



CHAPTER 3

Evolution of the FDIC's Resolution Practices

Introduction

This chapter reviews the various approaches employed by the Federal Deposit Insurance Corporation (FDIC) to address the successive waves of bank insolvencies resulting from high interest rates in the late 1970s and early 1980s, energy and agriculture sector problems in the mid-1980s, and collapsing real estate markets at the end of the 1980s and early 1990s. It traces the expansion of resolution alternatives from traditional deposit payoffs and purchase and assumption (P&A) transactions to later variations of those methods.

Such a review, which could provide enough material for a book unto itself, by necessity must be limited in some ways. As a result, this chapter focuses more on the treatment of assets in bank resolution transactions than it does on the treatment of deposits and other liabilities. Also, it provides a greater focus on the many smaller failed and failing bank transactions that took place during those years than on the fewer larger bank failures. Such a focus does not mean the other topics were viewed as less important; they are covered elsewhere in this study. The treatment of depositors and general creditors is the focus of chapters 9 and 10, while larger bank failures and the policy issues they raise receive attention in Part II, Case Studies of Significant Bank Resolutions.

Resolution Strategies of the FDIC

At the beginning of the 1980s, the FDIC's procedures for resolving failed institutions were guided by provisions of the Banking Acts of 1933 and 1935 and the Federal Deposit Insurance Act of 1950. Under the Banking Act of 1933, the FDIC's sole means of paying depositors of a failed institution was through a "new bank," or Deposit

Insurance National Bank (DINB), a national bank of limited life and powers that was chartered without any capitalization. A DINB allowed for a failed bank to be liquidated in an orderly fashion, minimizing disruptions to local communities and financial services markets. The FDIC Board of Directors was empowered to issue capital stock of the DINB and offer it for sale, giving the first opportunity to purchase it to the shareholders of the failed bank. The Banking Act of 1935 authorized the FDIC to pay off depositors either directly or through an existing bank. It also gave the FDIC the authority to make loans, purchase assets, and provide guarantees to facilitate a merger or acquisition. The added flexibility provided by new resolution powers was considered essential at a time when many newly insured banks were thought to be at risk of failure.¹

The Federal Deposit Insurance Act of 1950 included an open bank assistance (OBA) provision, granting the FDIC the authority to provide assistance, through loans or the purchase of assets, to prevent the failure of an insured bank. A bank was eligible for OBA if the FDIC Board of Directors deemed the continued operation of the institution essential to the community in which it was located. Because of the essentiality requirement, the FDIC did not use OBA until 1971.² The FDIC's authority to provide open bank assistance was expanded by the Garn–St Germain Depository Institutions Act of 1982, which eliminated the essentiality test except in instances in which the cost of open assistance would exceed the estimated cost of liquidating the subject institution.³ The elimination of the essentiality test enabled the FDIC to use OBA more frequently in the 1980s.

At the beginning of the 1980s, the FDIC relied on two basic methods to resolve failing banks: the purchase and assumption transaction and the deposit payoff. When determining the appropriate method for resolving bank failures, the FDIC considered a variety of policy issues and objectives. Four primary issues were (1) to maintain public confidence and stability in the U.S. banking system, (2) to encourage market discipline to prevent excessive risk-taking, (3) to resolve failed banks in a cost-effective manner, and (4) to be equitable and consistent in employing resolution methods.⁴ Certain secondary objectives also existed, including the desire to minimize disruption to the community in which the failing bank is located and to minimize the FDIC's role in owning, financing, and managing financial institutions and assets. With passage of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) in 1991, which mandated

1. Federal Deposit Insurance Corporation, *Federal Deposit Insurance Corporation: The First Fifty Years* (Washington, D.C.: FDIC, 1984), 81.

2. FDIC, *The First Fifty Years*, 94.

3. The Garn–St Germain Act was comprehensive legislation that effected major changes in federal laws governing the activities of financial institutions. Among the many provisions of the act, two were drafted specifically to enhance the FDIC's failed bank resolution capabilities. The first provision dealt with open bank assistance, discussed above; the second authorized the Net Worth Certificate Program, described later in this chapter.

4. John F. Bovenzi and Maureen E. Muldoon, "Failure-Resolution Methods and Policy Considerations," *FDIC Banking Review* 3, no. 1 (fall 1990), 1.

the use of the transaction that resulted in the least cost to the FDIC, such policy objectives became secondary in choosing among alternative resolution methods.

