and served as Senior Liquidation Specialist (Commercial Loans).

In 1984, he was named Deputy Regional Director of the Dallas Region. He also served as the Managing Liquidator for the $1.2 billion First National Bank of Midland, Texas. In 1985, Mr. Glassman moved to Kansas City, Missouri to help establish the new Kansas City Regional Office. He has overseen the closing and liquidation of over 250 commercial bank failures nationwide and the closing of the $1.2 billion Federal Land Bank of Jackson, Mississippi.

In February 1989 Mr. Glassman accepted the newly created position of Associate Director for the Assistance Transactions Branch of the Division of Liquidation. Mr. Glassman also served as the Chairman of the NCNB Texas Bank One Oversight Committees.

These committees administered over $14 billion in assets. Mr. Glassman administered and negotiated all Division of Liquidation Service Agreements nationwide.

In January 1993, Mr. Glassman became the new Deputy Director of the Division of Liquidation. He currently serves as Deputy Director (Operations) of the Division of Resolutions and Receiverships. Mr. Glassman holds a BBA from the University of Missouri at Kansas City and is a graduate of The Stonier Graduate School of Banking at Delaware University, Newark, Delaware.

Robert H. Hartheimer

Bob Hartheimer joined Friedman Billings Ramsey Group, Inc. (FBR) in January 1996 as a Managing Director of Investment Banking. Mr. Hartheimer is a senior member of the firm's Financial Services group calling on banks, thrifts and specialty finance companies and at the same time is responsible for the initial public offerings for Styling Technologies Corporation and Credit Management Solutions, Inc.

Prior to joining FBR, Mr. Hartheimer served as Director, Deputy and Associate Director of the Division of Resolutions at the Federal Deposit Insurance Corporation, Washington D.C. As Director of the 300-person Division of Resolutions, Mr. Hartheimer was responsible for the sale of all failing banking institutions, renegotiations of FSLIC assistance agreements and the sale of capital instruments held by the FDIC and FSLIC. During his four years at the agency, Mr. Hartheimer was responsible for the sale of over 200 failed banks aggregating $58 billion in assets. During his tenure, the FDIC took over and managed five banking institutions. Mr. Hartheimer was responsible for hiring new CEOs of these institutions overseeing the bank's restructuring and selling them to the public. Innovative transactions by the FDIC such as the $332 million public offering of Crossland Federal Bank and the breakup and record sale of 20 First City Banks were directed and initiated by Mr. Hartheimer.

For the nine years prior to the FDIC, Mr. Hartheimer was an investment banker specializing in financial institutions at both Smith Barney & Co. Inc. and Merrill Lynch & Co. Inc. During this period of time, Mr. Hartheimer worked with virtually every type of financial institution on a wide variety of transactions including mergers, public offerings, mortgage securities and credit card receivable sales.

Mr. Hartheimer has a B.A. from Hamilton College and an M.B.A. from the Wharton Business School at the University of Pennsylvania.

John G. Heimann

John G. Heimann is Chairman of Global Financial Institutions for Merrill Lynch & Co., Inc., with senior responsibility for financial institutions worldwide. He is also a member of the firm's Office of the Chairman and Executive Management Committee.

Mr. Heimann, who came to Merrill Lynch in 1984 as Vice Chairman of Merrill Lynch Capital Markets, served from 1988 to 1990 as Chairman of the Executive Committee for Merrill Lynch Europe/Middle East and, from 1991 to present, as Chairman of Global Financial Institutions.

Mr. Heimann began his career at Smith Barney & Co. in 1956. He joined E.M. Warburg Pincus & Co. in 1967 as Senior Vice President and Director. In 1975, he served as Superintendent of Banks for the State of New York, and the following year held the position of Commissioner for the New York State Division of Housing and Community Renewal. While serving as U.S. Comptroller of the Currency from 1977 to 1981, he was also a member of the Board of Directors at the Federal Deposit Insurance Corporation and the Federal National Mortgage Association, as well as Chairman of the Federal Financial Institutions Examination Council. He then served as Chairman of the Executive Committee at Warburg, Paribas Becker before being named Deputy Chairman for Becker Paribas Incorporated in 1982.

Mr. Heimann serves as Director to Merrill Lynch National Financial and Merrill Lynch Capital Markets Bank Limited, and as Chairman of Merrill Lynch International Bank. He is Chairman of the Financial Services Council, and a Vice Chairman of the Board of Trustees of the National Policy Association. He is also a Member and Treasurer of the group of Thirty; Member of the Board and Executive Committee of the Institute of International Finance; Member of the Advisory Committee of the Toronto International Leadership Centre for Financial Sector Supervision; and a Trustee of Hampshire College.

He is co-Chairman of the British-North American Committee, a Member of the International Capital Markets Advisory Committee for the Federal Reserve Bank of New York, and the Council of Foreign Relations. He also belongs to the Citizens Committee for New York City, New York City Housing Partnership. He is a Director of The American Ditchley Foundation.

Mr. Heimann served as Chairman of New York State's Committee on Transnational Banking Institutions; Chairman of New York State's Executive Advisory Commission on Insurance Industry Regulation Reform; Special Advisor to the Governor on Temporary Commission on Banking, Insurance, and Financial Reform; and a Member of the Yale School of Management Advisory Panel on the Financial Services for 1988.

Mr. Heimann was named "Housing Man of the Year" by the National Housing Conference in 1976. He was a distinguished Lecturer for Columbia University's School of Internal Affairs in 1979, also having received the Chancellor Medal from Syracuse University the year prior. The Bank Administration Institute honored him with a key for distinguished service in 1980, and he received the Alexander Hamilton Award from the Department of the Treasury the following year. In 1986, he accepted the Brotherhood Award from the National Conference of Christians & Jews and the Pacesetter Award from the National Association of Bank Women, Inc.

Mr. Heimann graduated from Syracuse University in 1950 with a B.A. in Economics. In 1979, he received a Doctor of Laws from St. Michael's College in Vermont.

Paul Horvitz

Paul Horvitz has been Professor of Banking and Finance at the University of Houston since 1977.

He received a B.A. degree from the University of Chicago, an M.B.A. degree from Boston University, and in 1958 he received the Ph.D. in Economics from M.I.T.

Dr. Horvitz was a Financial Economist at the Federal Reserve Bank of Boston from 1957 to 1960, Assistant Professor of Finance at Boston University from 1960 to 1962, and Senior Economist and Associate Director of Research at the Office of the Comptroller of the Currency from 1963 to 1966. In 1967, he joined the FDIC as Assistant Director of Research, becoming Director of Research in 1969, and Deputy to the Chairman for Policy in 1976.

Dr. Horvitz has authored or edited several books and numerous articles on banking and finance in professional and trade journals. He is currently a co-editor of the Journal of Financial Services Research. He has been a consultant to several government agencies and a number of financial institutions and trade associations, and has been an expert witness in litigation between financial institutions and government agencies. From 1983 to 1989 he was a Public Interest Director of the Federal Home Loan Bank of Dallas. Dr. Horvitz was a charter member, and remains a member of the Shadow Financial Regulatory Committee. He was a Director of Pulse EFT Association from 1990 to 1996, and is currently a Director of Bank United.

Doyle Mitchell

B. Doyle Mitchell is President of Industrial Bank, N.A., the second largest minority-owned commercial bank and the third largest minority financial institution in the country, according to the June 1996 issue of Black Enterprise. Under his leadership, the bank formed a bank holding company, IBW Financial Corporation, to facilitate expansion into Prince George's County, Maryland. He was also recognized by then Secretary of Treasury, Lloyd Bentsen, as a pioneer in the banking industry at the signing of the Interstate Banking Bill that was enacted in September 1994.

Mr. Mitchell was born and raised in the banking community of Washington, D.C. that his grandfather and father helped to create. At the age of 16, he began working summers in the bookkeeping department of the bank. In 1980, he enrolled in Rutgers University in New Brunswick, NJ., continuing his summer employment at the bank during his undergraduate years. He received a B.S. in Economics with a concentration in Finance and Accounting, and began a full-time career at Industrial, working in the accounting, loan, audit, and operations departments of the bank. During this period, he also earned his Retail Banking Diploma from the American Institute of Banking and completed the Business of Banking School sponsored by the American Bankers Association. By 1989, he was appointed Assistant Vice President, Commercial Loans, and was named to the Board of Directors in 1990. Mr. Mitchell became Vice President in 1991, and succeeded his father as president in 1993. He is a Certified Financial Planner.

Like his grandfather and father, Mr. Mitchell has a clear direction for the bank. As the District customers began to move to the Maryland suburbs, the bank needed to follow. Mr. Mitchell took advantage of a Resolution Trust Corporation opportunity and purchased two bank branches in Prince George's County.

Mr. Mitchell serves on the Board of Directors of the Luke C. Moore Academy, the Neighborhood Economic Development Corp., the MAAT Center for Human Development, the District of Columbia Chamber of Commerce, the D.C. Water and Sewer Authority, Bowie State Board of Visitors, and American Institute of Banking. He also sits on the Montgomery County/Prince George's County CEO Round Table of the Greater Washington Board of Trade, and is a member of the National Coalition of Minority Business. He also serves on the Board and is President of the U Street Theatre Foundation (Lincoln Theater).

James Montgomery

James F. Montgomery is past Chairman and Chief Executive of Great Western Financial Corporation and its principal subsidiary, Great Western Bank, a Federal Savings Bank. He was elected a Director and President of the company in 1975, Chief Executive in 1979 and Chairman of the Board of Directors in 1981.

Named "Outstanding Chief Executive Officer" in the savings and loan industry for six years by *The Wall Street Transcript*, Mr. Montgomery is a widely recognized leader in the financial services business.

Mr. Montgomery's experience in the financial services industry spans nearly 40 years. He began his business career in 1957 with the accounting firm of Price Waterhouse and Company in Los Angeles. In 1960, he joined Great Western as Assistant to the President before leaving the company in 1964 to serve as Director and President of United Financial Corporation and its subsidiary, Citizens Savings and Loan Association. Mr. Montgomery rejoined Great Western in 1975 as President.

Mr. Montgomery is a Director of the Federal Home Loan Mortgage Corporation, known as Freddie Mac, one of the nation's largest purchasers of home mortgages in the secondary market. A stockholder-owned corporation chartered by Congress, Freddie Mac helps maintain a continuous flow of funds to mortgage lenders in support of home ownership and rental housing.

Mr. Montgomery served as Chairman of the America's Community Bankers of America, the national trade association for savings institutions, in 1996. He is a past Director of the California Chamber of Commerce and a former advisor to the Federal Reserve System in Washington, D.C.

Mr. Montgomery served many terms as a Director of the Federal Home Loan Bank of San Francisco. Strongly committed to civic affairs, Mr. Montgomery served as a

Director of the Neighborhood Housing Services of America and the Local Initiative Support Corporation, a nationwide, non-profit organization that helps finance the construction or renovation of rental housing for low-income families. In addition, he was named the first recipient of the John Wayne Cancer Clinic's "Duke Award" for his outstanding service in the fight against cancer and his humanitarian service to the community.

Mr. Montgomery earned a bachelor's degree in accounting from the University of California, Los Angeles.

Joseph H. Neely

Joseph H. Neely became a Member of the Board of Directors of the Federal Deposit Insurance Corporation on January 29, 1996.

A native of Grenada, Mississippi, Joe Neely attended University of Southern Mississippi where he attained a Bachelor of Science degree in Business Administration, majoring in Finance. He continued his studies as a Graduate Fellow of the University of Southern Mississippi and earned a Masters of Business Administration degree.

Upon graduation, Neely served for two years as an instructor of Accounting and Economics at Hinds Community College in Raymond, Mississippi. He began his banking career in 1977 with the Grenada Sunburst Banking System, serving in the lending area of the bank. In 1980, he joined the Merchants National Bank of Vicksburg where he served as Senior Vice President. In April 1992, Governor Kirk Fordice appointed Mr. Neely Commissioner of the Department of Banking and Consumer Finance for the State of Mississippi. In July 1995, President Clinton appointed Mr. Neely to the FDIC Board of Directors. After confirmation by the United States Senate in December 1995, Mr. Neely was sworn in as a Director in January 1996.

Mr. Neely is a graduate of the American Bankers Association's Stonier Graduate School of Banking, the School of Bank Marketing, and the School of Bank Management and Strategic Planning. He has lectured at the Stonier Graduate School of Banking, the Graduate School of Banking at Louisiana State University, and the Alabama and Mississippi Schools of Banking. In addition, Mr. Neely regularly addresses banking groups and associations throughout the country on a variety of current industry issues.

Mr. Neely has served in numerous civic leadership positions and has been active in community affairs throughout his career.

Gail Patelunas

Ms. Patelunas joined the FDIC in 1990 to work on resolving failed financial institutions. One of the initial members of the Division of Resolutions, she gained increasing responsibility and became Acting Director for the year prior to its merger with the Division of Depositor and Asset Services in December 1996. Gail is currently a Deputy Director of asset management in the succeeding Division of Resolutions and Receiverships.

Prior to joining the FDIC, Ms. Patelunas worked as a Financial Analyst with the Board of Governors of the Federal Reserve, Division of Banking Supervision and Regulation. Ms. Patelunas was also a Bank Stock Analyst for Kidder Peabody and a Senior Manager in KPMG Peat Marwick's bank-consulting group.

Ms. Patelunas has a B.S. in business administration from Rochester Institute of Technology and an M.B.A. from the University of Maryland, graduated from the Stonier Graduate School of Banking and is a Chartered Financial Analyst.

Diana Reid

Diana W. Reid is a Managing Director-Senior Advisor of Credit Suisse First Boston, an international corporate and investment banking firm. Ms. Reid currently raises private placement debt and equity focusing on real estate and mortgage assets, companies or funds including recent innovative structures of catastrophic risk bonds, collateralized loan bonds, and unrated commercial mortgage-backed securities. Prior to her move to the Investment Banking Department in 1996, Ms. Reid managed the firm's real estate capital markets, sales and trading activities. She was named a Managing Director in February 1994.

Ms. Reid joined The First Boston Corporation in 1983 as a Vice President in mortgage trading, responsible for coverage of mortgage originators. She traded rated conventional mortgages from 1988 to 1991, forming the mortgage capital markets desk to structure and price new issue offerings of conventional mortgage loans, home equity loans and manufactured housing contracts.

Ms. Reid is a member of the Commercial Real Estate Finance division of the Mortgage Bankers Association and a member of the Executive Board of the Commercial Real Estate Securitization Association (CSSA). Ms. Reid received her B.S. from California State University in 1975 and her M.B.A. from the University of Virginia in 1980.

William H. Roelle

Bill Roelle joined General Electric Capital Corporation in 1996. He is the Managing Director, Business Development, Office of Executive Vice President for General Electric Capital Corporation.

Prior to joining G.E. Capital Corporation, Mr. Roelle was the Advisor to the Minister of Finance (Poland). In this capacity, he advised the Minister of Finance on Bank Privatization and related issues.

Between 1969 and 1995, Mr. Roelle held various executive positions with the Federal Deposit Insurance Corporation and the Resolution Trust Corporation. Among them, Deputy to the Director of the Federal Deposit Insurance Corporation wherein he served as an Advisor to the Board of Directors. Senior Vice President and Chief Financial

Officer, Resolution Trust Corporation, responsibilities included but were not limited to: Chairman of the Executive Committee, Director of Resolutions and Operations, Corporate and Field Accounting, Information Resource Management. As of December 31, 1993, the RTC had assumed control of 743 institutions with assets of $450 billion and had resolved 680 institutions with assets of $390 billion. Earlier in his career with the FDIC, he was the Associate Director, Division of Bank Supervision, wherein he was responsible for failing bank sales and assistance transactions, including assisted mergers.

Mr. Roelle served in the United States Marine Corps for four years and is a graduate of the University of Maryland and holds a B.A. in Economics.

Thomas A. Rose

Thomas A. Rose was selected as the Division of Resolutions and Receiverships' Senior Deputy Director in July 1996. In that capacity, he oversees the general operation of the Division. Mr. Rose joined the Division from the Legal Division, where he served as Deputy General Counsel for the FDIC's Liquidation Branch since 1985. As Deputy General Counsel for the Liquidation Branch, Mr. Rose worked closely with the Division and developed national policies relating to closed bank and thrift legal operations.

Mr. Rose began his career with the FDIC in October 1982 and held the positions of Senior Attorney, Counsel, and Assistant General Counsel prior to his appointment as Deputy General Counsel for the Liquidation Branch. Prior to his career with the FDIC, Mr. Rose worked for the Department of Commerce, the Small Business Administration, and a private law firm, Rengier, Musser & Stengel.

Mr. Rose completed his undergraduate studies in political science at Villanova University in 1970, and obtained a law degree from the Villanova University School of Law in 1973.

