



CHAPTER 6

Bridge Banks

Introduction

On August 10, 1987, Congress signed into law the Competitive Equality Banking Act (CEBA) of 1987, which authorized the Federal Deposit Insurance Corporation (FDIC) to establish bridge banks. A bridge bank is a temporary national bank chartered by the Office of the Comptroller of the Currency (OCC) and organized by the FDIC to take over and maintain banking services for the customers of a failed bank. It is designed to “bridge” the gap between the failure of a bank and the time when the FDIC can implement a satisfactory acquisition by a third party. An important part of the FDIC’s bank resolution process for large or complex failing bank situations, a bridge bank provides the time the FDIC needs to take control of a failed bank’s business, stabilize the situation, effectively market the bank’s franchise, and determine an appropriate resolution. See chart I.6-1, which shows the FDIC’s use of bridge banks.

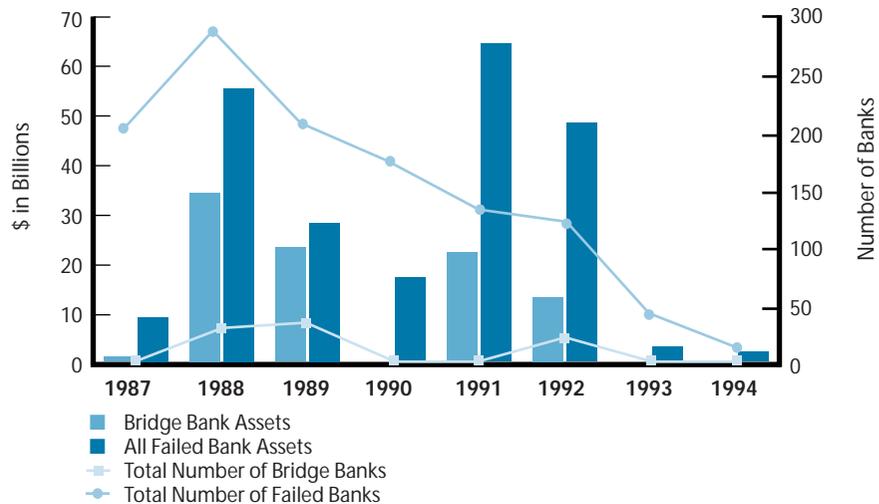
Background

Between 1987 and 1994, the FDIC used its bridge bank powers only 10 times; however, most of those instances involved multiple related bank failures. The 10 situations in which the FDIC used its bridge bank authority resulted in the creation of 32 bridge banks into which the FDIC placed 114 individual banks.¹ Those banks had total assets

1. Throughout this chapter, a distinction is made among (1) individual banks, (2) bridge banks, and (3) bridge bank situations. Number (1) refers to the number of individual failed banks that were put into bridge banks; (2) refers to the number of bridge banks that were created to handle the individual banks; and (3) groups all individual banks within a holding company into one “situation” that was handled by the FDIC with its bridge bank authority. For example, First RepublicBanks’ 41 individual banks were placed into two bridge banks. Table I.6-1 shows the results of those distinctions.

Chart I.6-1

Number and Total Assets of FDIC's Bridge Banks by Year 1987–1994



Source: FDIC Division of Research and Statistics.

of about \$90 billion. Between 1987 and 1994, bridge banks made up only a small portion (10 percent) of the total bank failures, but they represented a substantial portion (45 percent) of the total assets of failed banks. See table I.6-1 for details of the 10 bridge bank situations.

Bridge banks are designed to aid in the resolution of complicated, large failing banks. Seven of the 10 instances in which the FDIC used its bridge bank authority involved assets of more than \$1 billion. (See chart I.6-2.) The largest bridge bank situation was for First RepublicBanks (Texas), with \$33.4 billion in assets at resolution.

The location of the bridge banks reflects the economic problems of the late 1980s and early 1990s. All but 3 of the 32 bridge banks were located in the Southwest or Northeast. In the Southwest, 23 bridge banks were in Texas and 1 was in Louisiana. In the Northeast, two bridge banks were in Connecticut and one each was in Massachusetts, Maine, and Vermont. The remaining three bridge banks were in Delaware, Florida, and Missouri.

When the FDIC establishes bridge banks, it intends that the banks will be interim, rather than permanent, solutions for failing banks. Each bridge bank that the FDIC created has lasted less than seven months, with the exception of two early bridge banks, the First RepublicBanks (Texas) and the MCorp banks. In those two instances, acquirers were selected early in the bridge bank process, but because the FDIC took an equity position as part of the banks' resolutions, the bridge bank periods were extended. First

Table I.6-1

The FDIC's Use of Bridge Bank Authority**1987-1994**

(\$ in Thousands)

Bridge Bank Situations	Failure Date	Bridge Banks	Number of Failed Banks	Total Assets	Total Deposits
1	10/31/87	1 - Capital Bank & Trust Co.	1	\$386,302	\$303,986
2	07/29/88	2 - First RepublicBanks (Texas)	40	32,835,279	19,528,204
	08/02/88	3 - First RepublicBank (Delaware)	1	*582,350	*164,867
3	03/28/89	4 - MCorp	20	15,748,537	10,578,138
4	07/20/89	5 - Texas American Bancshares	24	*4,733,686	*4,150,130
5	12/15/89	6 - First American Bank & Trust	1	1,669,743	1,718,569
6	01/06/91	7 - Bank of New England, N.A.	1	*14,036,401	*7,737,298
	01/06/91	8 - Connecticut Bank & Trust Co., N.A.	1	*6,976,142	*6,047,915
	01/06/91	9 - Maine National Bank	1	*998,323	*779,566
7	10/30/92	10 - First City, Texas-Alice	1	127,990	119,187
	10/30/92	11 - First City, Texas-Aransas Pass	1	54,406	47,806
	10/30/92	12 - First City, Texas-Austin, N.A.	1	346,981	318,608
	10/30/92	13 - First City, Texas-Beaumont, N.A.	1	531,489	489,891
	10/30/92	14 - First City, Texas-Bryan, N.A.	1	340,398	315,788
	10/30/92	15 - First City, Texas-Corpus Christi	1	474,108	405,792
	10/30/92	16 - First City, Texas-Dallas	1	1,324,843	1,224,135
	10/30/92	17 - First City, Texas-El Paso, N.A.	1	397,859	367,305
	10/30/92	18 - First City, Texas-Graham, N.A.	1	94,446	85,667
	10/30/92	19 - First City, Texas-Houston, N.A.	1	3,575,886	2,240,292
	10/30/92	20 - First City, Texas-Kountze	1	50,706	46,481
	10/30/92	21 - First City, Texas-Lake Jackson	1	102,875	95,416
	10/30/92	22 - First City, Texas-Lufkin, N.A.	1	156,766	146,314
	10/30/92	23 - First City, Texas-Madisonville, N.A.	1	119,821	111,783
	10/30/92	24 - First City, Texas-Midland, N.A.	1	312,987	289,021
	10/30/92	25 - First City, Texas-Orange, N.A.	1	128,799	119,544
	10/30/92	26 - First City, Texas-San Angelo, N.A.	1	138,948	127,802