Clean Bank Purchase and Assumption Transactions

In purchase and assumption transactions of the early 1980s, the acquiring bank, referred to as the “assuming bank” or “acquirer,” generally assumed all the failed bank’s deposit liabilities and certain secured liabilities. The acquirer also purchased certain assets and received financial assistance from the FDIC. The P&A agreement listed the assets purchased and specified the respective rights, obligations, and duties of the assuming bank and the receiver.

At that time, for two reasons, it was common for an acquirer to bid on and purchase a failing institution without performing due diligence. First, the FDIC wanted to maintain secrecy about impending failures to avoid costly deposit runs; it was concerned that allowing due diligence teams access to a failing bank’s premises would arouse fears about an imminent closing. Second, because only “clean” assets, such as cash and cash equivalents, were passed, due diligence was not required by bidders.⁵ Bidders would determine the value of the bank on the basis of their knowledge of the local community and on deposit information provided by examiners.

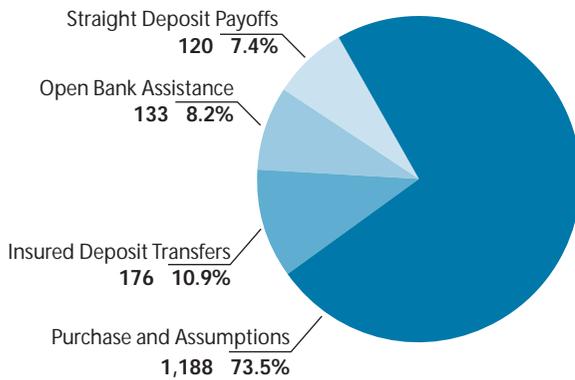
The FDIC generally did not sell loans to an acquiring institution at the time of resolution. Afterwards, though, loan officers of the acquirer often would review the borrower’s credit file and deposit relationships, pay off original notes, and draw up new loan documents to be executed by the borrower. Alternatively, to preserve the lender’s collateral position, the FDIC simply might assign notes to the acquirers. Thus, through those means, assuming banks could acquire large volumes of performing loans following resolution transactions. Nonperforming loans were not acquired by the assuming bank, even after completing the resolution transaction.

During the early 1980s, selling assets at the time of resolution, or immediately thereafter, was not a high priority for the FDIC for two reasons. First, because the frequency of bank failures was still relatively low, the FDIC was not burdened by a high volume of assets held in receivership. Second, from a supervisory viewpoint, the FDIC was not eager to place poor quality assets in the portfolios of acquiring banks. Later, as the number of failures increased and liquidity and workload pressures grew, the FDIC began to place more emphasis on selling assets as part of the initial resolution transaction. Numerous variations of P&A transactions would be developed over the course of the 1980s and early 1990s, most of which involved the treatment of a failed bank’s assets and the purchase of a failed bank’s loans from the FDIC. The P&A transaction

5. Cash equivalents included the bank securities portfolio. Banks generally purchased highly marketable, good-quality notes and bonds, usually either U.S. Government securities or issues from their local area (state, county, and municipal issues). The securities, if widely traded, were easily priced and would be sold to the acquirers on the basis of quotes from *The Wall Street Journal* or quotes obtained from several securities brokers.