John E. (Jack) Ryan

John E. (Jack) Ryan is Regional Director of the Office of Thrift Supervision – Southeast Region. As the region's highest ranking federal thrift regulatory official, he is responsible for the examination, supervision and regulation of the savings and loan industry in the District of Columbia, Maryland, Virginia, North Carolina, Florida, Georgia, Alabama, Puerto Rico and the Virgin Islands.

During 1994 and 1995, Mr. Ryan was on leave of absence from the OTS and served as the Acting CEO of the Resolution Trust Corporation.

Before being appointed Regional Director, Mr. Ryan served as Senior Executive Vice President and Chief Regulatory Officer of the Federal Home Loan Bank of Boston. He also served as its Acting President for a period of seven months in 1989. Mr. Ryan spent 25 years as a commercial bank and bank holding company regulator for the Federal

Reserve System. For eight years, Mr. Ryan served as Director of the Division of Banking Supervision and Regulation for the Federal Reserve Board in Washington, D.C., reporting directly to the Board during the terms of Chairmen Burns, Miller and Volcker.

The Southeast region (Atlanta Regional Office) of the OTS is responsible for 265 thrift institutions with aggregate total assets of more than $61 billion.

Theodore J. (Ted) Samuel

Ted Samuel has more than 25 years experience in the financial services and real estate industries. This experience has spanned several institutions, geographic areas and functional responsibilities. At the current time, Mr. Samuel is managing a personal investment corporation engaged in real estate and loan venture capital. Prior to that activity, he was Chairman and Chief Executive Officer of both Niagara Portfolio Management Corporation and Niagara Asset Corporation. These entities are subsidiaries of Key Bank of New York and were solely engaged in the management of the residual assets of the former Goldome Bank. The management of these assets was under contract with the FDIC. The Niagara Companies liquidated substantially all of Goldome's assets totaling more than $2 billion. Mr. Samuel was formerly with NationsBank, where he was Executive Vice President in the Special Asset Bank. This group handled the First Republic Bank asset liquidation agreement for the FDIC, and Mr. Samuel was responsible for a real estate loan workout portfolio exceeding $3 billion. This was the first large asset liquidation contract developed by the FDIC for use in failed bank situations. Mr. Samuel also assisted the Resolution Trust Corporation in pooled sales and collection activities.

Prior to these responsibilities, Mr. Samuel presided over TJS Advisory Corporation, a firm focused on bank building leasing and sales; served as head of real estate loan underwriting for NationsBank; headed the real estate credit group for Mellon Bank; and worked with a financial conglomerate serving in mortgage banking, lending, venture capital and loan workout roles. He was also the treasurer of a workout NYSE REIT during the 1974 real estate recession. Mr. Samuel holds a B.S.B.A. and an M.A. in Finance and Real Estate from Ohio State University.

H. Jay Sarles

H. Jay Sarles is Vice Chairman and Chief Administrative Officer of Fleet Financial Group. He is responsible for strategic planning and acquisitions, Fleet's administrative functions, and the financial services line of business including Fleet Equity Partners, Fleet Mortgage, and Fleet's credit card operations. In addition to serving as Vice Chairman and Chief Administrative Officer for Fleet Financial Group, Sarles also is chairman of Fleet Bank, N.A. and chairs Fleet Financial Group's Diversity Council. He reports to Terrence Murray, Chairman and Chief Executive Officer.

Since joining Fleet in 1968, Mr. Sarles has held a variety of positions. He oversaw the company's commercial real estate business in the 1970s. In 1980, Mr. Sarles was named Vice President of Fleet Financial Group and in 1986 was promoted to Executive Vice President. In 1991, he was appointed President and Chief Executive Officer of Fleet Banking Group, parent company of the former Bank of New England units in Massachusetts and Connecticut. He was named a Vice Chairman of Fleet Financial Group in 1993.

Active in several philanthropic and professional endeavors, Mr. Sarles is currently Chairman of the Metropolitan Boston Housing Partnership and a member of the Board of Trustees of Lifespan, a Providence-based health care system.

Mr. Sarles received his B.A. degree from Amherst College in Massachusetts and attended the Program for Management Development at Harvard Business School.

L. William Seidman

L. William Seidman is the Chief Commentator on cable network's CNBC-TV and publisher of *Bank Director* magazine. He has consulted with numerous organizations, including the Deposit Corporation of Japan, Tiger Management, J.P. Morgan, Inc., The World Bank, BDO Seidman, and The Capital Group, and is currently a member of the Board of Directors of Fiserv, Inc. and Intelidata, Inc. Prior to that, he served as the 14th Chairman of the Federal Deposit Insurance Corporation from 1985 to 1991. He became the first Chairman of the Resolution Trust Corporation in 1989 and served in that capacity until 1991. While at the RTC, he supervised the creation of an 8,000 person agency handling over $500 billion in assets from failed savings and loans.

At the time of his presidential appointment, he was completing his third year as Dean of the College of Business at Arizona State University, Tempe, Arizona, one of America's largest business colleges. When he left, the Seidman Institute of Research was created in his honor.

While in Arizona, he was Chairman of the Governor's Commission on Interstate Banking and wrote a business column for the *Phoenix Gazette*.

Mr. Seidman served on the White House staff of President Gerald Ford as Assistant for Economic Affairs from 1974 to 1977. In this role, he helped to develop a series of proposals in deregulation of transportation and other industries. He served President Reagan as co-chair of the White House Conference on Productivity in 1983 and 1984.

On the business side of his career, Mr. Seidman was Vice-Chairman and Chief Financial Officer of the Phelps Dodge Corporation from 1977 to 1982. He was Director of Phelps Dodge Corporation, The Conference Board and United Bancorp of Arizona.

In the 1960s he founded Sumercom, a TV, radio and newspaper company, where he was CEO until 1974 when the company was sold.

Mr. Seidman was managing partner of Seidman and Seidman, Certified Public Accountants (now BDO Seidman) from 1968 to 1974. Under his stewardship, the firm expanded from a small family enterprise to become one of the 10th largest public accounting firms in the nation. Mr. Seidman also served as Chairman (1970) and Director of the Detroit Bank of the Federal Reserve Bank of Chicago from 1966 to 1970.

As an educator, he is known as the father of Grand Valley State University, Allendale, Michigan. Grand Valley State is a state university which has grown to 15,000 students. He is also the founder of The Washington Campus, a consortium of major universities teaching in Washington, D.C.

Mr. Seidman is the author of two books: *Productivity: The American Advantage* (with Steven L. Shancke), Simon & Schuster, 1989, and *Full Faith and Credit*, Random House, 1993.

Mr. Seidman holds an A.B. from Dartmouth (Phi Beta Kappa), and LL.B from Harvard Law School, and is an honors graduate with an M.B.A. from the University of Michigan. He served in the United States Navy from 1942 to 1946, earning battle stars and the Bronze Star Medal on a destroyer in the Pacific Ocean.

Stanley C. Silverberg

Stanley Silverberg has been an independent consultant since 1987, when he retired from the FDIC. Much of his early consulting activity dealt with failing bank and thrift institutions and deposit insurance. During the late 1980s and early 1990s, he advised the Federal Home Loan Bank Board, consulted with the FDIC in connection with establishing the RTC, advised banks, thrifts and investor groups on acquisition of failing depository institutions, and worked on several law suits arising from bank failures. Mr. Silverberg also consulted with virtually all the bank and thrift trade associations on bank failure issues and deposit insurance.

When bank and thrift failures slowed, Mr. Silverberg began consulting on banking issues in developing countries, principally for The World Bank and the International Monetary Fund. Addressing such issues as bank liberalization, privatization, insolvent banks, and deposit insurance provided an opportunity to draw on many years of U.S. bank experience. During the past several years, Mr. Silverberg has consulted in about 15 countries, ranging from Argentina to Zambia.

Mr. Silverberg worked at the FDIC for almost 20 years, the last eight as Director of Research and Strategic Planning. At the FDIC, he played an important role in guiding the FDIC's research and statistics programs and played a major role in developing FDIC policies on deposit insurance, handling bank failures, and supervisory and liquidation issues. He played a lead role in developing the FDIC strategy for handling failing savings banks and the lead staff role in the Continental Illinois case.

Prior to joining the FDIC in 1967, Mr. Silverberg worked as an economist for Bank of America, and for the Treasury Department in the Office of the Comptroller of the Currency and in the Office of the Secretary. Mr. Silverberg received a B.A. from the University of Wisconsin and an M.A. and Ph.D. in economics from Yale University.

Sandra L. Thompson

Sandra L. Thompson is the Assistant Director, Asset Marketing for the Franchise and Asset Marketing Branch of the Federal Deposit Insurance Corporation. In this position, she oversees the marketing and sales activities for the FDIC's asset inventory. Prior to assuming this position in March 1997, Ms. Thompson was the Manager of Securitization and Mortgage-Backed Securities Administration for the Division of Depositor and Asset Services, and was responsible for the administration of FDIC and RTC issued securities and equity partnership transactions.

Ms. Thompson worked at the RTC from September 1990 until its closing in December 1995, as Assistant Vice President, Securitization Management. In this position, Ms. Thompson directed the Asset Management and Sales Division's securitization and equity partnership program for over $54 billion of loans and other assets.

Prior to Ms. Thompson joining the RTC and the FDIC, she was an Investment Banker at Goldman Sachs, & Co. in New York City where she worked on private label mortgage-backed securitizations for banks, thrifts and insurance companies. She holds a Bachelor of Business Administration Degree in Finance from Howard University.

Lawrence J. White

Lawrence J. White is Arthur E. Imperatore Professor of Economics at New York University's Stern School of Business. During 1986–1989 he was on leave to serve as Board Member, Federal Home Loan Bank Board, and during 1982–1983 he was on leave to serve as Director of the Economic Policy Office, Antitrust Division, U.S. Department of Justice.

He received a B.A. from Harvard University (1964), an M.Sc. from the London School of Economics (1965), and a Ph.D. from Harvard University (1969).

He is the author of *The Automobile Industry Since 1945* (1971); *Industrial Concentration and Economic Power in Pakistan* (1974); *Reforming Regulation: Processes and Problems* (1981); *The Regulation of Air Pollutant Emissions from Motor Vehicles* (1982); *The Public Library in the 1980's: The Problems of Choice* (1983); *International Trade in Ocean Shipping Services: The U.S. and the World* (1988); *The S&L Debacle: Public Policy Lessons for Bank and Thrift Regulation* (1991); and articles in leading economic and law journals. He is editor or co-editor of seven volumes: *Deregulation of the Banking and Securities Industries* (1979); *Mergers and Acquisitions: Current Problems in Perspective* (1982); *Technology and the Regulation of Financial Markets: Securities, Futures, and Banking* (1986); *Private Antitrust Litigation: New Evidence, New Learning* (1988); *The Antitrust Revolution* (1989; 2nd ed., 1994); *Bank Management and Regulation* (1992); and *Structural Change in Banking* (1993).

He also served on the Senior Staff of the President's Council of Economic Advisors during 1978–1979, and was Chairman of the Stern School's Department of Economics, 1990–1995.

James R. Wigand

James R. Wigand is the Deputy Director for Franchise and Asset Marketing, Division of Resolutions and Receiverships, FDIC, and oversees the resolution of failing insured financial institutions and the sale of their assets. Prior to assuming this position in January 1997, Mr. Wigand was Assistant Director, Capital Markets, Division of Depositor and Asset Services, and was responsible for the administration of FDIC and RTC issued securities and the sale of securities from failed thrifts.

Mr. Wigand worked at the RTC from December 1989 until its closing in December 1995, most recently as Assistant Vice President, Operations and Asset Management. In this position, Mr. Wigand oversaw the Asset Management and Sales Division's programs for asset management, seller financing, equity partnerships, management information systems, receivership operations, and internal review.

Prior to joining the RTC, Mr. Wigand worked in the Division of Liquidation, FDIC, the Federal Savings and Loan Insurance Corporation's Operations and Liquidation Division, Ferris & Company, and the U.S. General Accounting Office.

Mr. Wigand holds a B.S. degree in zoology from the University of Maryland and an M.B.A. with a specialization in finance from the University of Chicago Graduate School of Business.

APPENDIX B

Resolutions Panel

The large number of bank and thrift failures in the 1980s and early 1990s created challenges not seen in the U.S. financial system since the 1930s. The FDIC and the RTC modified basic resolution strategies with an eye toward maintaining public confidence and financial stability, without sacrificing other public policy objectives. This panel focuses on the issues and strategies that arose in connection with these bank and thrift failures.

Possible Issues for Discussion

Too Big To Fail—The FDIC and other regulators' preference for solutions that favored stability rather than market discipline was apparent in the treatment of larger banks during the 1980s. The transactions in the early 1980s involving First Pennsylvania, the mutual savings banks and Continental Illinois set the pattern for the treatment of large banks throughout the rest of the 1980s. In large-bank resolutions, the FDIC used purchase and assumptions transactions, bridge banks, and open bank assistance agreements that typically provided full protection for uninsured depositors and other general creditors. This raised questions of fairness, since numerous small bank failures were resolved through deposit payoffs, in which uninsured depositors suffered losses. This was said to have created incentives for depositors to place large deposits in larger banks.

Forbearance—Forbearance, as practiced by the FDIC, exempted certain distressed institutions that had been operating in a safe and sound manner from capital requirements for a limited period of time. The first formal forbearance program was the Net Worth Certificate Program, which was established in 1982 under the Garn-St Germain Act. Other forbearance programs established for banks in the mid-to-late 1980s included a temporary capital forbearance program for agricultural banks and banks with a concentration of energy loans and the agricultural loan loss amortization program adopted by Congress in 1987. There are many risks in offering forbearance programs, and without proper oversight, forbearance can permit further deterioration and result in increased costs. The experience of the savings and loan industry in the 1980s when forbearance was applied broadly to the whole industry is a clear example of the problems associated with forbearance.

Impact of FDICIA—While the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991 touched a wide range of regulatory areas, certain provisions—particularly those pertaining to prompt corrective action (PCA) on failing institutions and the least cost test—had profound effects on the way the FDIC conducted failed bank resolutions. The aspect of PCA that most directly affects the FDIC's approach to bank failures prescribes mandatory measures for critically undercapitalized institutions (those with a ratio of tangible equity to total assets equal to or less than 2 percent). In these cases, a conservator or receiver must be appointed no later than 90 days after the institution falls into the critically undercapitalized category. The FDIC may grant up to two 90-day extensions of the PCA period if it is determined that those extensions would better protect the insurance fund from long-term losses. FDICIA also requires the FDIC to pick the least costly resolution transaction available. All bids must be considered together and evaluated on the basis of comparative cost; other policy considerations cannot be factored into the determination of the appropriate transaction.

Ownership Interest—In several of the large bank failures in the 1980s, such as Continental Illinois and First City, the FDIC, as part of the resolution, took back stock and/or warrants as part of the deal. This resulted in the FDIC having an ownership position (in some cases a majority position) in the resulting institution. In most cases, this ownership position was later sold back to the resulting institutions. Some critics objected to the notion of a government agency acquiring ownership in a bank and considered it "nationalization." Others view this as an appropriate way for the FDIC to share in any "upside" potential given that it bears the "downside" risk.

Bridge Banks—A bridge bank is a temporary banking structure controlled by the FDIC to take over the operations of a failed bank and maintain banking services for the customers. As the name implies, a bridge bank is designed to "bridge" the gap between the failure of a bank and the time when the FDIC can implement a satisfactory resolution of the failed bank. Beginning in 1987, the bridge bank structure became an important part of the FDIC's bank resolution process for large banks with complex financial structures in danger of failing. The bridge bank provided the FDIC time to take control of the failed bank's business, stabilize the situation, and determine an appropriate permanent resolution. Many proponents of the bridge bank structure believe that the bridge bank structure will remain an integral part of large bank failures in the future. Some critics however have expressed concern that the government is running a bank and competing against other nongovernment owned banks.

Open Bank Assistance—The FDIC was authorized to provide open bank assistance (OBA) under Section 13(c) of the FDI Act. OBA was not used by the RTC. OBA transactions occurred when a distressed financial institution remained open with the aid of government financial assistance. Generally, the FDIC required new management, ensured that the ownership interest was diluted to a nominal amount, and called for a private sector capital infusion. OBA was also used to facilitate the acquisition of a failing bank or thrift by a healthy institution (e.g. mutual savings banks in the early 1980s). The FDIC provided financial help in the form of loans, contributions, deposits, asset purchases, or the assumption of liabilities. While minimizing cost to the deposit insurance funds was the ultimate goal, OBA was provided for public policy reasons, such as maintaining public confidence and maintaining banking services to a community. A major criticism of OBA has been that shareholders of failing institutions have benefited from government assistance. The FDIC moved away from OBA after 1988 as bridge bank authority gave the FDIC a more expedient and flexible alternative. Currently, in order for the FDIC to provide OBA, it must establish that the assistance is the least costly to the insurance fund of all possible methods for resolving the institution and insurance funds cannot be used to benefit shareholders of the failing institution. There have been no OBA transactions since 1992.