Table I.6-1

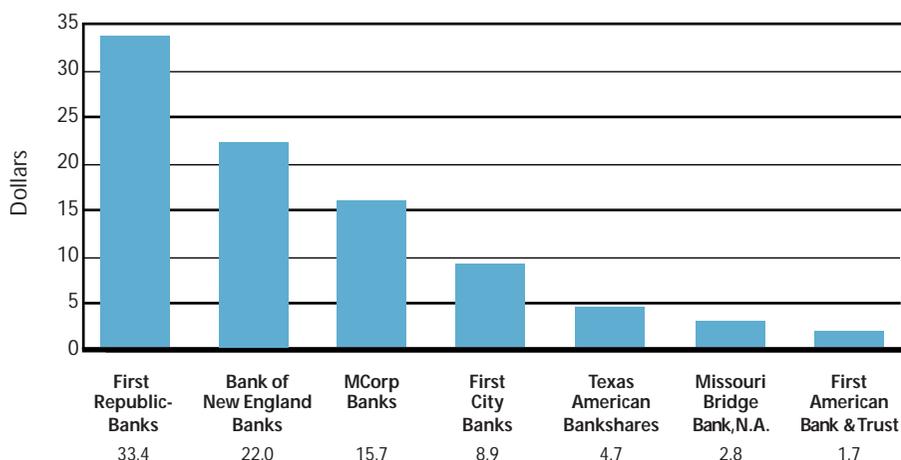
**The FDIC's Use of Bridge Bank Authority
1987-1994**
(\$ in Thousands)
Continued

Bridge Bank Situations	Failure Date	Bridge Banks	Number of Failed Banks	Total Assets	Total Deposits
	10/30/92	27 - First City, Texas-San Antonio, N.A.	1	\$262,538	\$244,960
	10/30/92	28 - First City, Texas-Sour Lake	1	54,145	49,701
	10/30/92	29 - First City, Texas-Tyler, N.A.	1	254,063	225,916
8	11/13/92	30 - Missouri Bridge Bank, N.A.	2	2,829,368	2,715,939
9	01/29/93	31 - The First National Bank of Vermont	1	224,689	247,662
10	07/07/94	32 - Meriden Trust & Safe Deposit Co.	1	6,565	0
10	Totals	32	114	\$89,877,439	\$61,043,683

Data for Total Assets and Total Deposits are as of resolution.
 Data marked with an asterisk (*) are from the quarter before resolution.
 Source: FDIC Division of Research and Statistics.

Chart I.6-2

**Bridge Bank Situations in which Assets Were Greater than \$1 Billion
1987-1994**
(\$ in Billions)



Source: FDIC Division of Research and Statistics.

RepublicBanks (Texas) lasted for a little more than a year, from July 29, 1988, to August 9, 1989, and MCorp operated from March 28, 1989, until October 28, 1991, for a total of 31 months. Although the bridge banks were in existence for a long period of time, they were under the control of the acquiring banks, which had contributed part of the banks' capital.

Reasons for a Bridge Bank

When a large bank with a complex structure, such as a multi-bank holding company, is in danger of failing, creating a bridge bank allows the FDIC to take control of the bank and stabilize it. It also enables the FDIC to gain sufficient flexibility for marketing the bank. After the bank is under the FDIC's control, the additional time allows for a thorough assessment of the bank's condition and a complete evaluation of alternate forms of resolution. Additional time also allows for due diligence by all interested parties. All of those functions can be performed without inhibiting the day-to-day operations of the bridge bank for its depositors.

Public disclosure of serious financial problems at a large bank can cause sudden liquidity problems that could result in the closing of the banks if they are not stabilized quickly. After a bridge bank is established, the FDIC can lend directly to the bridge bank and provide assurance to insured depositors that their money is safe. The alternative to creating a bridge bank may be to use a straight deposit payoff or, at best, an insured deposit transfer. Usually, in situations such as liquidity failures, far less advance preparation has taken place (compared to a situation in which asset quality problems have built up over time), so creating a bridge bank gives the FDIC and potential bidders an opportunity to review the bank in a more stable environment. In the case of multiple bank failures within a holding company, such as First RepublicBanks (Texas), bridge banks can facilitate the handling of multiple failures in a short time.

Bridge Bank Operations

The FDIC's bridge bank authority permits the creation of a national bank, and the FDIC has broad powers to operate, manage, and resolve that bank. Initially, the FDIC establishes bridge banks for two years maximum, with the possibility of up to three one-year extensions. A bridge bank operates in a conservative manner, while serving the banking needs of the community. It accepts deposits and makes low-risk loans to regular customers. Its management goal is to preserve the franchise value and lessen any disruption to the local community. For the early bridge banks, such as First RepublicBanks (Texas) and MCorp, the FDIC had an acquirer before the bridge bank was organized or shortly thereafter. The FDIC entered into a management agreement with the acquirer, who made almost all decisions concerning bank operations. The acquiring bank

managed the bridge bank under that contract until the acquisition was finalized. For the later bridge banks, the FDIC would select a chief executive officer (CEO) from the private sector or FDIC senior staff to conduct day-to-day operations. It would then appoint a board of directors, composed of senior FDIC personnel and the CEO, for the bridge bank. The bridge bank board, along with the CEO and management, is responsible for developing a strategic plan to meet the goals recommended and for addressing any operational issues confronting the bank. The bridge bank board is also responsible for reviewing and approving the bank's business plan and for assuming other management and oversight duties. The FDIC board retains authority to effect a final resolution of the bank and approve the sale of bank assets.