Chart I.3-1

**Bank Failures by Resolution Method
1980–1994**



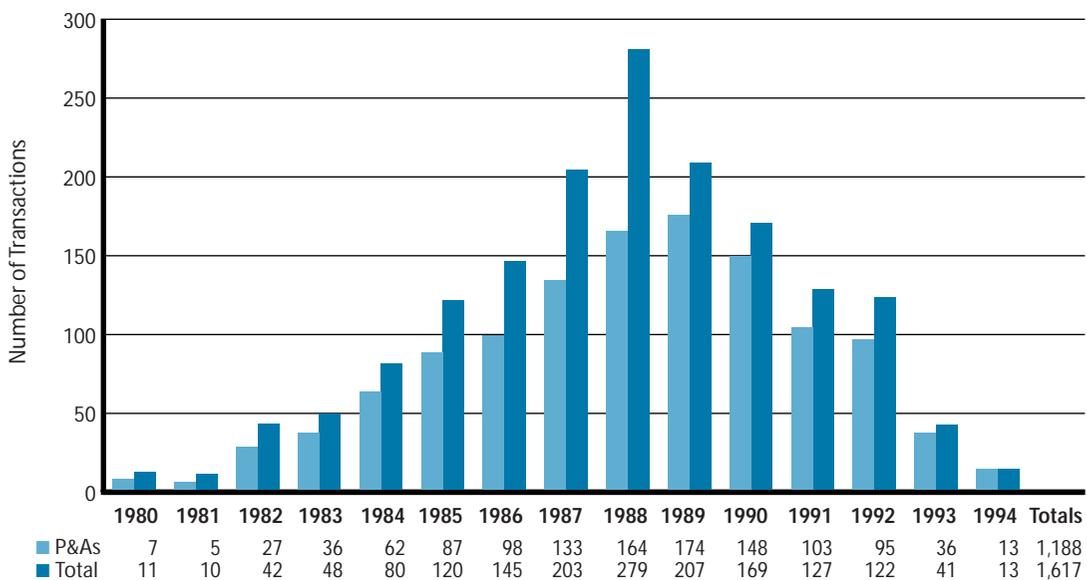
Total Bank Failures = 1,617

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

remained the dominant resolution method used by the FDIC through the 1980s and early 1990s. Of the 1,617 failing and failed institutions handled by the FDIC between 1980 and 1994, 1,188, or 73.5 percent, were handled through P&A transactions. (See charts I.3-1 and I.3-2.) Similarly, of the \$302.6 billion in assets and \$233.2 billion in deposits at those 1,617 institutions, \$204 billion of the assets, or 67.4 percent of the total, and \$161.3 billion of the deposits, or 69.2 percent of the total, were in the 1,188 institutions handled through P&A transactions. (See charts I.3-3 and I.3-4.)

Chart I.3-2

**Purchase and Assumption Transactions
Compared to All Failures and Assistance Transactions
1980–1994**



Source: FDIC Division of Research and Statistics.

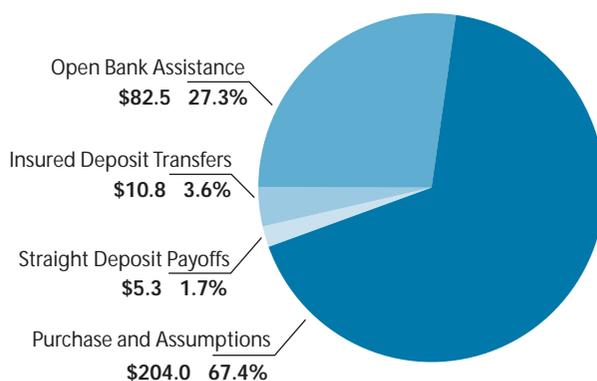
Deposit Payoffs

A deposit payoff was executed only if the FDIC did not receive a less costly bid for a P&A transaction. In a payoff, no liabilities are assumed, and no assets are purchased by another institution. The FDIC must pay, directly or through an agent, to depositors of the failed institution the amount of their insured deposits. The FDIC determines the amount in each depositor's account entitled to deposit insurance and pays that amount to the depositor. Early in the 1980s, a customer would collect a check in the amount of his deposit balance directly from an FDIC claim agent on the premises of the former bank. After that time, a customer would receive a check mailed by the FDIC within a few days after the institution's closing. In calculating the amount of each customer's check, the FDIC would include all the interest accrued under the contractual terms of the depositor's account through the date of closing.

The two main resolution methods used by the FDIC in the early 1980s, P&A transactions and deposit payoffs, differed in their effect on uninsured depositors. In a payoff, the FDIC did not cover that portion of a customer's deposits that exceeded the insured limit. The owners of uninsured claims were given receiver's certificates that entitled them to a share of collections from the receivership estate. The percentage of the claims they eventually received depended on the value of the bank's assets, the number of uninsured claims, and each claimant's relative position in the distribution of claims. In contrast, acquirers generally assumed all deposits in a P&A transaction, thereby providing 100 percent

Chart I.3-3

Failed Bank Assets by Resolution Method 1980–1994
(\$ in Billions)