Cross-Guarantee Authority—The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 gave the FDIC the authority to assess cross-guarantee claims against banks that were affiliates of a failed bank. This was designed to prevent affiliated banks from shifting assets and liabilities in anticipation of the failure of one or more of their number in an attempt to retain value for the owners while depriving the FDIC of that value and increasing the FDIC's costs. The cross-guarantee authority allowed the FDIC to apportion loss among all the banks within the affiliated group in the event that one or more of the institutions failed. Since the addition of this authority, the FDIC has closed affiliated banks that would otherwise have remained open and has sold the entire group of affiliated banks at the same time.

Loss Sharing—The loss sharing transaction was designed to address problems associated with marketing large banks that typically had sizeable commercial loan and commercial real estate portfolios. Acquiring institutions had been reluctant to acquire commercial assets in FDIC transactions because of limited due diligence periods, poor or questionable underwriting criteria of the failed bank, and declining and volatile commercial real estate markets in the late 1980s and early 1990s. Under loss sharing, the FDIC agreed to absorb a significant portion, typically 80 percent, of the losses on a specified pool of commercial-type loans, with the acquiring bank liable for the remaining portion of the loss. By limiting an acquirer's exposure to a maximum loss of 20 percent, the FDIC hoped to pass most of the failed bank assets while still receiving a substantial premium for the deposit franchise. The FDIC also hoped to induce rational, economic asset management behavior.

Interim Capital Assistance—FIRREA mandated that the RTC attempt to preserve the minority ownership of failed minority thrifts. To achieve this objective, the RTC developed and administered programs for minority participation. As part of the program, the RTC provided interim capital assistance (ICA) of up to two-thirds of the required capital for the acquisition. Initially, these funds were to be short-term bridge financing but were later extended up to 5 years. These ICA loans carried interest rates equal to the RTC's borrowing cost, which was much lower than comparable financing. The use of ICA raised issues over public policy benefits versus least cost.

Advanced Dividends—An advance dividend is a payment made to uninsured depositors immediately after a bank fails, based on a conservative estimate of the value of the receivership's assets and a determination of the uninsured depositors' *pro rata* share of that value. Advance dividends were developed to reduce the disruption caused by a deposit payoff to uninsured depositors by providing uninsured depositors with greater liquidity.

Branch Breakups—In certain failing institutions, there have been few, if any, acquirers willing to assume the deposits of a multi-branch bank or thrift. This became a major concern to the RTC in the early 1990s as the large size of many of the failed thrifts and the general health of the banking and thrift industries limited the amount of interest in these institutions. In response, the RTC used the branch breakup transaction to increase bidder participation and competition, and add flexibility to the resolution process. The RTC marketed institutions through branch breakup transactions unless their accounting systems were incapable of handling multiple acquirers. Because the branch breakup approach enabled potential acquirers to bid on individual branch offices of failed thrifts, it appealed to a much broader group of potential investors. While the branch breakup was also used by the FDIC, usually when competition for the entire franchise was expected to be limited, it was used more frequently by the RTC. This process, which initially was used only in situations where there were few bidders for the entire franchise, became a means to enhance value through increased competition. However, certain disadvantages exist with branch breakup transactions. Electronic data processing costs are generally higher than in whole franchise transactions, and it is more difficult to complete transactions within the required timeframes. Branch breakups also require one of the acquiring institutions to be lead acquirer and provide backroom operations for all the acquirers during the transition period.

APPENDIX C

Asset Disposition Panel

The rapid increase of failures in the 1980s and early 1990s resulted in an unparalleled volume of assets in the hands of the FDIC and RTC. This panel will focus on the variety of techniques used by the FDIC and the RTC to dispose of the substantial volume of assets once held by both agencies, and will discuss the respective merits of each of the different strategies used by the agencies.

Possible Issues for Discussion

Asset Disposition Methods—The FDIC and RTC used a variety of asset disposition methods to handle the liquidation of over $400 billion in assets that the FDIC and RTC did not sell to an assuming institution during the resolution process. The methods used evolved in response to the circumstances of the times. The methods range from negotiating/compromising with a borrower on one asset to more sophisticated methods, including securitized sales of assets and equity partnerships with private sector firms. Other methods included auctions, sealed bid sales, and sales by brokers.

Selling at Resolution Vs. Outside of Resolution—The FDIC sold a majority of the assets in failed banks at the time of resolution by selling them to assuming banks. Of the $302.6 billion in failed bank assets, about $230 billion, or 76 percent, were sold immediately at resolution to assuming banks. Initially, the RTC tried to sell assets at resolution but found few takers. Later, the RTC found it more effective to split the assets from the deposit liabilities and therefore sold a relatively smaller percentage of assets at the time of resolution. Instead, the RTC disposed of the assets either during conservatorship or after completion of the resolution transaction. Of the $402.6 billion in assets from failed thrifts, only $75.3 billion, or 18.7 percent, were handled at the time of resolution.

Private Sector Contracting—At the beginning of the crisis years (1980–1984), the FDIC used primarily in-house staff to liquidate assets on an individual basis. However, as the number of failures rose and the total volume of assets to be liquidated increased, it became more difficult to perform these functions entirely with in-house personnel. In response, the FDIC began to use outside contractors to handle some of the assets. The FDIC first began using contractors to manage and dispose of distressed assets in the mid-1980s with the resolution of Continental. By the late 1980s, it was standard practice for contractors to be used by the FDIC for the management and disposition of assets retained from some of the larger bank failures. The early contracts evolved into the use of Asset Liquidation Agreements (ALAs) and Regional Asset Liquidation Agreements (RALAs). The FDIC used 16 asset management contracts to liquidate assets with a book value of over $33 billion, or nearly half, of the post-resolution assets the FDIC retained for liquidation. For the RTC, with its large volume of assets at day one, asset management contractors were utilized from the outset. In addition, FIRREA required the RTC to hire private-sector contractors if such services were available in the private sector and if such services were practicable, cost effective, and efficient. The RTC issued 199 Standard Asset Management and Disposition Agreements (SAMDAs) to 91 contractors covering assets with a book value of approximately $49 billion.

Bulk Sales—As asset inventories increased and bank-closing activity accelerated, FDIC policies began to emphasize bulk sales for broader classes of assets, including delinquent and charged-off loans. The RTC also implemented a Bulk Sale Program, which initially focused on the RTC's vast holdings of performing residential and commercial mortgages. At first, the RTC adopted the FDIC methodology of internally packaging and selling asset portfolios. However, some critical differences later developed between the agencies. By 1990, the RTC was relying predominantly on private-sector firms to evaluate, package, and market its loan portfolios. The RTC also adopted the use of seller financing as a marketing tool for portfolio sales. To boost the demand for nonperforming multi-family and commercial mortgages and other real estate, the RTC introduced the Structured Transaction Program. A structured transaction was a form of portfolio sale created to achieve a high volume of portfolio sales, as opposed to the sale of commercial assets on an individual basis. Packages were structured based on input from investor groups and financing was made available.

Securitizations—Securitization is the process by which assets with generally predictable cash flows and similar features are packaged into interest-bearing securities with marketable investment characteristics. Securitized assets have been created using diverse types of collateral, including home mortgages, commercial mortgages, manufactured housing loans, leases, and installment contracts on personal property. The FDIC did not use securitized loan sales as a major asset disposition method. However, the RTC, due to the large volume of mortgage loans in its inventory, used securitized sales as a method to meet its FIRREA mandate of maximizing returns while also liquidating assets expeditiously. From June 1991 to June 1997, 72 RTC and 2 FDIC securitized transactions closed, representing loans with a book value of $42 billion for the RTC and $2 billion for the FDIC.

Equity Partnerships—The RTC, and to a much more limited extent, the FDIC used equity partnership programs with private-sector partners as an asset disposition method. During the 1990s, the RTC created 72 partnerships with a total book value of about $21 billion. The FDIC became a partner in two partnerships holding assets having a book value of about $4 billion. Under the equity partnership program, the RTC established joint ventures between itself, acting as limited partner (LP), and a private sector investor, usually a joint venture between an equity investor and an asset management company, acting as general partner (GP). The RTC contributed asset pools (usually subperforming loans, nonperforming loans, and owned real estate), and arranged for financing to the partnership. The GP invested both equity capital and asset management services. After the debt was paid off, the remaining proceeds were usually split according to the ownership percentage each respective partner held. Thus, unlike a direct asset sale, the RTC retained a residual interest, which entitled it to receive some proceeds at closing and, as the assets were liquidated, receive the remainder of the proceeds periodically throughout the life of the portfolio. It was believed by the RTC that the net present value of the residual income stream, when added to the upfront cash receipts would be greater than the total proceeds that would have been received from a direct asset sale.

Asset Valuation—The FDIC and RTC differed in their asset valuation procedures. The FDIC generally relied on in-house staff to value assets based on estimated collections from all sources of recovery, subtracted anticipated expenses, and applied a present value to the cash flows. The RTC relied on an asset evaluation methodology developed in coordination with outside real estate professionals. That methodology attempted to value asset portfolios as investors would perceive their value. The RTC relied predominantly on actual net cash flows, and gave less weight to other, more subjective sources of recovery. In general, RTC procedures resulted in lower estimates of value. Both agencies used reserves to set base prices for portfolio sales and required wide marketing to ensure maximum competition. The RTC, however, tended to be more market oriented and more inclined to let the market speak concerning the acceptability of bids. In contrast, the FDIC was driven more by appraisals and relied more on internal reserves to set benchmarks for determining the acceptability of bids.

Liquidation Differential—While there is no empirical evidence, it is generally believed that after an asset from a failing bank is transferred to a receivership, the asset suffers a loss in value. Loans have unique characteristics and prospective purchasers need to gather information about the loans to properly evaluate them. Such "information costs" are factored into the price that the outside parties are willing to pay for the loans. A loss in value can also occur because of the break in the bank-customer relationship.

Environmental/Historical Assets Policy—In the early 1990s, the FDIC and RTC developed environmental programs to prepare and train staff to oversee implementation of federal and state environmental statutory provisions. The environmental programs were premised on identifying hazardous environmental conditions or substances, such as underground storage tanks, lead based paint, damaged, friable asbestos, and special environmental resources including wetlands, habitats of endangered species, and nationally significant historic sites. To help identify assets with environmental conditions, contractors with expertise in resource identification and environmental site assessments were engaged. Various disposition methods were used including national sales and environmental representations and warranties for loans collateralized by real estate that were securitized or sold into trust arrangements. A primary difference between the RTC's and FDIC's sales of real estate with environmental conditions was the RTC's use of "buyer remediation agreements." The RTC, as part of its standard sales documents, established requirements for buyer remediation, including an asset specific statement and schedule of work, an escrow account for funding such remediation from the sale proceeds, and a system for determining when remediation was completed. The FDIC, on the other hand, sold the properties "as is" without formally requiring that the buyer take corrective action.

Affordable Housing Program—Marketing and sales of owned real estate were affected in both the FDIC and RTC by legally mandated affordable housing programs. FIRREA established the framework for such programs, and required that the RTC implement an affordable housing program, whose purpose was to provide home ownership and rental housing opportunities for families with low-to-moderate incomes. Section 40 of FDICIA required that the FDIC establish an affordable housing program for the same purpose. The major difference between the FDIC and RTC programs was in the funding of the programs. Because the FDIC does not use public funds for its operations, it required a separate federal appropriation for an affordable housing program. The FDIC and RTC developed many strategies for marketing affordable housing. Those strategies included using clearinghouses, retaining assistance advisers, developing seller financing, establishing repair funding, developing a direct sale program, adjusting the value for a reduced price, developing a donation policy, establishing an exclusive marketing period, and using auctions and sealed bids.

While the FDIC and RTC affordable housing programs provided housing to low-income and moderate-income households, it did come at a price to taxpayers. The added costs are not high relative to the overall cost of the FDIC and RTC as a whole, but may be considered significant when viewed within the smaller confines of the affordable housing programs themselves.

APPENDIX D

Managing Bank Crises in Other Countries Panel

The rapid rise of private banking in Eastern Europe and around the world and the emerging financial crises occurring in the Far East raise issues regarding how other countries deal with banking failures. This panel will focus on the resolution strategies used by other countries and how they differ from those typically used in the United States.

Issues for Discussion

Past Crises—Other nations have had banking crises over the past several decades. Sweden in the 1980s, Latin America and Eastern Europe in the mid 1990s and most recently Japan and other countries in Southeast Asia. One issue is how these nations have chosen to address these past or current crises in their banking systems. In some countries the private sector has taken a much more active role, while in others, the government has been the primary architect behind the solution. In addition, the range of responses is broad, ranging from forbearance to liquidation. Some nations have relied primarily on "open bank" type assistance while others have chosen to actively close failing institutions and dispose of the assets. Finally, some countries follow a judicial liquidation approach (bankruptcy laws), while other countries, like the U.S., have their own liquidation system for failed institutions.

Current Crises—The Japanese government recently announced a multi-trillion-yen package to strengthen its banking system and lessen the risk of global financial crisis. Certain troubled banks would be aided through temporary capital assistance and/or the purchase of over one billion yen in troubled assets by the government. Other troubled banks would be allowed to fail. This raises issues about how the government plans to resolve the troubled banks and dispose of these troubled assets and what effects, if any, it could have on banking in other countries, especially those in southeast Asia. In the past, the Japanese government has been reluctant to take over troubled institutions but instead has relied on private sector assistance.

Consistency of Approach—With the continuing globalization of financial markets, some have called for a uniform system on resolution, receivership, and bankruptcy practices. The intent of a uniform approach is purportedly to reduce the impact of failures in one country on another, to recognize insolvency proceedings in each country, and permit the orderly and timely liquidation of assets located in another country. Is consistency really the best solution for each country?