Lending

In the early bridge bank transactions, little lending took place until the acquiring bank took control. In the later transactions, in which the FDIC would be in control for a longer time, however, the bridge bank would attempt to maintain a presence in the local community to prevent a significant outflow of commercial and retail loan customers. Specifically, the bridge bank would be expected to make limited loans to the local community and to honor the previous institution's commitments that would not create additional losses, including funding the completion of unfinished projects.

Assets

The bridge bank staff completes an inventory to identify, evaluate, and work out troubled assets. It develops realistic market values for assets and assigns appropriate loss reserves. The bridge bank may sell assets if such an action is suitable. For a period of up to 90 days after the bridge bank begins operations, assets that could benefit from the powers of the receivership or assets that would be difficult to sell to a franchise acquirer can be transferred by the bridge bank management to the receivership. The assets transferred from the bridge bank to the receivership would be those with the most problems and the least potential for improvement, including nonperforming loans, owned real estate, subsidiaries, assets in litigation, and fraud-related assets.

The bridge bank management attempts to maintain the quality of the assets that remain in the bank and, to the extent possible, work out or reduce nonperforming assets. Under the latter scenario, the bank focuses on a workout program that offers a greater chance for recovery than alternatives such as foreclosure and litigation. Another cost-effective option is a compromise settlement. The CEO, in consultation with the bridge bank's board of directors, makes the final decision on the most appropriate type of asset workout.

Liabilities

Before the failing bank is closed, the FDIC must decide whether to pass all deposits or only insured deposits to the bridge bank. Before the passage of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991, all the deposits were passed to a bridge bank. Since FDICIA, the FDIC has passed only insured deposits to a bridge bank when there is an expected loss to the receivership; uninsured depositors share in any loss with the FDIC. Those depositors are entitled to their proportionate share in the liquidation of the receivership. Usually, most unsecured nondeposit creditors are also left with the receivership. Secured creditors are passed to the bridge bank, along with their collateral.

Like any other bank that has assumed deposits from the FDIC, the bridge bank must notify depositors that their accounts have been transferred to the bridge bank. In turn, depositors must contact the bank within 18 months to claim their deposits. Unclaimed deposits are subject to state escheat laws and are turned over to the respective state if they are not claimed. Bridge bank management also decides whether to maintain or change the interest rates paid on deposits by the failing bank. The FDIC requires that rates remain the same for the first 14 days and that the bank provide depositors 7 days' notice of a rate change. Customers can withdraw their funds without penalty until they enter into new contracts with the bridge bank.

Liquidity

The FDIC reviews the failing bank's liquidity during the bridge bank preparation phase. It monitors liquidity levels to determine if the bridge bank can meet its own funding needs or if it needs access to the FDIC's revolving credit facility. The bridge bank also attempts to reestablish lines of credit and correspondent banking relationships that were maintained by the failing institution.

The FDIC's Experience with Bridge Banks

Passage of CEBA in 1987 authorized the FDIC to create bridge banks to resolve failing institutions. According to CEBA, the FDIC may establish a bridge bank if the board of directors determines that such an action is cost-effective; that is, that the action is in accordance with the cost test (before December 1991) or the least cost test (after December 1991).

The FDIC used its bridge bank authority for the first time on October 30, 1987, when the Louisiana banking commissioner closed Capital Bank & Trust Company, Baton Rouge, Louisiana, and placed the failed bank into a bridge bank. On May 23, 1988, Grenada Sunburst System Corporation, Grenada, Mississippi, acquired the bridge bank. The FDIC determined that using the new bridge bank authority was the most

cost-effective way to preserve existing banking services and give sufficient time to arrange a permanent transaction.²

Some of the early bridge banks—First RepublicBanks (Texas), MCorp, and Texas American Bancshares—involved many banks within a holding company.³ First RepublicBanks (Texas) combined 40 failed banks into one bridge bank; MCorp combined 20 failed banks into one bridge bank; and Texas American Bancshares combined 24 failed banks into one bridge bank.

First RepublicBanks (Texas), MCorp, and Texas American Bancshares were large multi-bank holding companies whose banks failed during 1988 and 1989. During that period, the FDIC's policy was to sell large institutions in total rather than by part or by branch, so the holding company's failed banks were combined into one bridge bank.⁴ In each case, all deposits, including uninsured deposits, were transferred to the bridge bank. At the time those banks were bridged, the test for establishing a bridge bank was whether the cost of organizing and operating the bridge bank was less than the cost for liquidating the failed bank. Acquirers were either selected before going into the bridge bank, as with First RepublicBanks (Texas) and Texas American Bancshares, or shortly thereafter, as with MCorp. The FDIC sold each bridge bank to one acquirer. In those cases, the acquiring institution operated the bridge bank under a management agreement, while negotiating the final terms of the transaction.

Bank of New England (1991) and the Use of Cross Guarantee Authority

On August 9, 1989, Congress signed into law the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA). The law focused primarily on the thrift crisis, but also included significant provisions for bank failures. The cross guarantee provision of FIRREA allowed the FDIC to recover part of its costs of liquidating or aiding a troubled insured institution by assessing those costs against the solvent insured institutions in the same holding company.