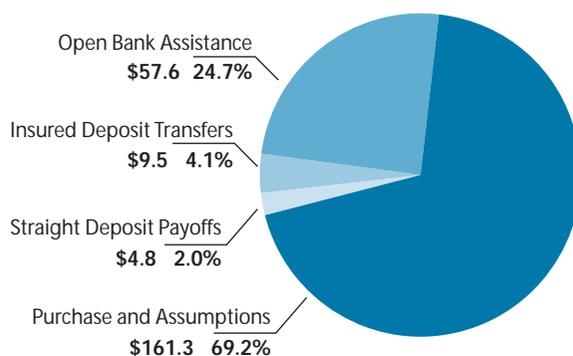


Total Failed Bank Assets = \$302.6

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

Chart I.3-4

Failed Bank Deposits by Resolution Method 1980–1994
(\$ in Billions)

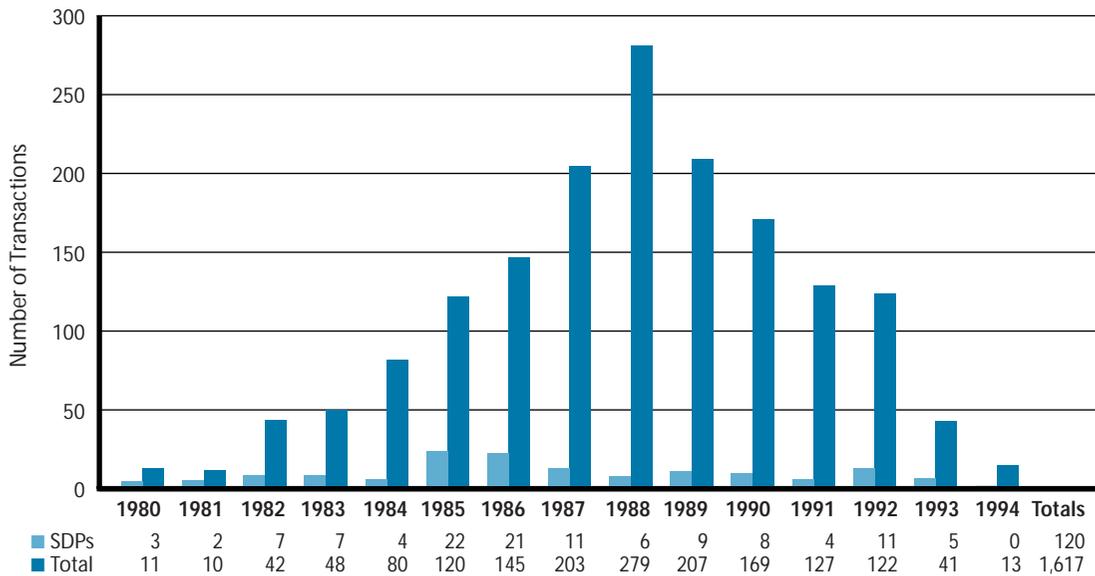


Total Failed Bank Deposits = \$233.2

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

Chart I.3-5

Straight Deposit Payoffs Compared to All Failures and Assistance Transactions 1980–1994



Source: FDIC Division of Research and Statistics.

protection to all depositors. In the two decades before the 1980s, most failing banks were resolved through P&As, and uninsured depositors rarely suffered losses, particularly after 1966, when the FDIC instituted a procedure for competitive bidding to effect P&A transactions. Bidding—in contrast to negotiated deals with individual acquirers—increased the likelihood that the FDIC would receive a premium for the failed bank that would reduce the cost of a P&A transaction relative to a payoff.

Of the 1,617 failing and failed institutions handled by the FDIC between 1980 and 1994, deposit payoffs were used only 296 times, or 18.3 percent of the total. Such payoffs sometimes involved the use of an agent institution to pay depositors for the FDIC, in which case they were called insured deposit transfers (IDTs). IDTs accounted for 176 of the 296 deposit payoffs, or 59.5 percent of the total. (See charts I.3-1 and I.3-8.) Deposit payoffs generally were used for smaller institutions. While 18.3 percent of the total number of transactions were deposit payoffs, only 5.3 percent of the assets and 6.1 percent of the deposits of the banks handled by the FDIC between 1980 and 1994 were in the institutions in which the FDIC used deposit payoffs. (See charts I.3-3 and I.3-4.)