APPENDIX E

Charts and Graphs

The FDIC and RTC

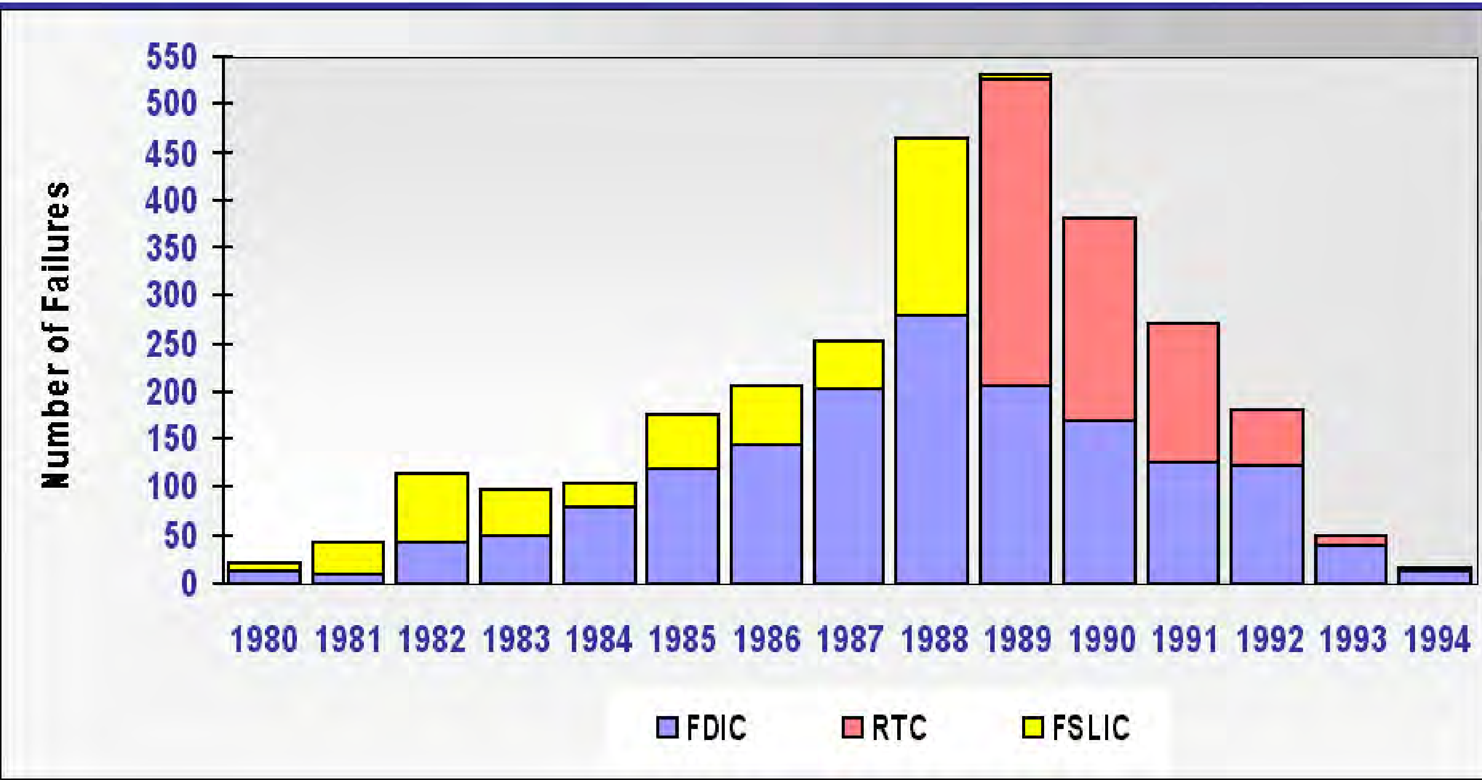
experience

MANAGING THE CRISIS

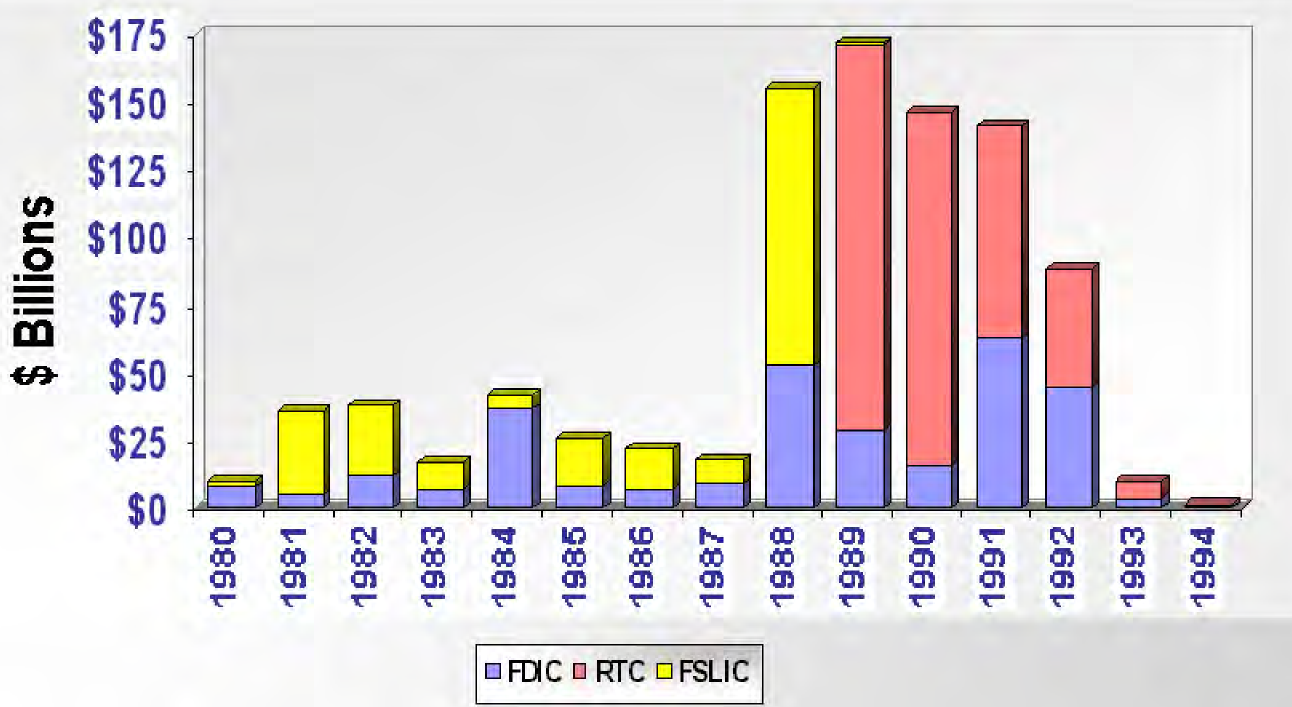
The Federal Deposit Insurance Corporation

MANAGING THE CRISIS

NUMBER OF FAILURES (BANK AND S&L)



FAILED BANK AND S&L ASSETS



MANAGING THE CRISIS

RESOLUTION TYPES

Purchase and Assumption (P&A)

- Clean Bank
- Whole Bank
- Bridge Bank
- With Loss Sharing
- With Optional Loan Pools

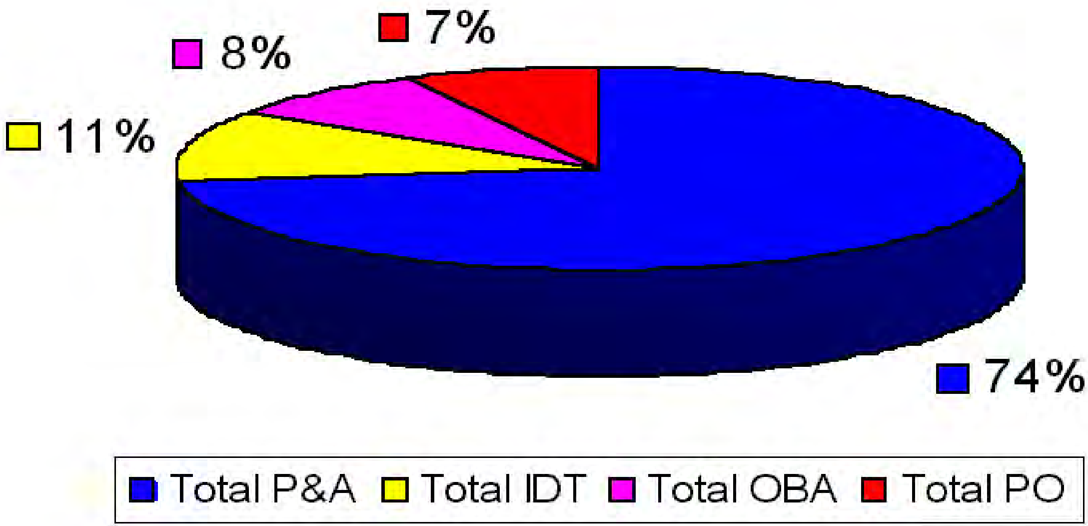
Open Bank Assistance (OBA)

- Assisted Merger
- Failing Institution Remains Open

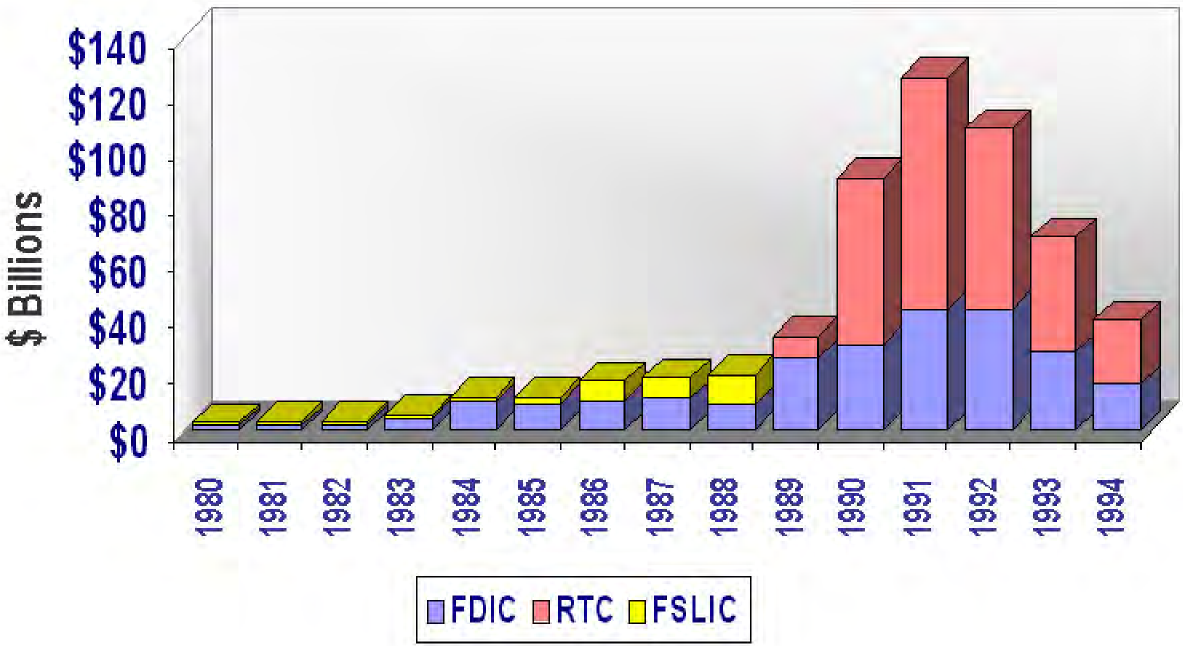
Insured Deposit Transfer (IDT)

Straight Deposit Payoff (PO)

BANK FAILURES BY RESOLUTION TYPE



BANK AND S&L ASSETS IN LIQUIDATION



MANAGING THE CRISIS

ASSET DISPOSITION STRATEGIES

- Sell at Resolution
- Auction/Sealed Bids
- Asset Management Contractors
- Securitization
- Equity Partnerships
- Professional Liability Claims
- Affordable Housing Program

APPENDIX F

Overheads Used by the Panelists

MANAGING THE CRISIS

The FDIC and RTC Experience

Symposium Presentation Materials Used by:

H. Jay Sarles

Hubert Bell, Jr.

Ted Samuel

Lawrence White

Arne Berggren

Bill Roelle

MANAGING THE CRISIS

Resolutions

Presentation Materials
For

H. Jay Sarles

Vice Chairman
Fleet Financial Group

MANAGING THE CRISIS

Resolutions

FDIC's Method of Resolution

- Bank of New England (BNE) failure - January 1991
- Bridge Bank established - January 1991
- Bid and due diligence process - February - April 1991
- Deal Structure: Good Bank / Bad Bank
  - Good Bank sold in competitive bid
  - Bad Bank asset ownership retained by FDIC - private sector firm hired to resolve assets
- Sale to Fleet - July 1991

Resolutions

Fleet's View of the Opportunity

- Attractive financial dynamics
  - "Guaranteed" earnings from "Good Bank"
  - Fee income from managing "Bad Bank" assets
- Opportunity to build strong New England franchise - MA, CT
- Quantifiable risk due to "put" capability - 3 year term
- Vehicle to attract outside capital - $283 million from KKR

MANAGING THE CRISIS

Resolutions

Deal Structure

- Purchaser: Fleet Financial Group
- KKR Position
  - $283 million investment
  - Dual convertible preferred with warrants
  - Convertible up to 22.5 million Fleet shares or down into 50% ownership of BNE franchise (MA & CT)
- The Prize: A clean $15 billion dollar bank with a strong franchise
- Consideration
  - $500 million in capital
  - $125 million premium (preferred stock)

MANAGING THE CRISIS

Resolutions

How Did It Work?

- $200 + million in annual earning from BNE franchise after 18 months (40% ROE)
- $140 million in net fee income from RECOLL
- KKR Profit
  - Investment $283 Million
  - Value 4/24/98 $2.26 Billion
  - Profit $1.98 Billion
  - Investment return 35% average annual return
- Fleet positioned for success

MANAGING THE CRISIS

Resolutions

What Made the Deal Work for Fleet

- Experience in mergers and acquisitions
- Ability to reduce costs ($350 million in savings)
- Improved overall financial condition and earnings with addition of "clean" portfolio of "Good Bank"
- Attractive fee income from "Bad Bank" resolution (RECOLL subsidiary)
- Rapid turnaround of regional economy - driven by lower interest rates

Resolutions

FDIC's View of the Results (Fleet's Opinion)

- **Quick resolution of large bank failure**
  - **Six months period from failure to Fleet's legal ownership (January - July 1991)**
  - **Freed up FDIC resources and insurance fund to deal with high volume of other failures**
  - **Returned management and assets to private sector**
- **Attracted new capital to the banking industry through innovative structure**
- **Helped to stabilized the New England banking environment**

MANAGING THE CRISIS

Resolutions

Bad Bank Resolution: Approach

- Five year contract with Fleet to manage and collect non-performing loans and ORE (Bad Bank)
- RECOLL formed by Fleet to operate independently to liquidate the Bad Bank
- $6.0 Billion initial portfolio (16,000 + loans)
- $750 Million in "additional" loans put to RECOLL
- Local decisions on loan resolutions

Resolutions

RECOLL Structure

- Wholly owned subsidiary of Fleet
- Sole purpose to manage and liquidate Bad Bank
- 1,200 employees at peak
- Incentive fee structure
  - Percentage of net cash collected
  - Net cash = cash less interest carry less two times expenses
  - 1 1/2% increasing to 18 1/2% based on success

MANAGING THE CRISIS

Resolutions

RECOLL Issues

- Collection/liquidation approach: its impact on the New England economy
- Balancing RECOLL's cash payment incentive contract with goals and objectives of FDIC
- Political environment
- Performing non-performing loans (small business loans) "Soft 7's"

MANAGING THE CRISIS

Resolutions

Lessons

- Private/Public partnership achieved effective results
  - Successful resolution
  - Strengthened banking sector and local economy
- Accelerated resolution process protected clean asset values
- Political sensitivity contributed to success
- Economic recovery played important role
- Resolution process (structure) should be flexible to fit economic and political environment

MANAGING THE CRISIS

Asset Disposition

Presentation Materials
For

Hubert Bell, Jr.

Attorney
The Law Office of Hubert Bell, Jr.

MANAGING THE CRISIS

Asset Disposition

Texas Banks

	1979	1986	1990	1994	1997
State	627	1076	606	478	417
National	808	896	577	502	423

MANAGING THE CRISIS

Asset Disposition

Legal Highlights

	Legal Matters	Average Assets in Liq. (Billions)
1997	15,168	10.2
1994	24,528	13.5
1991	46,570	43.3
1988	65,000	15.6

Source: FDIC

MANAGING THE CRISIS

Asset Disposition

Commercial Bank Failures: 1983-1992

Year	Texas Failures	U.S. Failures	Texas % of U.S.
1984	6	79	7.6
1986	26	138	18.8
1987	50	184	27.2
1988	113	200	56.5
1990	103	168	61.3

Source: The Banking Department of Texas

MANAGING THE CRISIS

Asset Disposition

Savings & Loan Failures: 1983-1992

Year	Texas Failures	U.S. Failures	Texas % of U.S.
1984	2	22	9.1
1986	2	46	4.3
1988	90	205	43.9
1990	72	315	22.9
1991	55	232	23.7

Source: The Great Texas Banking Crash, by Joseph M. Grant, 1996

MANAGING THE CRISIS

Asset Disposition

Professional Liability Recoveries & Outside Counsel Expenses ($ in millions)

	FDIC		RTC	
	Recoveries	Outside Counsel Cost	Recoveries	Outside Counsel Cost
1986	83.3	10.9		
1988	90.0	20.8		
1990	363.1	79.6	11.2	3.4
1992	609.8	85.2	288.4	69.8
1996	81.1	15.1	114.8	33.0
Total	5042.1	444.6	1,548.9	466.3

Source: FDIC, Legal Division

MANAGING THE CRISIS

Asset Disposition

Presentation Materials
For

Ted Samuel

Former Chairman & Chief Executive Officer
Niagara Asset Corporation
Niagara Portfolio Management Corporation

MANAGING THE CRISIS

Asset Disposition

Objectives

- Liquidate large numbers of poorly understood assets
- Quickly
- For cash

Asset Disposition

MANAGING THE CRISIS

Constraints

- Obtain fair market value
- Deal fairly with borrowers
- Not destabilize markets with fire sales

Asset Disposition

MANAGING THE CRISIS

Concepts

- Seek low cost funding
  - Replacement funding for banks liabilities
  - Lower costs create higher values

Asset Disposition

Concepts

- Temperament adjustment
  - –Bulk sales changed the temperament of collections and settlements
  - –From losing to winning

Asset Disposition

MANAGING THE CRISIS

Presentation Materials
For

Lawrence White

Professor of Economics
Stern Business School
New York University

Asset Disposition

The FSLIC / FHLBB was ill-prepared for the wave of S&L failures that began in 1985.

MANAGING THE CRISIS

Asset Disposition

Asset disposition was a neglected area at the FSLIC / FHLBB.

- The major “action” was in making “deals” (whole-bank resolutions);
- The disposal of assets was laborious, time consuming, and outside the leadership’s expertise.

Asset Disposition

MANAGING THE CRISIS

Whole-bank resolution was strongly favored:

- To preserve going-concern value (brand-name reputation, firm-specific capital, etc.);
- To keep the assets in the hands of those who were most likely to manage and dispose of them well.

MANAGING THE CRISIS

Asset Disposition

Assets were acquired by the FSLIC when an institution was liquidated (a transfer of deposit accounts only, or a payout) or when an institution's acquiror refused to accept some of its assets

MANAGING THE CRISIS

Asset Disposition

As of year-end 1987, the FSLIC / FHLBB owned (in receiverships) about $7 billion in various types of assets, ranging from single-family homes to commercial properties to mortgages to loans-in-foreclosure to securities.