The first time the FDIC used the cross guarantee in connection with a bridge bank was with the Bank of New England (BNE), Boston, Massachusetts, failure on January 6, 1991. BNE, Connecticut Bank & Trust Company, N.A. (CBT), Hartford, Connecticut, and Maine National Bank (MNB), Portland, Maine, were all subsidiaries of the Bank of New England Corporation. BNE was considered the flagship bank and was significantly larger than the other two banks. BNE's failure was attributed to rapid growth, particularly in commercial real estate lending, which was adversely affected by deterioration of the local economy. Following an announcement of major increases in

2. FDIC, *1987 Annual Report*.

3. See Part II, Case Studies of Significant Bank Resolutions, Chapter 6, First RepublicBank Corporation, and Chapter 7, MCorp.

4. First RepublicBanks Corporation also had a credit card subsidiary located in another state (Delaware), which was placed in its own bridge bank and was sold in a separate transaction.

loan loss reserves and an erosion of deposit funding, BNE experienced severe liquidity problems and subsequent failure. Because BNE experienced heavy deposit withdrawals, the FDIC used the essentiality provision of Section 13(c) of the Federal Deposit Insurance (FDI) Act to help stabilize the situation and explicitly guaranteed all deposits, including uninsured deposits, in all three banks.⁵ CBT failed at the same time as BNE because of losses on federal funds sold to BNE. Using the cross guarantee provision, MNB was assessed with the FDIC losses for BNE and CBT, causing MNB's failure.

The FDIC placed each of the three institutions into a separate bridge bank, transferring all deposits and most assets. The FDIC marketed the bridge banks individually and as a total package. On April 22, 1991, the FDIC Board of Directors awarded the three bridge banks to Fleet/Norstar Financial Group (Fleet). Fleet managed the banks on an interim basis until the sale closed on July 14, 1991.⁶

First City Bancorporation of Texas, Inc. (1992) and Least Cost Resolution

On December 19, 1991, Congress signed FDICIA into law, an act that had far-reaching effects on the FDIC. The law's provision for least cost resolutions had a major effect on bridge banks. Before FDICIA, the FDIC could select any resolution method as long as it was less costly than a payoff of insured deposits and a liquidation of the assets. FDICIA, however, requires the FDIC to choose the least cost alternative in resolving failing institutions. The least cost provision can be waived only in a systemic risk situation in which the least cost resolution of a failed institution would have a serious effect on economic conditions or financial stability.⁷ Before establishing a bridge bank, the FDIC prepares a cost analysis comparing the estimated operation and resolution costs of the bridge bank to the cost of liquidation. The FDIC can establish a bridge bank only if it is the least costly resolution method.

Following the open bank assistance (OBA) transaction between the FDIC and the First City Bancorporation of Texas, Inc. (First City), in 1988, First City continued to be affected by the poor quality of its loan portfolio and experienced additional losses on real estate.⁸ In October 1992, the two largest First City banks in Houston and Dallas were found insolvent and closed. The remaining 18 First City banks were closed after

5. A bank was deemed essential when, in the opinion of the FDIC Board of Directors, the continued operation of the bank was essential to providing adequate banking service in the community. Ultimately, the provision would come under scrutiny by Congress because large banks were being treated differently than small banks.

6. FDIC, *1991 Annual Report*.

7. The provision was the result of a reaction to the perceived FDIC policy of "too big to fail," and as a result, in all future bridge banks only insured deposits will be placed in the bridge bank, except in cases of systemic risk or cross guarantee in which there is no loss in the bank. Any case of systemic risk must be approved by the secretary of the Treasury in consultation with the president of the United States.

8. See Chapter 5, Open Bank Assistance, for a discussion of the 1988 open bank assistance transaction for First City and Part II, Case Studies of Significant Bank Resolutions, Chapter 5, First City Bancorporation of Texas, Inc.

the FDIC exercised its cross guarantee authority to assess the other subsidiaries for anticipated losses from the Houston and Dallas banks.

Each of the 20 banks was placed in an individual bridge bank. By separating the banks, an individual sale of each bank was possible. Unlike previous multi-bank bridge banks, such as First Republic Banks (Texas), in which the bridge bank was made up of 40 individual banks and was purchased by one acquirer, the First City bridge banks could have had one acquirer or different acquirers. By selling each bank separately, the FDIC opened the door for smaller institutions to join the resolution process and generally increased interest from banks of all sizes. Previously, the FDIC had sold only one large institution, American Savings Bank, New York, New York, by breaking the branch network into parts or clusters and selling them to several acquirers.

To comply with the least cost requirement, the FDIC analyzed each of First City's banks to determine if a loss was anticipated. In the four banks in which the FDIC projected a loss—those in Houston, Dallas, San Antonio, and Austin—uninsured deposits were not passed to the bridge banks but stayed with the receiverships. The remaining 16 better-capitalized banks passed all deposits to the bridge banks. In February 1993, the FDIC sold the First City bridge banks to 13 acquirers in transactions that were projected to result in no loss to the Bank Insurance Fund (BIF). It sold 3 of the 20 bridge banks with loss share arrangements, which were five-year assistance agreements that provided protection on certain assets sold in the resolution. Loss share arrangements, which after 1991 became standard resolution tools for larger banks with more than \$500 million in assets, followed the FDIC's preference for keeping bank assets in the private sector.⁹

Initially, at the time of failure in October 1992, the uninsured depositors of the Houston, Dallas, San Antonio, and Austin banks received an advance dividend of 80 percent of their claims on the receivership. In January 1993, when it became apparent that losses at Dallas, San Antonio, and Austin were likely to be less than projected, the FDIC made an additional 10 percent advance dividend to the uninsured depositors of those three banks (thus increasing their cumulative advance dividend to 90 percent). The receivership eventually was able to pay uninsured depositors, other creditors, and bondholders 100 percent of their claims. It was even able to return some funds to the failed bank's stockholders.