In the instances in which the FDIC used deposit payoffs, it was subjected to criticism that its resolution policies were inconsistent and inequitable. Observers pointed out that uninsured depositors in large banks were less likely to suffer losses than those in

small banks because it was easier for the FDIC to arrange P&A transactions to resolve large failures.⁶ The P&A approach minimized disruption to local communities and to financial markets generally, but it appeared to provide unfair protection for uninsured deposits in larger institutions.

Deposit Insurance National Bank

The Banking Act of 1933 authorized the FDIC to form a new bank called a Deposit Insurance National Bank to pay off the insured depositors of an insured institution. After the Banking Act of 1935 granted the FDIC authority to pay off depositors directly or through an existing bank, DINBs were rarely used. Of the five DINBs created by the FDIC after 1935, the most well-known was established in 1982 to resolve Penn Square Bank, N.A. (Penn Square), a \$516.8 million institution located in Oklahoma City, Oklahoma. Before the Penn Square resolution, every bank failure involving assets greater than \$100 million had been handled through a P&A transaction. In the case of Penn Square, which was declared insolvent by the Office of the Comptroller of the Currency (OCC) on July 5, 1982 (a federal holiday), the FDIC decided that a P&A transaction was impractical. Although Penn Square was only a \$500 million institution, it had been able to convince some of the largest banks in the country to purchase more than \$2 billion in oil and gas loans that it had originated. Most of those loans were poorly documented, and collection in full was doubtful by the time of the bank failure. Because the accuracy of loan information provided by Penn Square to the participants was suspect, the FDIC expected the loans to spawn many lawsuits from participants seeking to recover part or all of their investments. That expectation, along with other factors, made it difficult for the FDIC to estimate the losses it could incur on the bank and to evaluate P&A bids for the institution. Given the circumstances, the FDIC decided to effect a payoff of the bank by using a DINB, thus limiting its maximum potential loss to the approximately \$250 million in insured deposits.

At closing, depositors with balances in excess of the insurance limit had their insured deposits transferred to the DINB, while the excess became a claim against the receivership. Receivers' certificates totaling \$459.1 million were issued to claimants, who eventually received around 70 percent of their claims from the net sale and liquidation proceeds of the failed bank's assets. The FDIC's resolution cost was \$65 million, which represented 12.6 percent of assets at the date of resolution.⁷

6. Before 1982, the largest bank failure handled through a payoff was the \$78.9 million Sharpstown State Bank in Houston, Texas, in 1971. See Irvine H. Sprague, *Bailout* (New York: Basic Books, 1986), 117.

7. See Part II, Case Studies of Significant Bank Resolutions, Chapter 3, Penn Square Bank, N.A.

New Resolution Alternatives

The sustained period of high and volatile interest rates, coupled with an erosion of traditional funding sources through disintermediation, had a serious effect on the capital levels and earnings of FDIC insured institutions. Mutual savings banks (MSBs) were particularly affected by rising interest rates because those institutions held large portfolios of long-term, fixed-rate mortgages. MSBs were chartered in 19 states, although 95 percent of the total deposits in MSBs were in 9 states: Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, and Washington.⁸ In 1975, there were about 450 MSBs compared to nearly 5,000 savings and loan associations and approximately 14,600 commercial banks. The average asset size of the MSBs was \$254 million compared to \$69 million for savings and loan associations and \$66 million for commercial banks.

By 1982, the MSBs were losing \$2 billion annually.⁹ In many instances, the market value of MSBs' assets fell to 25 to 30 percent below outstanding liabilities.¹⁰ The FDIC faced the possibility of incurring significant losses for a problem—high interest rates—that it thought was transitory. The FDIC's major concern was how to control the costs of resolving failing savings banks while avoiding raising the public's concern over the stability of savings banks in general.

Income Maintenance Agreements

One of the FDIC's primary strategies was to force weaker savings banks to merge into healthier banks or thrifts by guaranteeing a market rate of return on the acquired assets through an income maintenance agreement. The FDIC paid the acquirer the difference between the yield on acquired earning assets and the average cost of funds for savings banks, thereby assuming the interest rate risk. If interest rates declined to where the cost of funds was below the yield on earning assets, the acquirer was required to pay the FDIC. The FDIC entered into those agreements only if the resulting institution was viable.