MANAGING THE CRISIS

Asset Disposition

Asset disposition was a major problem for the agency.

- The agency was generally a poor manager of assets, which was a special problem for asset categories (e.g., residential real estate) that required active management.

MANAGING THE CRISIS

Asset Disposition

Asset disposition was a major problem for the agency.

- The agency was a poor seller of assets.
- It was difficult to acquire high-quality expertise at government salaries, the absence of commissions, bonuses, etc.

Asset Disposition

Asset disposition was a major problem for the agency.

- Incentive structures were a problem.
- Financing was a problem.

Asset Disposition

Asset disposition was a major problem for the agency.

- The one effort to deal with these problems, the Federal Asset Disposition Association (FADA), foundered on political and bureaucratic insensitivities.

Asset Disposition

Selling real estate would always be a problem in this environment. It was too easy to be criticized, regardless of the strategy pursued.

Asset Disposition

- Holding assets too long could be criticized;
- Selling too soon could be criticized.

Asset Disposition

Active management / sales of real estate in a political fishbowl ain't easy.

Crises in Other Countries

Presentation Materials
For

Arne Berggren

International Banking Consultant

MANAGING THE CRISIS

Crises in Other Countries

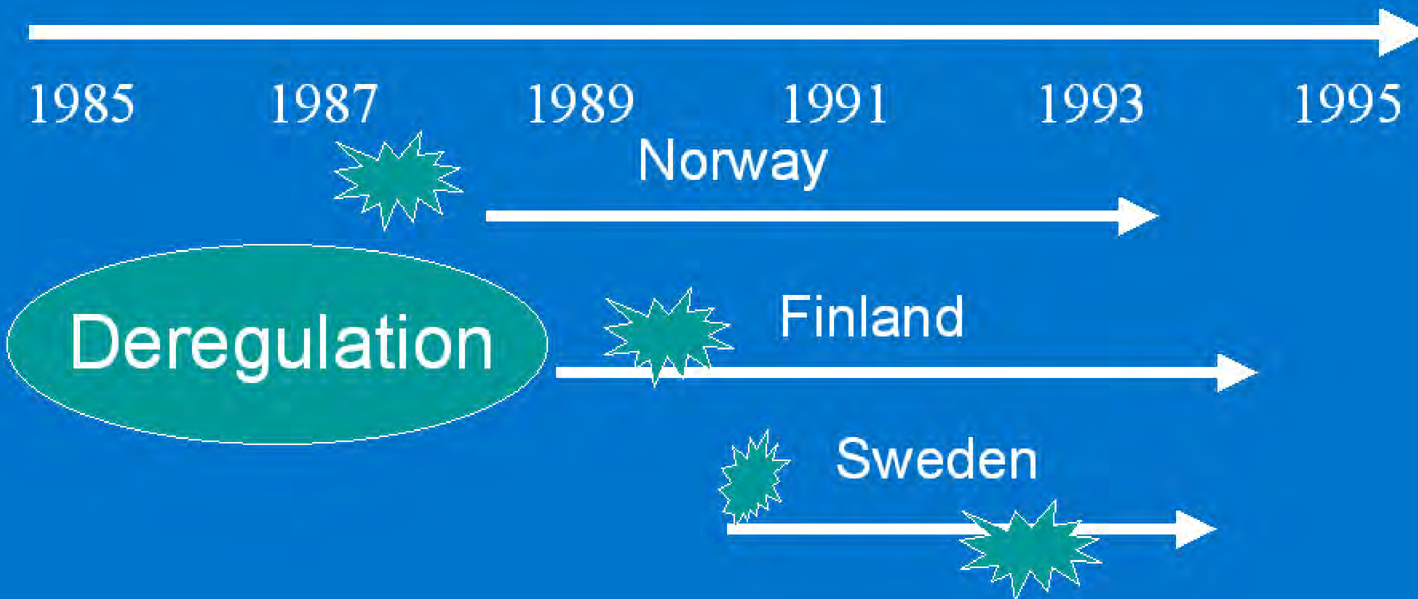
The Swedish Banking Crisis

- Origin and causes
- Measures
- The Restructuring of Nordbanken
- The General Guarantee
- The bank support process

MANAGING THE CRISIS

Crises in Other Countries

Scandinavian Banking Crisis

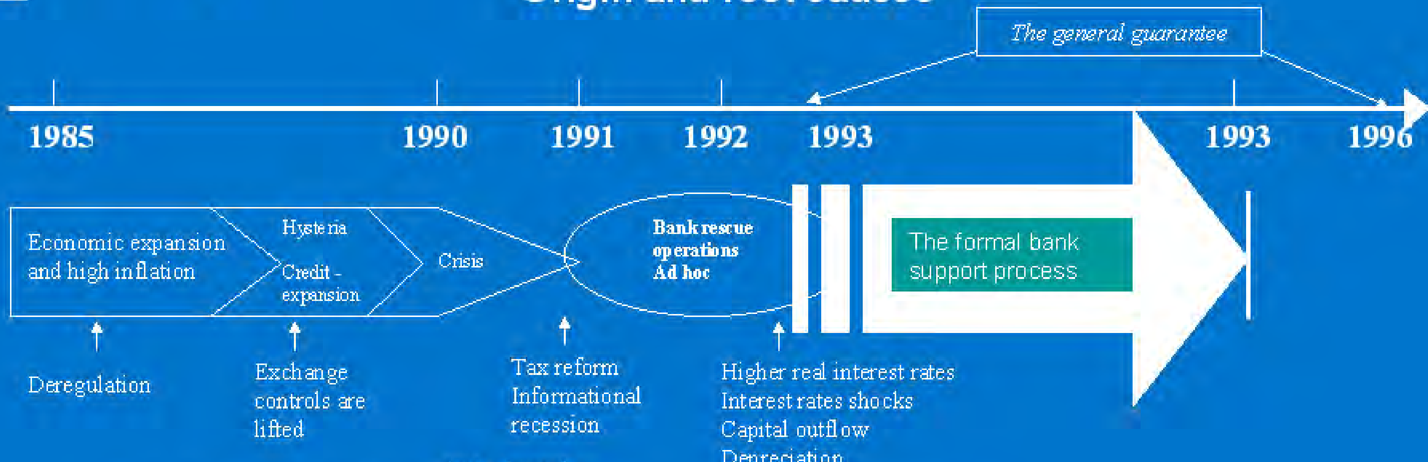


Crises in Other Countries

MANAGING THE CRISIS

Swedish Banking Crisis
Origin and root causes

Macro



1987-90: Credits/GDP from 90-140%
During 1980s: Real estate + 2.5% p.a.
Leverage buyouts
Low unemployment/inflation

Asset-value peak
Fall in industry production
Higher real interest rates
Overheated labor market
Fall in world market share

Large number of bankruptcies
Currency unrest in western Europe
Unemployment/fall in disp. Income
Portfolio adjustments/fall in asset prices

Structure

	1989		1992
Finance companies	292	Liquidations	133
Savings banks			90
Commercial banks	Mergers		17
Mortgage institutions	Mergers		21

6 largest bank groups: 75% of the system

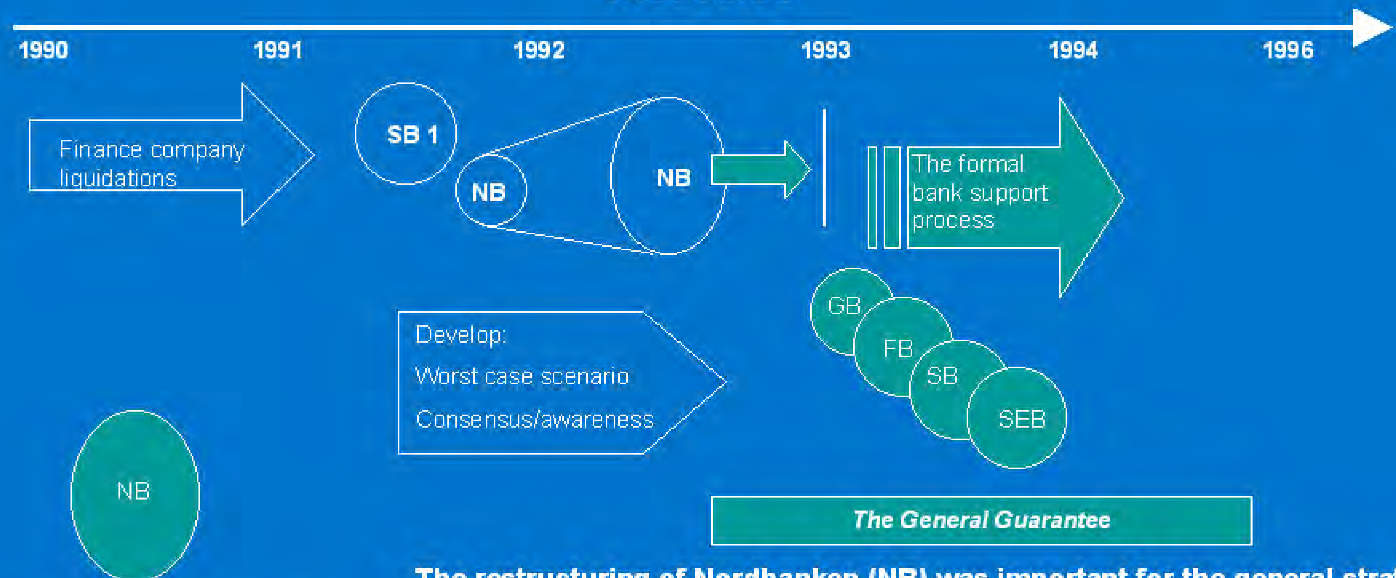
40% of bank lending in foreign currency

MANAGING THE CRISIS

Crises in Other Countries

Swedish Banking Crisis

Measures



- Total assets / GDP : 23%
- Cash cost / GDP : 2.8%
- Final cost :Profit

The restructuring of Nordbanken (NB) was important for the general strategy

- Demonstrated Government's determination and gained respect
- Practical example of what could be done operationally & financially
- Demonstrated important policies & principles
- Demonstrated necessary data requirements

MANAGING THE CRISIS

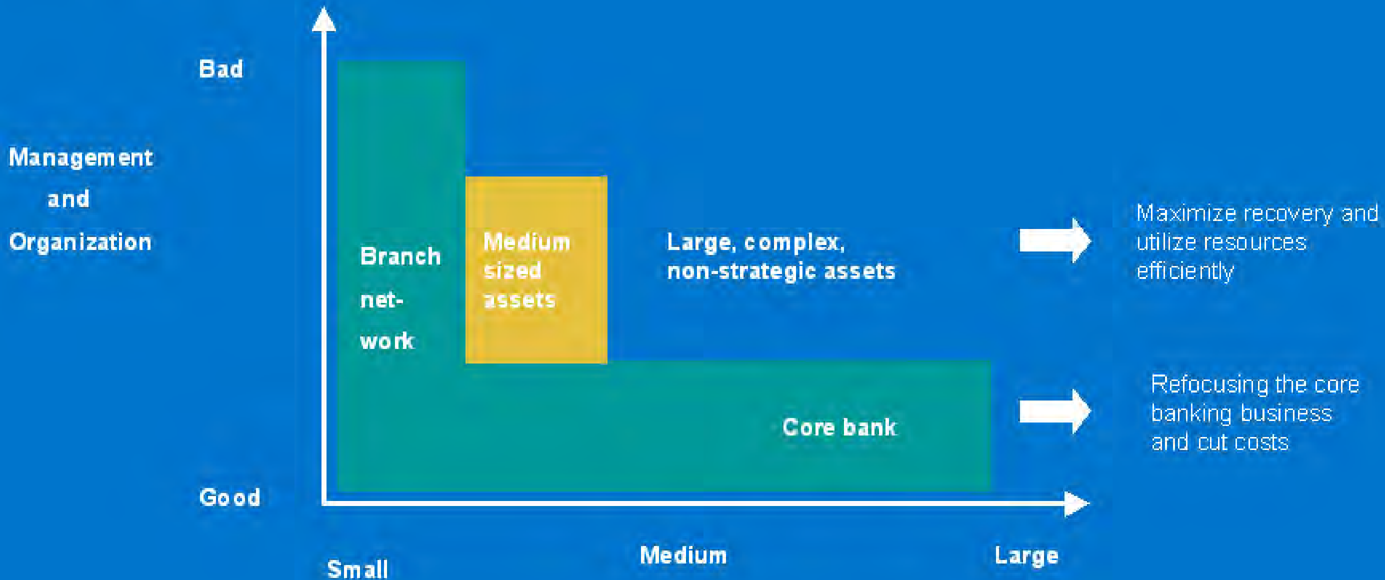
Crises in Other Countries

Swedish Banking Crisis

General focus in bank restructuring

Nordbanken Case (1)

First



MANAGING THE CRISIS

Crises in Other Countries

Swedish Banking Crisis

General focus in bank restructuring

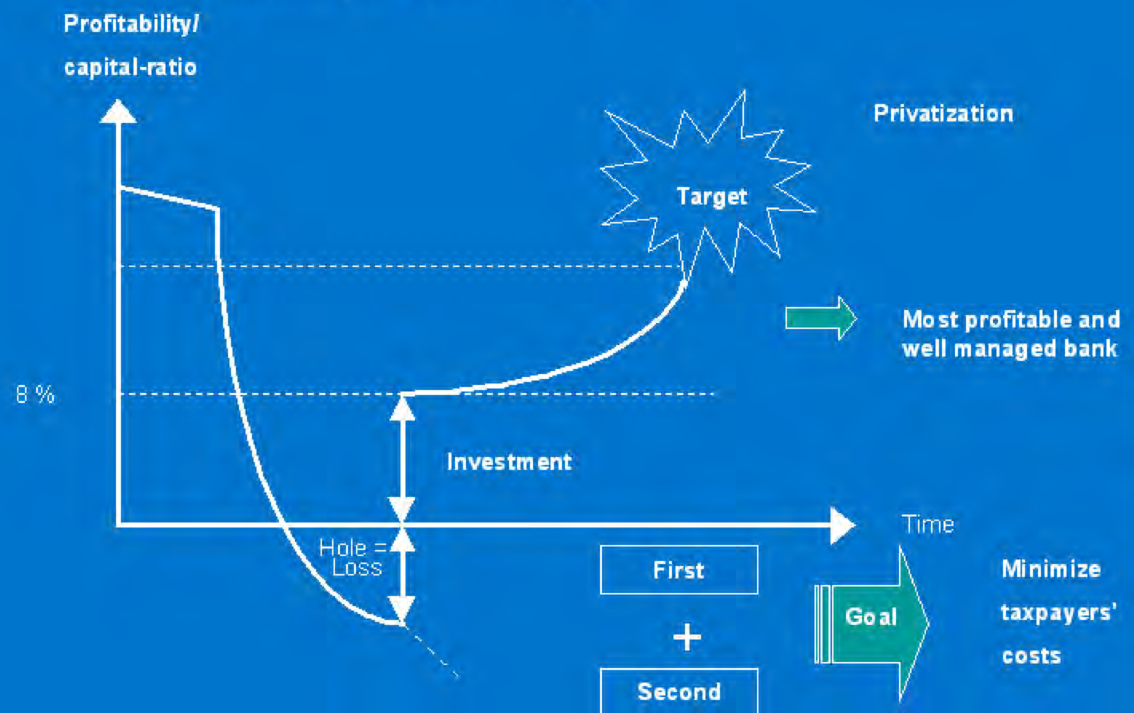
Nordbanken case (2)