Smaller Bridge Banks (1993 to 1994)

In January 1993, the FDIC placed The First National Bank of Vermont (FNB), Bradford, Vermont, in a bridge bank. Although FNB was smaller than most bridge banks, with \$225 million in assets, the FDIC placed it in a bridge bank because Vermont statutes did not include emergency provisions for an interstate acquisition of a failing

9. See Chapter 7, Loss Sharing, for more detail.

institution, thus severely limiting the number of potential bidders. Moreover, the FDIC could not use section 13 of the FDI Act, which allowed the FDIC to market institutions on an interstate basis before interstate branching was allowed, because section 13 is applicable only to banks with more than \$500 million in assets. Section 13, however, can be used in the case of a bridge bank. In addition, FNB was created by a merger of three banks in July 1992, but the operations of the banks had not been merged when FNB failed, making resolution activities such as data gathering and due diligence difficult. A bridge bank structure gave the FDIC the time necessary to prepare the institution for sale. It also gave the FDIC an opportunity to offer the bank to both in-state and out-of-state bidders. On June 4, 1993, New FNB was sold to Merchants Bank, Burlington, Vermont.

Another small institution, The Meriden Trust & Safe Deposit Company (Meriden), Meriden, Connecticut, was an FDIC insured institution based on its charter as a depository institution and on its past deposit activities, although it no longer made loans or accepted deposits from the public. Meriden, with assets of \$6.6 million, primarily operated a trust department. Meriden became critically undercapitalized and failed when it was assessed on October 16, 1992, for cross guarantee liability by the FDIC in connection with Meriden's failed affiliate, Central Bank (Central), Meriden, Connecticut. Both Meriden and Central were owned by Cenvest, Inc., Meriden, Connecticut. In court, Cenvest, Inc., challenged the FDIC's assessment of Meriden with Central's losses, partly on the basis that Meriden was not an insured depository institution. Because of the protracted litigation between the FDIC and Meriden, it was uncertain when the FDIC would be able to appoint itself receiver. On June 30, 1994, the U.S. District Court in Connecticut ruled in favor of the FDIC, and for the first time, the FDIC closed an institution and appointed itself receiver of Meriden on July 7, 1994 (in contrast to being appointed receiver by the chartering authority). The FDIC was not able to plan and schedule a resolution to occur simultaneously with the self-appointment, so the FDIC used a bridge bank to provide staff with the necessary time to market the institution to maximize the FDIC's recovery on the cross guarantee claim. On October 18, 1994, New Meriden was acquired by Peoples Savings Bank of New Britain, New Britain, Connecticut.

The FNB and Meriden cases illustrate the versatility of the FDIC's bridge bank authority. A bridge bank is not just a valuable tool for the resolution of large failing banks, but it is also useful for resolving smaller failing institutions with complex issues that are not easily solved within the 90-day prompt corrective action (PCA) period.¹⁰

10. Prompt corrective action is a provision of FDICIA that affects the timing of bank failures. Prompt corrective action requires that an institution must be closed by its primary regulator if it is "critically undercapitalized" for a prolonged period. A bank that is critically undercapitalized is defined as having tangible capital that is equal to or less than 2 percent of total assets. Under previous law, an institution typically was closed only after its capital had been exhausted.

Resolution Cost of Bridge Banks

The FDIC applies the least cost test twice in cases in which it uses bridge banks: first, before a failed bank (or failed banks) goes into the bridge bank and, second, at final resolution of the bridge bank. The FDIC compares the estimated cost of a bridge bank and its subsequent resolution to the estimated cost of the two alternatives: an immediate sale without the bridge bank structure or a payoff of deposits. The FDIC determines the estimated cost using several factors such as the cost of operating a bridge bank, the market value and relative attractiveness of the bridge bank's assets, and the premium expected from the eventual sale of the franchise. The FDIC also factors in the significant negative effect a substantial shrinkage of the deposit base could have on the amount of premium ultimately received and on the viability of the bridge bank as a cost-effective resolution mechanism for the failed bank.

The FDIC also must consider another factor: treatment of the uninsured deposits. In the earlier bridge banks, the FDIC transferred both insured and uninsured deposits to the bridge bank. In later bridge banks, the FDIC made a determination on the basis of treatment of the uninsured deposits in keeping with the least cost resolution requirement. If the FDIC's initial cost analysis, made when a bank is placed in a bridge structure, indicates a loss is going to occur in the bridge bank, the FDIC will transfer only insured deposits to the bridge bank. It leaves uninsured deposits with the receivership created when the bridge bank is established. Uninsured deposits and unsecured creditors that are left with the receivership become claimants of the receivership and share in any losses.

At the sale of each bridge bank, all deposits in the bank, including uninsured deposits accepted during the bridge period, will pass to the acquirer. The FDIC determined that the cost savings of leaving the new uninsured depositors behind in a receivership would be outweighed by the impairment of the usefulness of bridge banks as a resolution method in the future. The bridge bank, however, does not attempt to increase deposits and, in fact, attempts to limit any new uninsured deposits.

Before forming a bridge bank, the FDIC completes a timetable and strategy for resolution, which varies, depending on whether the bridge bank will be held short term or long term. Of the 32 bridge banks resolved, all but 2 were short term, lasting seven months, or less. The two long-term bridge banks, First RepublicBanks and MCorp, were resolved within seven months but, as a part of the transaction, the FDIC maintained a stock ownership position in each of the new entities. The FDIC expects that future bridge banks will continue to be short term because the ultimate purpose is to resolve failing banks as quickly, efficiently, and cost-effectively as possible. Table I.6-2 shows the FDIC's resolution costs for each situation in which the FDIC used its bridge bank authority.

It is difficult to make resolution cost comparisons among failed banks because each failing bank is unique. The problems that led one bank into failure may not be the same ones that lead another bank into failure. Also, banks vary in their asset mix and a bank

with certain assets may be more marketable than others; the assets may benefit the sale of the failing bank franchise and the sale of assets remaining in the receivership after the bank is sold. In addition, a bank's regional location may affect the ease with which the bank franchise and the assets are sold. If the bank's region is in a severe downturn, marketing the bank might be more difficult. Indeed, it was the unique characteristics that a failing bank (particularly a large failing bank) can have that led to the creation of the bridge bank as a resolution tool.