Second

Capital

Policy of ownership

Incentives



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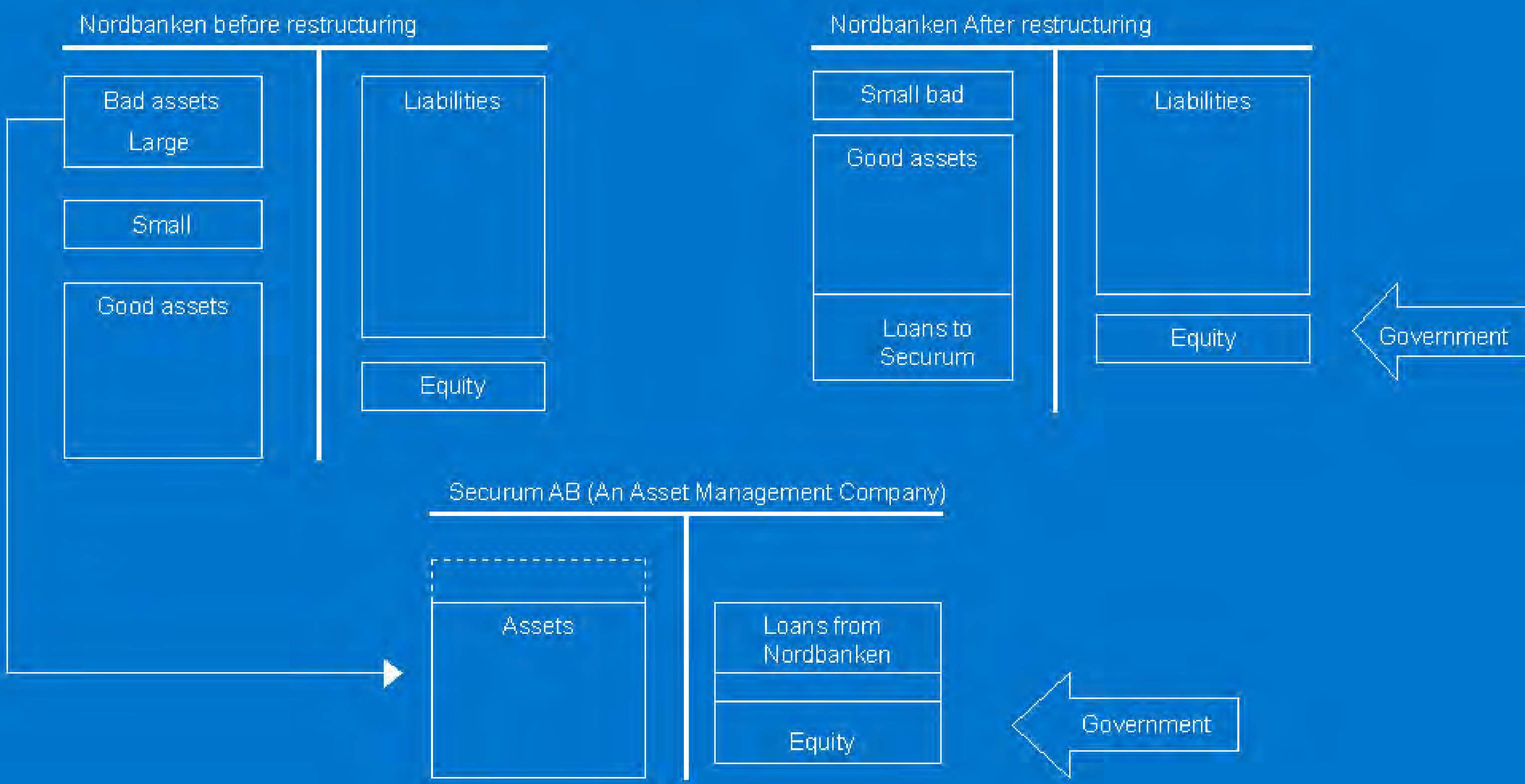
Crises in Other Countries

Swedish Banking Crisis

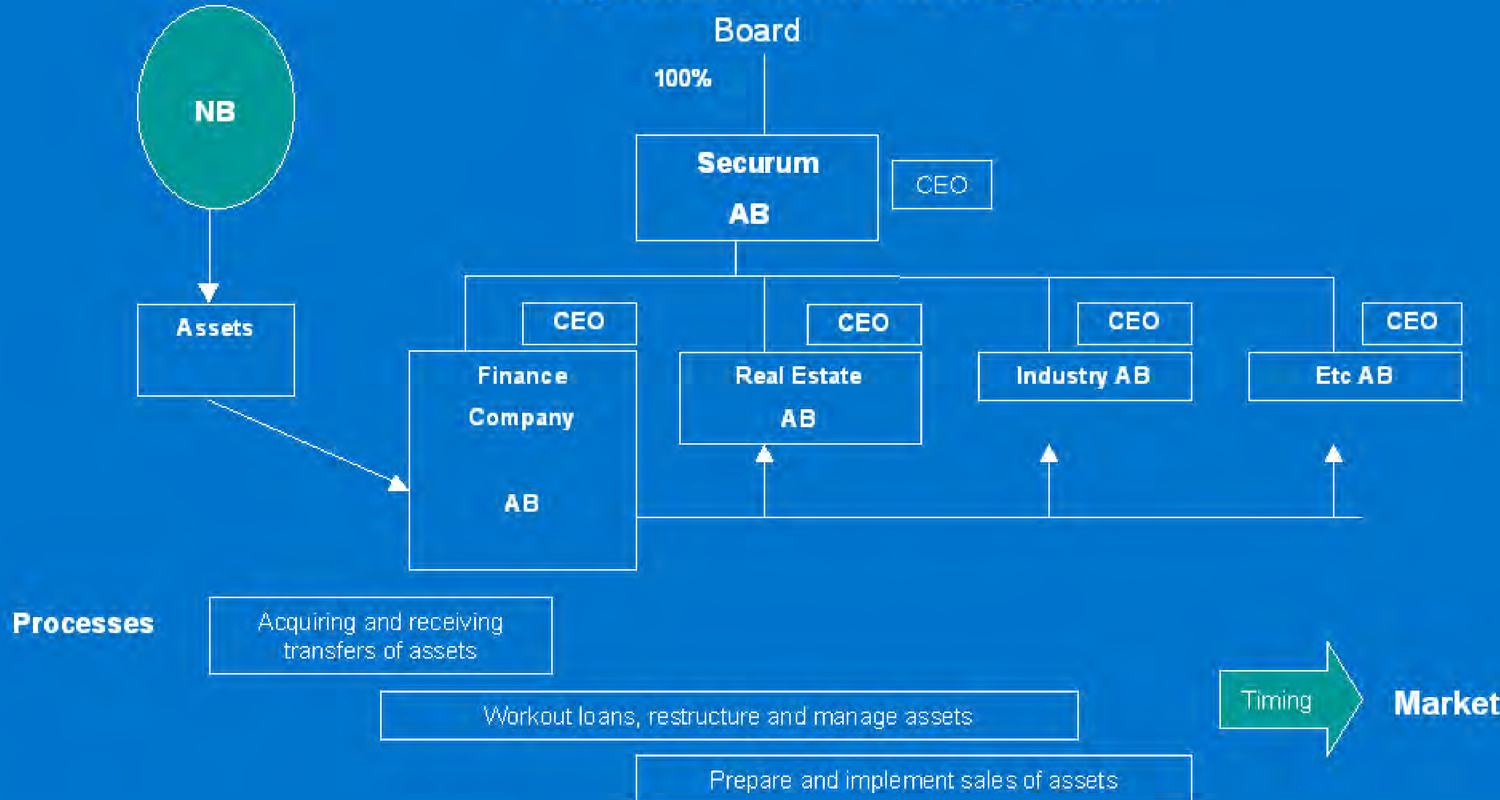
The restructuring of Nordbanken



MANAGING THE CRISIS

Crises in Other Countries

Swedish Banking Crisis
Securum AB
Organization and Management



MANAGING THE CRISIS

Crises in Other Countries

Swedish Banking Crisis

The General Guarantee

- The State guarantees that banks… can meet all their commitments on a timely basis.
- The Government is authorized to decide measures to implement this undertaking.
- The authorization is not limited to any specific amount.
- The State shall meet its undertaking by providing support for a continuation of operations in viable institutions or for the restructuring or orderly wind- up of those that cannot be expected to become profitable in the long run.
- The support system is to be available for as long as it is needed and shall not be discontinued until this can be done without jeopardizing the rights of creditors.

Crises in Other Countries

Swedish Banking Crisis

The General Guarantee
Principles and Conditions for Support

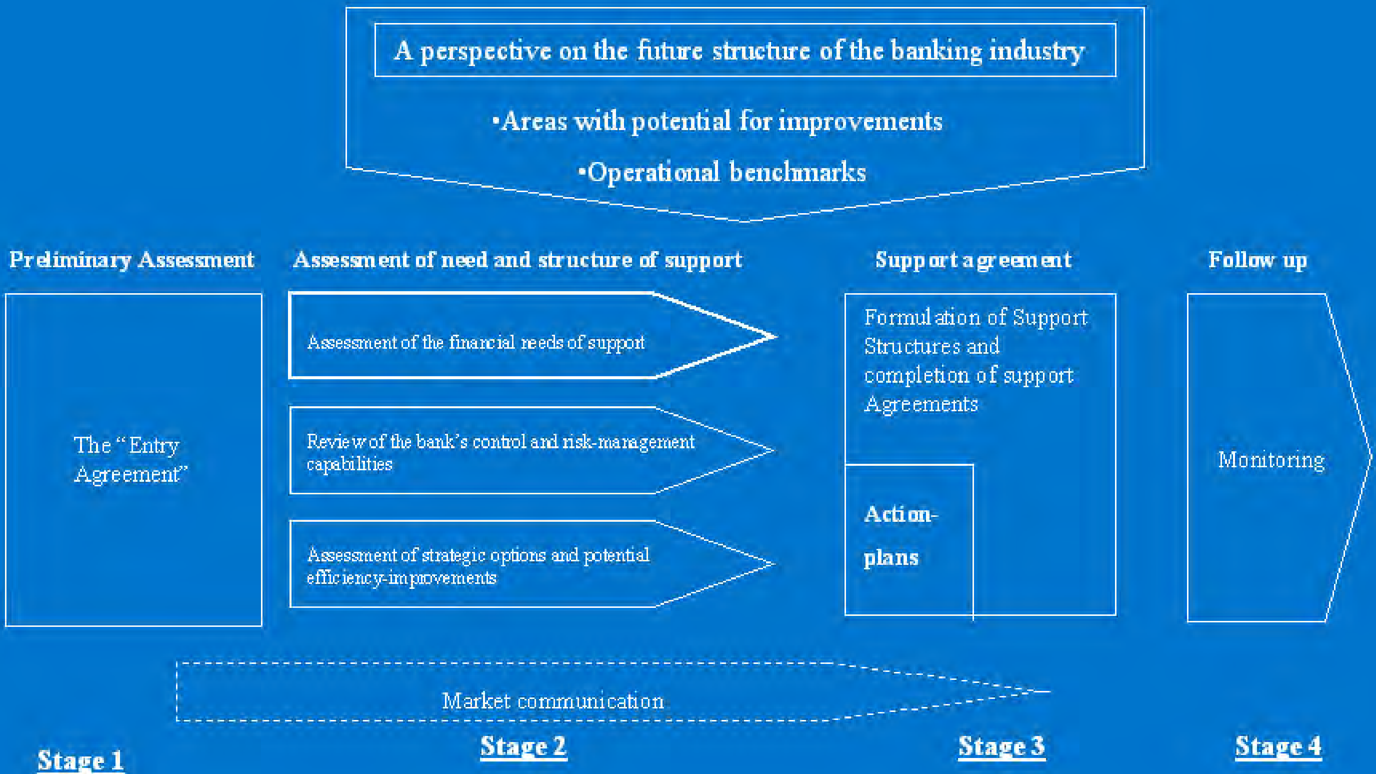
- Voluntary and adopted to the conditions in the institution in question
- Non-viable institutions should be restructured or closed in an orderly manner
- The measures taken should be competitive neutral and account for factors like efficiency and variety
- It should be based on commercial principles to minimize the long term costs for the state
- If possible government ownership should be avoided unless this is considered appropriate with reference to capital requirements and the commercial interest of the state. In such instances the aim shall be to dispose of the shares when this is commercially suitable
- The support should be structured in such a way that the banks had no grounds for requesting more than was necessary
- The Government's expenditures should be minimized and to the largest extent possible recovered
- Institutions applying for support should be required to produce plans for their handling of problem assets and for improving their core operations.

MANAGING THE CRISIS

Crises in Other Countries

Bank Support Process

Main Components

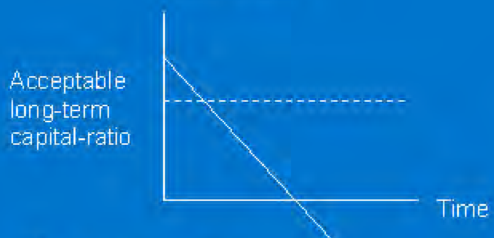


MANAGING THE CRISIS

Crises in Other Countries

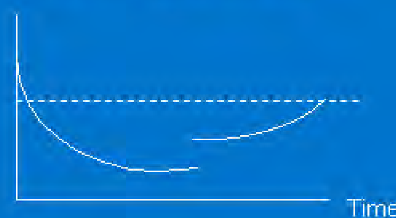
Type Banks
Projected performance and measures

Non-viable



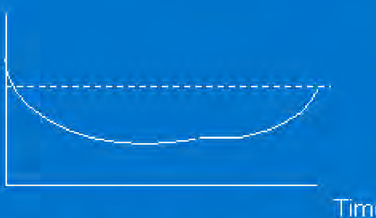
Measures:
- Liquidation
- Merger with viable bank

Viable with major restruction



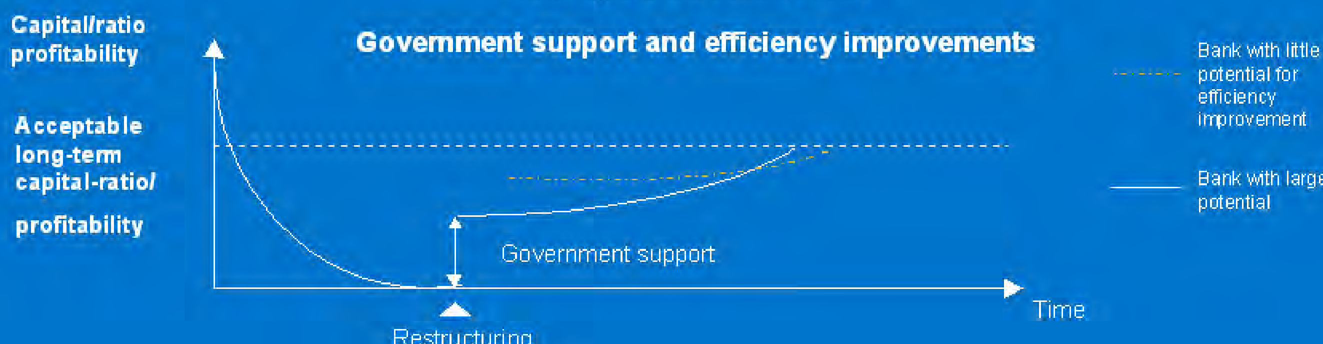
- Capital injection
- Cost-Cuts & reorientation of operations
- Measures to improve operations
- Create specialized workout entities

Viable bank



- Asset guarantees
- Measures to improve profitability

Government support and efficiency improvements



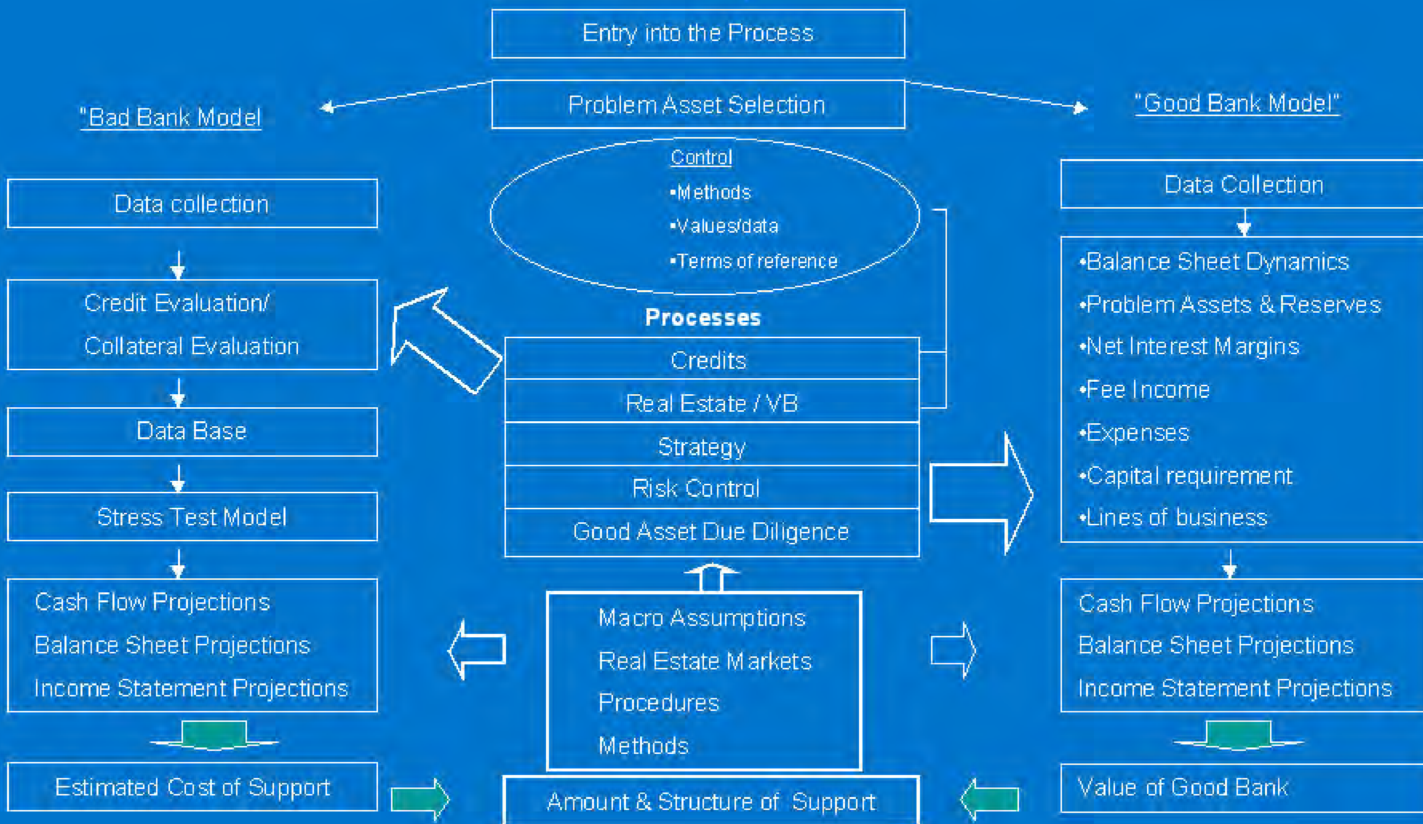
MANAGING THE CRISIS

Crises in Other Countries

Swedish Banking Crisis

Assessment of need and structure of support

The valuation process



MANAGING THE CRISIS

Crises in Other Countries

Swedish Banking Crisis

Main Points

- Develop a worst case scenario and a general strategy for handling it
- Develop consensus / awareness among key Government players
- Develop a strict and realistic work process
- Market communication, public relations & organization (who is in charge)
- Management & incentives are important
- Develop a “Show case” demonstrating the strategy and the rules of the game
- Restructurings based on facts (not wishes)
- Develop data that is useful for management decisions
- Explain the difference between expenditures and final costs