Table I.6-2

Bridge Bank Resolutions

1987–1994

(\$ in Thousands)

Bridge Bank Situations	Total Assets (as of failure)	FDIC Resolution Cost (as of December 31, 1996)*	Costs as a Percentage of Assets	Time Elapsed Until Resolution (days)
Capital Bank & Trust Co.	\$386,302	\$55,594	14.4	206
First RepublicBanks	33,417,629	3,856,826	11.5	†273
MCorp	15,748,537	2,839,514	18.0	†308
Texas American Bancshares	4,733,686	1,076,760	22.7	147
First American Bank & Trust	1,669,743	388,573	23.3	129
Bank of New England Banks	22,010,866	889,379	4.0	189
First City Banks	8,850,054	0	0.0	121
Missouri Bridge Bank, N.A.	2,829,368	355,765	12.6	161
The First National Bank of Vermont	224,689	33,638	15.0	126
Meriden Trust & Safe Deposit Co.	6,565	0	0.0	123
Totals/Average	\$89,877,439	\$9,486,049	10.6	NA

* For bridge banks with open receiverships, the cost of resolution is the estimated total cost of resolution as of December 31, 1995.

† Acquirers for the bridge banks were chosen within seven months of their inception; the time elapsed represents the time needed to finalize the transaction. As part of the resolution, the FDIC took an equity position in the bridge banks. The First RepublicBanks' bridge bank was terminated after 376 days and the MCorp bridge bank was terminated after 944 days, when the acquirers purchased the FDIC's stock in each.

NA: Not applicable.

Source: FDIC Division of Research and Statistics.

Bridge Bank Issues

Several issues regarding the future use of a bridge bank and the effect on uninsured depositors' and shareholders' interests include future effects from passage of FDICIA, nationalization, depositor discipline, and loss to stockholders.

Future Effects from the Passage of FDICIA

Two key provisions of FDICIA could make the use of bridge banks more likely in the future.

1. The prompt corrective action provision limits regulatory discretion and requires that institutions be closed by their chartering authority within 90 days of their becoming critically undercapitalized (capital is less than or equal to 2 percent). Before FDICIA, an institution typically was not closed until it was book insolvent. In the case of publicly traded institutions, PCA directives become public information and could lead to deposit withdrawals and liquidity crises for the failing bank.
2. FDICIA also restricts the authority of a Federal Reserve Bank (Federal Reserve) to make advances to institutions that are undercapitalized or critically undercapitalized. By limiting a failing institution's ability to borrow from the Federal Reserve banks, FDICIA makes it more likely that failing banks could face liquidity shortages in the future.

Whether increased liquidity pressures could result in the potential for more bridge bank transactions will depend on the size, complexity, and other characteristics of the specific failing institution. Since passage of FDICIA in 1991, numerous banks have failed because of liquidity crises; however, most have been relatively small, and none have required the use of a bridge bank.

Nationalization

When the FDIC creates a bridge bank from a failing bank and maintains control of the bank until it is sold or resolved, the bridge bank is in effect a nationalized bank. Critics have expressed concern that the government is running a bank and competing against other nongovernment owned banks. That concern can be mitigated by the short-term nature of the bridge bank as they are meant to be sold as quickly as possible.

Depositor Discipline

Until 1992, the FDIC protected all depositors, insured and uninsured, in bridge banks. Beginning with the First City transaction, the FDIC, as required by statute, focused on

obtaining the least costly resolution. The FDIC now leaves uninsured deposits with the receivership when a bridge bank is created and a loss is associated with the failed bank. The new policy moves responsibility for uninsured deposits from the FDIC to the depositors themselves and imposes market discipline on the public.

Loss to Stockholders

Before the passage of CEBA, which first enabled the FDIC to establish bridge banks, the FDIC resolved most large failing banks through open bank assistance. OBAs allowed holding company shareholders and creditors to retain an interest in the bank, though their interest was significantly diluted from their previous position. In a bridge bank, the FDIC transfers liabilities and some assets of the failing bank to the new bridge bank, while the shareholders' and creditors' interests remain with the receivership. The 1988 First RepublicBanks (Texas) transaction was the first large failing bank resolution that eliminated holding company interests in the new bank. That treatment of the holding company interests raised concern within the financial sector that it would be more difficult for holding companies to raise capital and would force them to pay a higher rate of return to lure investors. If anything, such treatment likely has instilled greater market discipline into the system by placing more of the burden on shareholders and creditors of the holding company to scrutinize large banks and carefully consider their investments.

FDIC Alternative to Use of Bridge Banks

When the FDIC is dealing with insured financial institutions that are not banks (savings banks and thrifts), it does not have the authority to use a bridge bank; in these situations, the FDIC can create a conservatorship. The FDIC has used its conservatorship authority only once, in January 1992, with CrossLand Savings Bank, FSB (CrossLand), Brooklyn, New York.¹¹ Although the Office of Thrift Supervision (OTS) was CrossLand's primary regulator, the bank was insured by the BIF. The FDIC did not use a bridge bank for CrossLand because it had a thrift charter. When CrossLand was closed by the OTS, the FDIC was appointed receiver. The FDIC created a new federal mutual savings bank, which was chartered by the OTS and for which the FDIC was appointed conservator. The new savings association, CrossLand Federal Savings Bank (New CrossLand), acquired substantially all the assets and assumed all deposits and certain other liabilities of the original CrossLand.

In many ways the CrossLand resolution was unique. It was the first time the FDIC exercised its conservatorship authority. Also, the FDIC determined that the least cost resolution would be for the FDIC to operate New CrossLand as an ongoing bank with

11. See Part II, Case Studies of Significant Bank Resolutions, Chapter 11, CrossLand Savings Bank, FSB.

the goal of improving its franchise value, rather than liquidating it. The FDIC carried out its objective by shrinking New CrossLand to its core franchise, cleaning up its balance sheet (working out bad assets as appropriate), and reducing noninterest expenses. By the time New CrossLand was ready to be returned to the private sector almost 19 months later, it had reduced total assets by more than \$2 billion, closed or sold 45 non-core branches, sold 2 major operating subsidiaries, and reduced the number of employees by 1,200.

Using a method unlike the resolution practice it typically used, the FDIC converted New CrossLand to stock ownership and sold it through a private placement of stock and debt to a group of 40 institutional investors for \$332 million. The FDIC also received warrants providing the FDIC the right to purchase one million shares, or 7 percent, of the common stock of New CrossLand. Finally, to effect the sale, the FDIC entered into a loss sharing assistance agreement with New CrossLand providing loss coverage on the commercial and real estate assets.

As of December 31, 1995, the cost to the FDIC for resolving CrossLand was \$739.9 million, a relatively favorable 10.2 percent of CrossLand's assets at time of failure. That cost is considerably less than the estimated \$1.2 billion cost of liquidation, which was the least costly alternative available in January 1992. Previous marketing attempts by the FDIC had resulted in no acceptable offers for CrossLand that were less than the cost of liquidation. In February 1996, New CrossLand was acquired by Republic New York Corporation (Republic), New York, New York, and the FDIC was able to exchange its warrants for a price equal to the difference between the exercise price and Republic's offer price, resulting in additional cost savings of \$10 million to the FDIC.

Conclusion

The bridge bank vehicle has proved to be a valuable tool for the FDIC and has been used to resolve some of the largest and most complex failures in recent history. Bridge banks were created 32 times in 10 failing bank situations between 1987 and 1994. When banks face a poor regional economy and a sudden or severe liquidity crisis, the bridge bank structure allows time to evaluate the bank's condition and to address outstanding problems before the marketing and sale of the bank. Bridge banks have been used effectively in the past and likely will continue to be useful in the future.

Table I.6-3

Individual Failed Banks that Were Placed into Bridge Banks

(\$ in Thousands)

Bridge Date	Failed Institution	Location	Total Assets
Oct. 87	Capital Bank & Trust Co.	Baton Rouge, LA	\$386,302
July 88	First RepublicBank-Austin, N.A.	Austin, TX	1,734,407
July 88	First RepublicBank-A&M	College Station, TX	92,090
July 88	First RepublicBank-Abilene, N.A.	Abilene, TX	214,305
July 88	First RepublicBank-Brownwood, N.A.	Brownwood, TX	124,218
July 88	First RepublicBank-Cleburne, N.A.	Cleburne, TX	114,816
July 88	First RepublicBank-Clifton	Clifton, TX	77,693
July 88	First RepublicBank-Conroe, N.A.	Conroe, TX	206,393
July 88	First RepublicBank-Corsicana, N.A.	Corsicana, TX	198,593
July 88	First RepublicBank-Dallas, N.A.	Dallas, TX	18,162,609
July 88	First RepublicBank-Denison, N.A.	Denison, TX	141,514
July 88	First RepublicBank-El Paso, N.A.	El Paso, TX	212,114
July 88	First RepublicBank-Ennis, N.A.	Ennis, TX	96,137
July 88	First RepublicBank-Forney	Forney, TX	50,994
July 88	First RepublicBank-Fort Worth, N.A.	Ft Worth, TX	1,905,148
July 88	First RepublicBank-Galveston, N.A.	Galveston, TX	261,089
July 88	First RepublicBank-Greenville, N.A.	Greenville, TX	82,781
July 88	First RepublicBank-Harlingen, N.A.	Harlingen, TX	208,383
July 88	First RepublicBank-Henderson, N.A.	Henderson, TX	120,083
July 88	First RepublicBank-Hillsboro	Hillsboro, TX	63,530
July 88	First RepublicBank-Houston, N.A.	Houston, TX	2,886,126
July 88	First RepublicBank-Jefferson Co.	Beaumont, TX	221,573
July 88	First RepublicBank-Lubbock, N.A.	Lubbock, TX	496,207
July 88	First RepublicBank-Lufkin	Lufkin, TX	218,720
July 88	First RepublicBank-Malakoff	Malakoff, TX	47,978
July 88	First RepublicBank-Midland, N.A.	Midland, TX	616,165
July 88	First RepublicBank-Mineral Wells, N.A.	Mineral Wells, TX	167,841
July 88	First RepublicBank-Mt. Pleasant, N.A.	Mt. Pleasant, TX	142,692

Table I.6-3

Individual Failed Banks that Were Placed into Bridge Banks
Continued

Bridge Date	Failed Institution	Location	Total Assets
July 88	First RepublicBank-Odessa, N.A.	Odessa, TX	167,958
July 88	First RepublicBank -Paris	Paris, TX	77,906
July 88	First RepublicBank-Plano, N.A.	Plano, TX	183,784
July 88	First RepublicBank-Richmond, N.A.	Richmond, TX	94,945
July 88	First RepublicBank-San Antonio, N.A.	San Antonio, TX	743,428
July 88	First RepublicBank-Stephenville, N.A.	Stephenville, TX	119,699
July 88	First RepublicBank-Temple, N.A.	Temple, TX	163,400
July 88	First RepublicBank-Tyler, N.A.	Tyler, TX	600,406
July 88	First RepublicBank-Victoria	Victoria, TX	173,057
July 88	First RepublicBank-Waco, N.A.	Waco, TX	703,104
July 88	First RepublicBank-Wichita Falls, N.A.	Wichita Falls, TX	287,558
July 88	First RepublicBank-Williamson	Austin, TX	41,681
July 88	National Bank of Ft. Sam Houston	San Antonio, TX	614,155
Aug. 88	First RepublicBank-Delaware	Newark, DE	582,350
Mar. 89	MBank Abilene, N.A.	Abilene, TX	189,363
Mar. 89	MBank Alamo, N.A.	San Antonio, TX	687,646
Mar. 89	MBank Austin, N.A.	Austin, TX	591,009
Mar. 89	MBank Brenham, N.A.	Brenham, TX	143,838
Mar. 89	MBank Corsicana, N.A.	Corsicana, TX	190,909
Mar. 89	MBank Dallas, N.A.	Dallas, TX	6,973,816
Mar. 89	MBank Denton County, N.A.	Lewisville, TX	230,149
Mar. 89	MBank Fort Worth, N.A.	Fort Worth, TX	766,273
Mar. 89	MBank Greenville, N.A.	Greenville, TX	166,244
Mar. 89	MBank Houston, N.A.	Houston, TX	3,098,989
Mar. 89	MBank Jefferson County, N.A.	Port Arthur, TX	325,646
Mar. 89	MBank Longview, N.A.	Longview, TX	261,253
Mar. 89	MBank Marshall, N.A.	Marshall, TX	217,748