MANAGING THE CRISIS

Crises in Other Countries

Presentation Materials
For

Bill Roelle

Head of Operations
Financial Services Group
GE Capital

MANAGING THE CRISIS

Crises in Other Countries

The Polish Experience

Since 1989 the Polish banking system has been transforming from a collection of highly specialized State owned banks into financial services institutions or "Universal" banks

MANAGING THE CRISIS

Crises in Other Countries

The Polish Experience

The National Bank of Poland Act created a relatively strong central bank

- Monetary Policy
- Bank regulation & supervision
- Split up National Bank of Poland

Crises in Other Countries

The Polish Experience

The <u>Banking Act</u> established a framework for demonopolization State owned System

MANAGING THE CRISIS

Crises in Other Countries

The Polish Experience

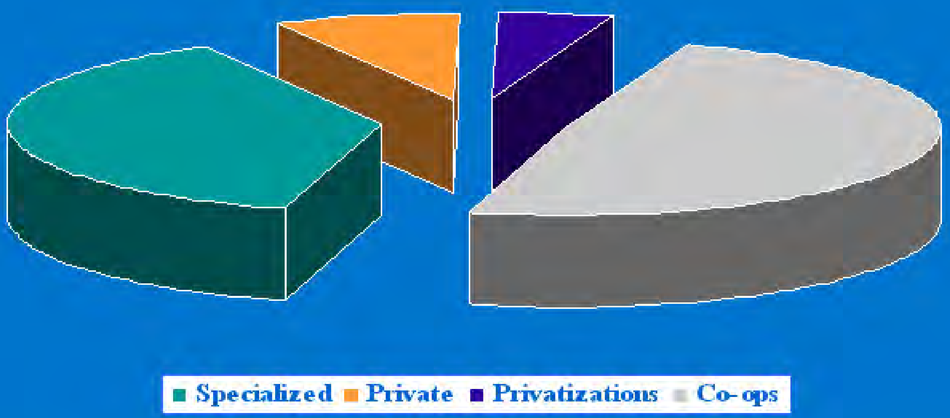
The Deposit Insurance Act created a scheme similar to U.S. deposit insurance, **but** the differences are significant and debilitating

Crises in Other Countries

Managing the Crisis: Eastern Europe

The Bank Sector

Gross Asset Distribution



A Ways to Go Yet!

MANAGING THE CRISIS

Crises in Other Countries

Managing the Crisis: Eastern Europe

The Opportunity

- A stable democratic government with a market-driven-economy orientation
- Help from international community through Polish Bank Privitization Fund
- Strong Real Growth (Ave. 6% over last three years)
- EBRD investment in banking sector
- Substantial foreign interest in banking sector investment
- A well organized and growing stock market

The Potential is There But Roadblocks Exist

Crises in Other Countries

MANAGING THE CRISIS

Managing the Crisis: Eastern Europe

The Challenges

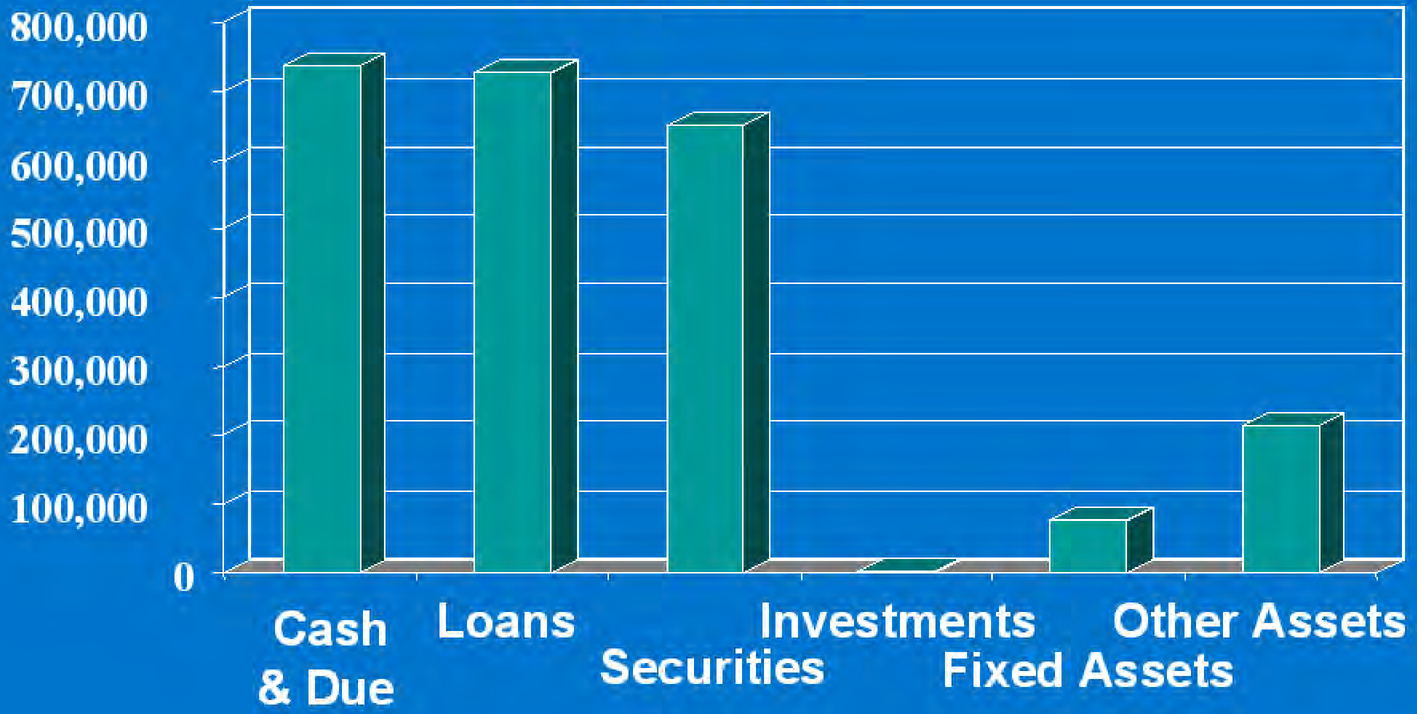
- Deposit insurance responsibility split among three agencies
- Coalition government(s) slow to act
- Central bank too political, slow to implement bank regulation and supervision
- Government has been inconsistent and confusing in its privatization initiatives
- By and large boards and senior management in banks are inept, <u>not all</u>, but far too many for comfort
- Legal infrastructure not yet conducive to safe and sound banking practices

Lots To Do!

Crises in Other Countries

The Polish Experience

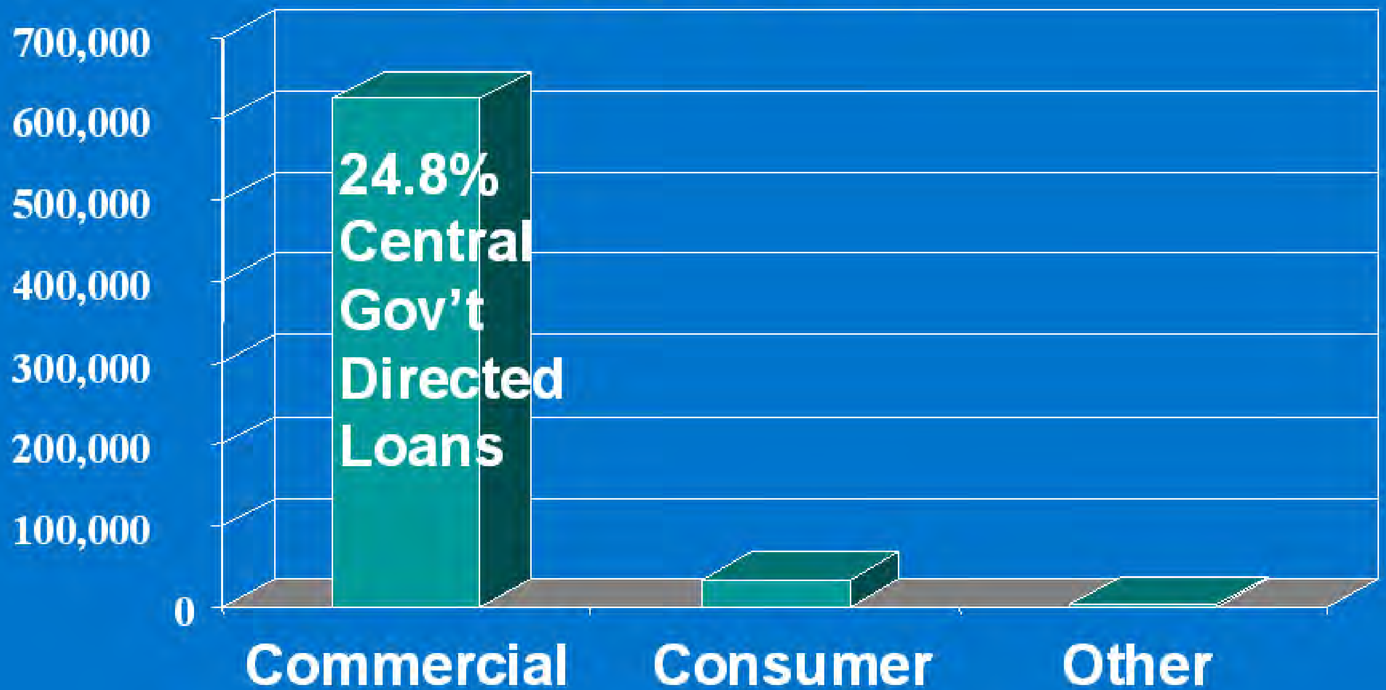
PBK Assets



Crises in Other Countries

The Polish Experience

PBK Net Loans



Crises in Other Countries

The Polish Experience

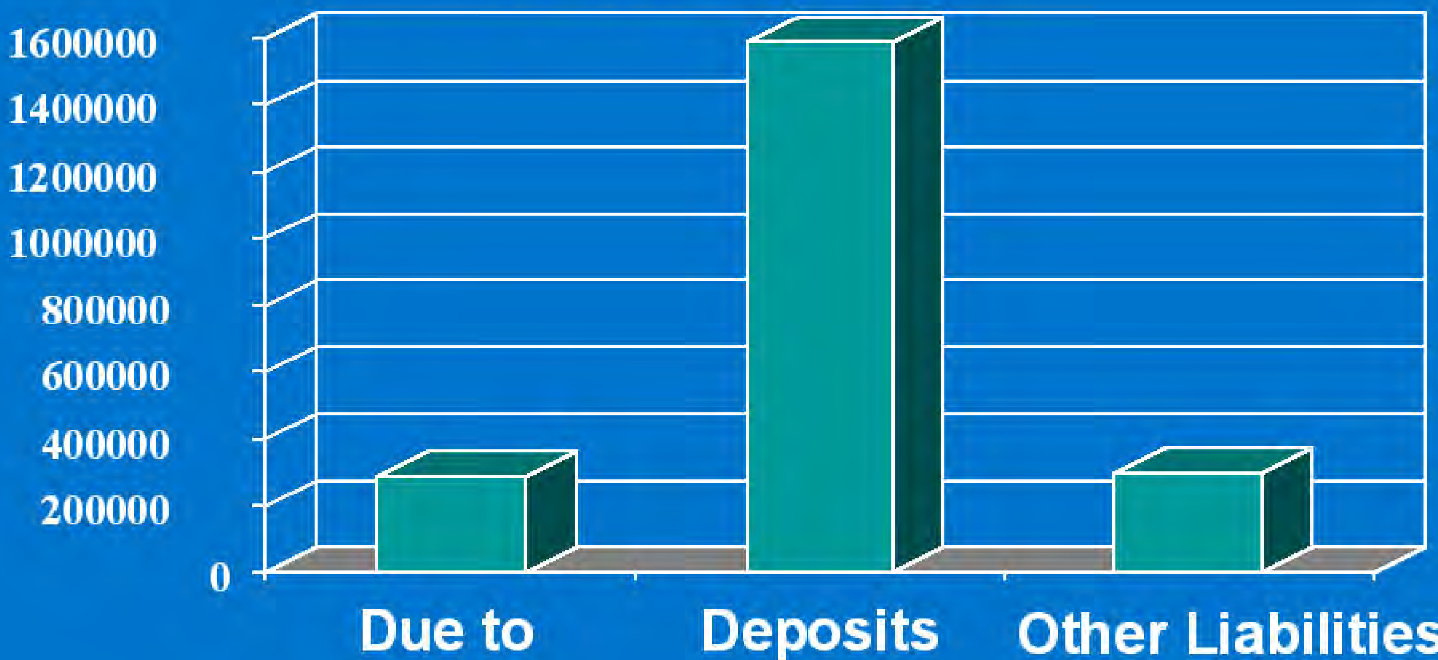
PBK Loan Loss Reserves

MANAGING THE CRISIS

Crises in Other Countries

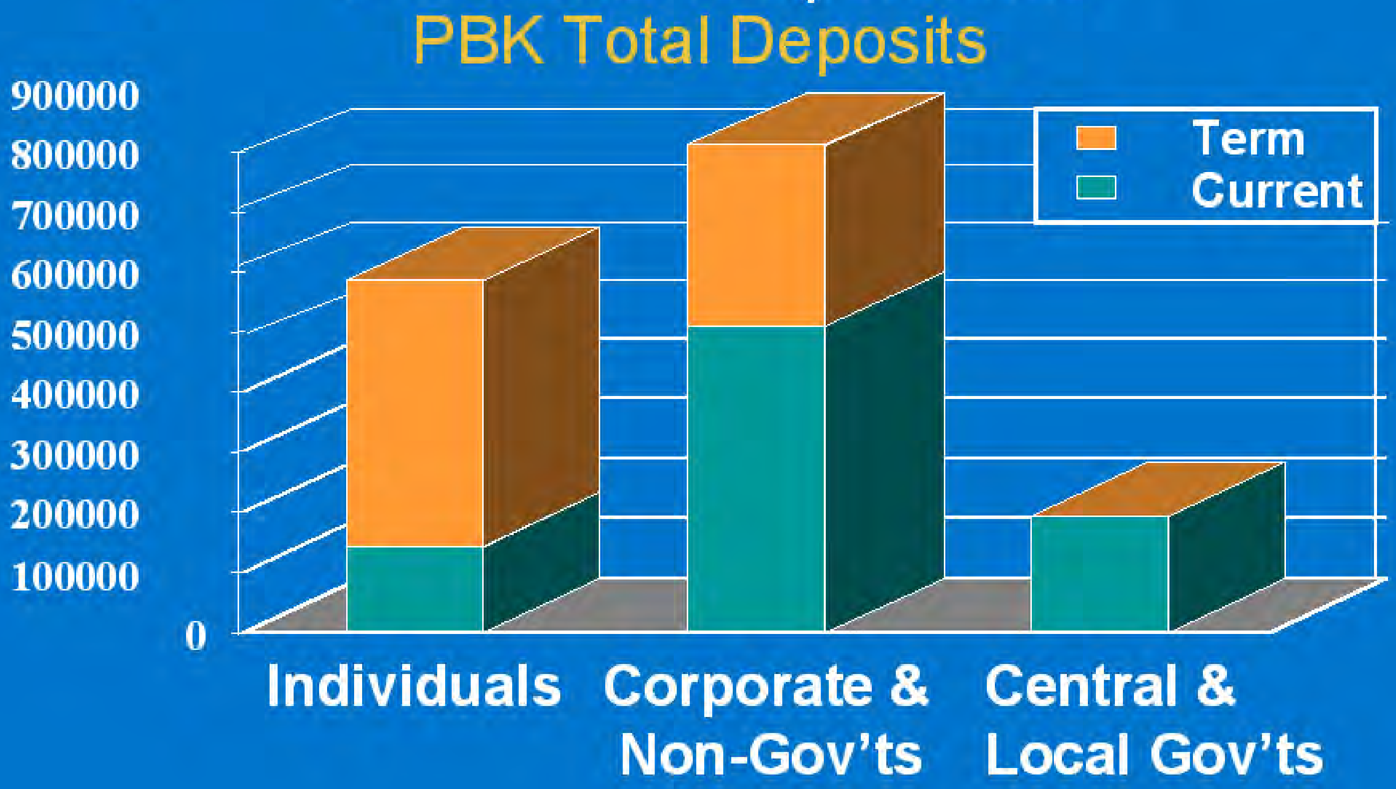
The Polish Experience

PBK Liabilities



Crises in Other Countries

The Polish Experience



APPENDIX G

Symposium Participant List

Liz Aaron
Regulatory Policy Representative
Independent Bankers Association of America

Hank Abbot
Manager, Equity Oversight
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Rick Aboussie
Associate General Counsel
Legal Division
Federal Deposit Insurance Corporation

Jack Adair
Auditor to the Board of Supervisors
Fairfax County, Virginia

Jerry Anderson
Senior Partner
Heskin/Signet Partners Joint Venture

Carol Armstrong
Assistant Transactions Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Kevin Bailey
Office of Comptroller of the Currency

Scott Barancik
American Banker

David Barr
Public Affairs Specialist
Office of Corporate Communications
Federal Deposit Insurance Corporation

Phil Battey
Director
Office of Corporate Communications
Federal Deposit Insurance Corporation

Mary Bean
Senior Resolutions Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Donald Bean, Jr.
Fensterheim & Bean
Ginsberg, Feldman & Bress

Hubert Bell, Jr.
Attorney
Law Office of Hubert Bell, Jr.

Richard Berg
Chairman of the Board
The First National Bank of Ordway
and Gunnison Bank & Trust

Arne Berggren
International Banking Consultant
Stockholm, Sweden

Mitch Berns
Director
Office of Supervision
Federal Housing Finance Board

Ron Bieker
Deputy Director
Division of Compliance and Consumer Affairs
Federal Deposit Insurance Corporation

John Binkley
Counsel
Legal Division
Federal Deposit Insurance Corporation

Christine Blair
Financial Economist
Division of Research and Statistics
Federal Deposit Insurance Corporation

Joe Blalock
Principal Consultant
Price Waterhouse L.L.P.

John Bovenzi
Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Gary Bowen
Deputy Regional Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Bruce Brown
Assistant Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

David Bufton
Consultant

Glenn Burdick
Director
Aldrich, Eastman & Waltch Capital Management, L.P.

Bill Carley
Retired
Federal Deposit Insurance Corporation

Fred Carns
Assistant Director
Division of Insurance
Federal Deposit Insurance Corporation

Casey Carter
Vice President and Representative
The Fuji Bank, Ltd.

Sherry Chen
Senior Resolutions Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

James Chessen
Chief Economist
American Bankers Association

Barbara Chiapella
American Bankers Association

Jim Collins
Special Advisor to the Chief Operating Officer
Federal Deposit Insurance Corporation

Bill Collishaw
Assistant General Counsel
Legal Division
Federal Deposit Insurance Corporation

Mary Connelly
Chief Operating Officer
Farm Credit System Insurance Corporation

David Cooke
Director
Barents Group, L. L. C.

Erica Cooper
Deputy General Counsel
Legal Division
Federal Deposit Insurance Corporation

Don Crocker
Vice Chairman
J.E. Robert Company

Steve Davidson
Division of Research
America's Community Bankers

James Davis
Manager
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Lee Davison
Historian
Division of Research and Statistics
Federal Deposit Insurance Corporation

Don Demitros
Director
Division of Information Resources Management
Federal Deposit Insurance Corporation

Vijay Deshpande
Director
Office of Internal Control Management
Federal Deposit Insurance Corporation

John Donovan
Price Waterhouse L.L.P.

Thomascine Douglas
Division of Administration
Federal Deposit Insurance Corporation

Martha Duncan-Hodge
Senior Resolutions Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Dean Eisenberg
Supervisory Internal Review Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Bert Ely
President
Ely and Company, Inc.

Michelle Enger
Policy Analyst, Financial Institutions Branch
Office of Management & Budget
Executive Office of the President

John Eveland
Supervisory Financial Analyst
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Mary Farnan
Counsel
Legal Division
Federal Deposit Insurance Corporation

Bob Feldman
Executive Secretary
Office of Executive Secretary
Federal Deposit Insurance Corporation

A. J. Felton
Deputy Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Jonathan Fiechter
Director
Special Financial Operations
The World Bank Group

Carlos Fiol
Manager, Projects & Planning
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Dick Fischman
Assistant Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Jim Forrestal
Associate Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Jeanette Franzel
Assistant Director
Corporate Audits
U.S. General Accounting Office

George French
Deputy Director
Division of Insurance
Federal Deposit Insurance Corporation

Judith Friedman
Special Counsel
Legal Division
Federal Deposit Insurance Corporation

Francine Gage
Division of Administration
Federal Deposit Insurance Corporation

Jim Gallagher
Senior Resolutions Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Ann Gay
Symposium Coordinator/Greeter
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Dennis Geer
Deputy to the Chairman & Chief Operating Officer
Federal Deposit Insurance Corporation

Gaston Gianni
Inspector General
Office of Inspector General
Federal Deposit Insurance Corporation

Mike Gibson
Economist
Federal Reserve Board

Gary Gilbert
Government Relations
America's Community Bankers

William Ginsberg
Managing Director
Federal Housing Finance Board

Mitchell Glassman
Deputy Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Alan Glenn
Chief Financial Officer
Farm Credit System Insurance Corporation

Leanna Gouthro
Legislative Analyst
Office of Legislative Affairs
Federal Deposit Insurance Corporation

Bob Gramling
Director
Corporate Audits and Standards
U.S. General Accounting Office

Matt Green
Financial Analyst
Office of Financial Institutions Policy
U.S. Department of Treasury

Henry Griffin
Assistant General Counsel
Legal Division
Federal Deposit Insurance Corporation

Jay Hambric
Vice President
Mexico
GE Capital

George Hanc
Associate Director
Division of Research and Statistics
Federal Deposit Insurance Corporation

Denis Harootunian
Senior Analyst
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Norma Hart
President
National Bankers Association

Bob Hartheimer
Managing Director
Investment Banking Division
Friedman, Billings, Ramsey & Co.

Margaret Hawley
Asset Marketing Specialist
Small Business Administration

Larry Hayes

John Heimann
Chairman
Global Financial Institutions
Merrill Lynch & Company, Inc.

Herb Held
Assistant Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Jo-Ann Henry
Director
Office of Diversity & Economic Opportunity
Federal Deposit Insurance Corporation

Shelby Heyn-Rigg
Program Manager
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Rod Hood
Deputy to the Vice Chairman
Federal Deposit Insurance Corporation

Tom Horton
Principal
EYKL

Paul Horvitz
Professor of Banking and Finance
University of Houston

Andrew Hove
Chairman
Federal Deposit Insurance Corporation

Stephen Hudak
Special Assistant to Chairman
Federal Housing Finance Board

Don Inscoe
Associate Director
Division of Research and Statistics
Federal Deposit Insurance Corporation

Colleen Ivie
Vice President
RER Financial Group

Stan Ivie
Assistant Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Ann Jaedicke
Office of Comptroller of the Currency

Milton Joseph
President
Joseph Consulting

Stefan Jouret
Professional Staff Member
Committee on Banking & Financial Services
House of Representatives

Jay Jupiter
Attorney

Chris Kallivokas
Chairman
RER Financial Group

Martin Kamarck
Chief Operating Officer
Aldrich, Eastman & Waltch Capital Management, L.P.

Hiroshi Kamiguchi
Financial and Payment System Office
The Bank of Japan

Jon Karlson
Regional Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Arleas Upton Kea
Director
Office of the Ombudsman
Federal Deposit Insurance Corporation

Sally Kearney
Senior Writer/Editor
Office of Corporate Communication
Federal Deposit Insurance Corporation

Pat Keough
Writer
Bostonia Government Services

Nick Ketcha
Director
Division of Supervision
Federal Deposit Insurance Corporation

Howard Kinhart
Director
Office of the Inspector General
Federal Deposit Insurance Corporation

Alvin Kitchen
Deputy Director
Division of Finance
Federal Deposit Insurance Corporation

Barry Kolatch
Deputy Director
Division of Research and Statistics
Federal Deposit Insurance Corporation

Marilyn Kraus
Deputy Assistant Inspector General
Office of the Inspector General
Federal Deposit Insurance Corporation

Bill Kroener
General Counsel
Legal Division
Federal Deposit Insurance Corporation

Rose Kushmeider
Financial Economist
Division of Research and Statistics
Federal Deposit Insurance Corporation

Ronald Label
Managing Partner
EYKL

Edward Lane-Reticker
Associate Director
Boston University School of Law

Lee Lassiter
Ombudsman
Office of Thrift Supervision

Roger Lerner
Attorney
Lerner, Reed, Bolton & McManus, L.L.P.

John Liles
Senior Counsel
Legal Division
Federal Deposit Insurance Corporation

Tom Lucey
Director
Corporate Properties
Fleet Financial Group

Sharon Lusk
Oversight Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Nancy Maginn
Resolutions Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Ed Mahaney
Associate Director
Division of Finance
Federal Deposit Insurance Corporation

Ralph Malami
MBS Administrative Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

John Marchant
Senior Resolutions Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Jim Marino
Associate Director
Division of Research and Statistics
Federal Deposit Insurance Corporation

Bernie Mason
Deputy to Director Seidman
Office of Thrift Supervision

Kate McDermott
Oversight Manager/Symposium Hostess
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Jim McDermott
Assistant Director
Financial Institutions and Markets
U.S. General Accounting Office

Beverly McFarland
Chief Executive Officer
The Beverly Group

Don McKinley
Regional Counsel
Legal Division
Federal Deposit Insurance Corporation

David Meadows
Deputy to Director Neely
Federal Deposit Insurance Corporation

Jim Meyer
Assistant Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Phil Mistretta
Financial Institutions and Markets
U.S. General Accounting Office

Doyle Mitchell
President
Industrial Bank, N.A.

James Montgomery
Past Chairman
Great Western Financial

Bill Murden
Director
Office of International Banking & Securities
U. S. Department of Treasury

Jack Murphy
Partner
Cleary, Gottlieb, Steen, Hamilton

Art Murton
Director
Division of Insurance
Federal Deposit Insurance Corporation

Marcia Myerberg
CEO
Myerberg & Company, L.P.

Joseph Neely
Director
Federal Deposit Insurance Corporation

Lynn Nejezchleb
Special Assistant to the Vice Chairman
Federal Deposit Insurance Corporation

Mike Newton
Regional Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Dina Nichelson
Executive Director
American League of Financial Institutions

Tom O'Keefe
Assistant Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Bill Ostermiller
Assistant Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Lorraine Padgett
Supervisory Risk Management Analyst
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Gail Patelunas
Deputy Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Neal Peterson

Bill Phipps
Senior Information Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Marcia Potter
Senior Project Manager
Heskin/Signet Partners Joint Venture

Rosalia Pratt
President
Nationwide Mortgage Services, Inc.

Paul Pryde
President
Capital Access Group, L.L.C.

John Quinn
Executive Assistant to Chief Financial Officer
Division of Finance
Federal Deposit Insurance Corporation

Mitch Rachlis
Senior Economist
U.S. General Accounting Office

Paul Ramey
Former Executive
Federal Deposit Insurance Corporation and Resolution Trust Corporation

John Recchia
Assistant Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Clyde Reid
Senior Writer/Editor
Office of Corporate Communication
Federal Deposit Insurance Corporation

Diana Reid
Managing Director, Senior Advisor
Credit Suisse First Boston

Jack Reidhill
Financial Economist
Division of Research and Statistics
Federal Deposit Insurance Corporation

Craig Rice
Senior Regional Analyst
Division of Insurance
Federal Deposit Insurance Corporation

Steven Rigg
Board Member F.H.L.B. of Topeka

Bill Roelle
Head of Operations
Financial Services Group
GE Capital

Claude Rollin
Special Assistant to Director Neely
Federal Deposit Insurance Corporation

Tom Rose
Senior Deputy Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Ed Rosenthal
J.E. Robert Company

Yeeleng Rothman
Principal
Rothman and Associates

Marian Rush
Attorney
Salem, Saxon & Nielsen

Bob Russell
Director
Office of Policy Development
Federal Deposit Insurance Corporation

Theresa Rutledge
Financial Analyst
Office of International Banking & Securities
U.S. Department of Treasury

Jack Ryan
Acting Executive Director of Supervision
Office of Thrift Supervision

Paul Sachtleben
Director
Division of Finance
Federal Deposit Insurance Corporation

Tony Samson
Senior Resolutions Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Ted Samuel
Former Chairman & Chief Executive Officer
Niagara Asset Corporation,
Niagara Portfolio Management Corp.

H. Jay Sarles
Vice Chairman
Fleet Financial Group

Jane Sartori
Director
Division of Administration
Federal Deposit Insurance Corporation

Robert Schmidt
Financial Services Practice
KPMG Peat Marwick

Tom Schulz
Assistant General Counsel
Legal Division
Federal Deposit Insurance Corporation

Steve Seelig
Deputy Director
Division of Research and Statistics
Federal Deposit Insurance Corporation

Bill Seidman
Chief Commentator
CNBC-TV

Fred Selby
Deputy Director
Division of Finance
Federal Deposit Insurance Corporation

Anuraag Shah
Goldman Sachs

Kevin A. Sheehan
Senior System Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Stan Silverberg
Banking and Economic Consultant

Ed Smith
Chief Operating Officer
Banc One Mortgage Capital Markets, L.L.C.

Jack Smith
Deputy General Counsel
Legal Division
Federal Deposit Insurance Corporation

Ronald Sommers
Senior Resolutions Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Mike Spaid
Acting Special Assistant to Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Joci Spector
Oversight Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Eric Spitler
Deputy Director
Office of Legislative Affairs
Federal Deposit Insurance Corporation

Tom Stack
Senior Advisor
Cash and Credit Management
Office of Management and Budget

Jerry Stanton
Principal
GBS Associates

Doug Stinchcum
Assistant Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Steve Stockton
Supervisory Liquidation Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

John Stone
Retired Executive
Federal Deposit Insurance Corporation

Robert Strand
Senior Economist
American Bankers Association

Maureen Sweeney
Special Assistant to Director
Division of Insurance
Federal Deposit Insurance Corporation

Steve Switzer
Deputy Inspector General for Audits
Office of Inspector General
Federal Deposit Insurance Corporation

Barbara Taft
Assistant General Counsel
Legal Division
Federal Deposit Insurance Corporation

Nobusuke Tamaki
Chief Representative
Representative Office in Washington, DC
The Bank of Japan

John Tautges
Senior Investment Officer
The Baltic-American Enterprise Fund

T. Michael Thompson
Vice President
OAO Corporation

Sandra Thompson
Assistant Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Jun Tomita
The Bank of Japan

Maurizio Trapanese
Banking and Financial Supervisor
Banca d'Italia, Research Division

John Treanor
Banking Advisor
Financial Institutions and Markets
U.S. General Accounting Office

Tom Tsui
Country Program Coordinator
Thailand
The World Bank

Carol Van Cleef
Partner
Katten, Muchin, Zavis

Alice Veenstra
Office of Management & Budget
Executive Office of the President

Muriel Watkins
President
MW Financial, Inc.

Roger Watson
Director
Division of Research and Statistics
Federal Deposit Insurance Corporation

Donald Weyback
Senior Resolutions Specialist
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Lawrence White
Professor of Economics
Stern Business School
New York University

Susan Whited
Assistant Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Jim Wigand
Deputy Director
Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Frank Willis
Accounting Manager
Division of Finance
Federal Deposit Insurance Corporation

Cecile Yepes
Assistant to the Minister, Financial Counselor
French Embassy, Financial Ministry Office

Mike Yuenger
U.S. Department of Treasury

Tom Zemke
Deputy to Director Ludwig
Office of Comptroller of the Currency

Diane Zyats
Vice President
Newmyer Associates