Table I.6-3

Individual Failed Banks that Were Placed into Bridge Banks
Continued

Bridge Date	Failed Institution	Location	Total Assets
Mar. 89	MBank Midcities, N.A.	Arlington, TX	\$369,280
Mar. 89	MBank Odessa, N.A.	Odessa, TX	322,582
Mar. 89	MBank Orange, N.A.	Orange, TX	158,888
Mar. 89	MBank Round Rock, N.A.	Round Rock, TX	159,912
Mar. 89	MBank Sherman, N.A.	Sherman, TX	274,782
Mar. 89	MBank The Woodlands, N.A.	The Woodlands, TX	165,063
Mar. 89	MBank Wichita Falls, N.A.	Wichita Falls, TX	455,147
July 89	Texas American Bank-Amarillo, N.A.	Amarillo, TX	222,179
July 89	Texas American Bank-Austin, N.A.	Austin, TX	144,372
July 89	Texas American Bank-Breckenridge, N.A.	Breckenridge, TX	85,676
July 89	Texas American Bank-Dallas, N.A.	Dallas, TX	227,312
July 89	Texas American Bank-Denison, N.A.	Denison, TX	139,323
July 89	Texas American Bank-Duncanville, N.A.	Duncanville, TX	218,539
July 89	Texas American Bank-Farmers Branch, N.A.	Farmers Branch, TX	49,381
July 89	Texas American Bank-Fort Worth, N.A.	Fort Worth, TX	1,974,591
July 89	Texas American Bank-Forum, N.A.	Arlington, TX	66,618
July 89	Texas American Bank-Frederickson, N.A.	Fredericksburg, TX	145,123
July 89	Texas American Bank-Galleria, N.A.	Houston, TX	300,022
July 89	Texas American Bank-Greater Southwest	Grand Prairie, TX	40,997
July 89	Texas American Bank-LBJ, N.A.	Dallas, TX	67,192
July 89	Texas American Bank-Levelland	Levelland, TX	198,523
July 89	Texas American Bank-Longview, N.A.	Longview, TX	92,880
July 89	Texas American Bank-McKinney, N.A.	McKinney, TX	168,389
July 89	Texas American Bank-Midland, N.A.	Midland, TX	145,952
July 89	Texas American Bank-Plano, N.A.	Plano, TX	35,503
July 89	Texas American Bank-Prestonwood, N.A.	Dallas, TX	227,312
July 89	Texas American Bank-Richardson, N.A.	Richardson, TX	43,059

Table I.6-3

Individual Failed Banks that Were Placed into Bridge Banks
Continued

Bridge Date	Failed Institution	Location	Total Assets
July 89	Texas American Bank-Southwest, N.A.	Stafford, TX	\$36,015
July 89	Texas American Bank-Temple, N.A.	Temple, TX	68,011
July 89	Texas American Bank-Tyler, N.A.	Tyler, TX	148,321
July 89	Texas American Bank-Wichita Falls, N.A.	Wichita Falls, TX	66,699
Dec. 89	First American Bank and Trust	North Palm Beach, FL	1,669,743
Jan. 91	Bank of New England, N.A.	Boston, MA	14,036,401
Jan. 91	Maine National Bank	Portland, ME	998,323
Jan. 91	Connecticut Bank & Trust Co., N.A.	Hartford, CT	6,976,142
Oct. 92	First City, Texas-Alice	Alice, TX	127,990
Oct. 92	First City, Texas-Aransas Pass	Aransas Pass, TX	54,406
Oct. 92	First City, Texas-Austin, N.A.	Austin, TX	346,981
Oct. 92	First City, Texas-Beaumont, N.A.	Beaumont, TX	531,489
Oct. 92	First City, Texas-Bryan	Bryan, TX	340,398
Oct. 92	First City, Texas-Corpus Christi	Corpus Christi, TX	474,108
Oct. 92	First City, Texas-Dallas	Dallas, TX	1,324,843
Oct. 92	First City, Texas-El Paso, N.A.	El Paso, TX	397,859
Oct. 92	First City, Texas-Graham, N.A.	Graham, TX	94,446
Oct. 92	First City, Texas-Houston, N.A.	Houston, TX	3,575,886
Oct. 92	First City, Texas-Kountze	Kountze, TX	50,706
Oct. 92	First City, Texas-Lake Jackson	Lake Jackson, TX	102,875
Oct. 92	First City, Texas-Lufkin, N.A.	Lufkin, TX	156,766
Oct. 92	First City, Texas-Madisonville, N.A.	Madisonville, TX	119,821
Oct. 92	First City, Texas-Midland, N.A.	Midland, TX	312,987
Oct. 92	First City, Texas-Orange, N.A.	Orange, TX	128,799
Oct. 92	First City, Texas-San Angelo, N.A.	San Angelo, TX	138,948
Oct. 92	First City, Texas-San Antonio, N.A.	San Antonio, TX	262,538

Table I.6-3

Individual Failed Banks that Were Placed into Bridge Banks
Continued

Bridge Date	Failed Institution	Location	Total Assets
Oct. 92	First City, Texas-Sour Lake	Sour Lake, TX	\$54,145
Oct. 92	First City, Texas-Tyler, N.A.	Tyler, TX	254,063
Nov. 92	Metro North State Bank	Kansas City, MO	685,045
Nov. 92	The Merchants Bank	Kansas City, MO	2,161,323
Jan. 93	The First National Bank of Vermont	Bradford, VT	224,689
Nov. 94	The Meriden Trust and Safe Deposit Co.	Meriden, CT	6,565

Source: FDIC Division of Research and Statistics.



The original goals of loss sharing were to (1) sell as many assets as possible to the acquiring bank and (2) have the nonperforming assets managed and collected by the acquiring bank in a manner that aligned the interests and incentives of the acquiring bank and the FDIC.