Between 1981 and 1983, the FDIC used income maintenance agreements to resolve 11 of the assisted mergers of FDIC insured mutual savings banks. (See table I.3-1.) Because they were merged into operating institutions, those banks did not fail, and depositors and general creditors suffered no losses. In most cases, however, the failing bank's senior management was requested to resign, and subordinated noteholders received only a partial return of their investments. Because MSBs have no stockholders,

8. *National Fact Book of Mutual Savings Banking, 1980* (Washington, D.C.: National Association of Mutual Savings Banks), 17.

9. FDIC, *The First Fifty Years*, 99.

10. FDIC, *The First Fifty Years*, 99.

Table I.3-1

Income Maintenance Agreements

(\$ in Millions)

Date	Bank Name	Location	Assets	Acquirer	Comments
11/4/81	Greenwich Savings	New York, NY	\$2,475	Metropolitan S.B.* (Renamed CrossLand in 1984)	Failed in 1992
12/4/81	Central S.B.	New York, NY	910	Harlem S.B. (Renamed Apple Bank for Savings in 1983)	
12/18/81	Union Dime S.B.	New York, NY	1,453	Buffalo S.B. (Renamed Goldome Bank for Savings in 1984)	Failed in 1991
1/15/82	Western NY S.B.	Buffalo, NY	1,025	Buffalo S.B. (Renamed Goldome)	Failed in 1991
2/20/82	Farmers & Mechanics S.B.	Minneapolis, MN	1,002	Marquette National Bank	
3/11/82	Fidelity Mutual S.B.	Spokane, WA	703	First Interstate National Bank	
3/26/82	New York Bank for Savings	New York, NY	3,404	Buffalo S.B. (Renamed Goldome)	Failed in 1991
4/2/82	Western Savings Fund Society	Philadelphia, PA	2,126	Philadelphia Savings Fund Society (Renamed Meritor S.B.)	Failed in 1992
10/15/82	Mechanics Savings Bank	Elmira, NY	55	Syracuse Savings Bank	Failed in 1987
2/9/83	Dry Dock Savings Bank	New York, NY	2,452	Dollar S.B. (Renamed Dollar Dry Dock Savings Bank)	Failed in 1992
10/1/83	Auburn Savings Bank	Auburn, NY	133	Syracuse Savings Bank	Failed in 1987
Totals	11 Institutions		\$15,738		

* Savings Bank

Sources: FDIC annual reports, 1981 to 1993.

the FDIC did not have to concern itself with interests of existing stockholders. While the cost savings of the program are difficult to quantify, the Income Maintenance Agreement Program successfully provided the resulting merged institution with a safety net until the interest rate scenario became more favorable. Interestingly, as shown in the far right column of table I.3-1, 8 of the 11 merged institutions that were saved by income maintenance agreements in early 1980s eventually failed as a result of the real estate crisis of the late 1980s.

Net Worth Certificates

The FDIC developed another resolution strategy: the Net Worth Certificate Program (NWCP). The program's purpose was to buy time for savings banks to correct rate sensitivity imbalances and restore capital to acceptable levels. The Garn–St Germain Act of 1982 enabled any insured institutions that met statutory requirements to apply for capital assistance in the form of net worth certificates.

Under the program, institutions received promissory notes from the FDIC representing a portion of current period losses in exchange for certificates that were to be considered as part of the institution's capital for reporting and supervisory purposes. Although the Garn–St Germain Act did not prescribe a formula based on specific capital levels, the FDIC established a working formula to semi-annually purchase certificates equal to between 50 percent and 70 percent of the institution's net operating loss.

Originally, the FDIC provided assistance only to institutions with a positive level of capital. Later, it limited eligibility to institutions having a minimum capital ratio of 1.5 percent and established other requirements for participants. To be eligible, the FDIC required an institution to develop a business plan based on reasonable economic assumptions over reasonable time periods. Participating savings banks were prohibited from allowing insider trading and speculative management activity. To raise additional capital, if the need subsequently arose, the institutions also agreed to convert from mutual to stock form at the FDIC's request.

The Net Worth Certificate Program allowed solvent, well-managed institutions to survive until the results of restructured balance sheets produced profitable operations or until the banks could arrange unassisted mergers with stronger institutions. Of the 29 savings banks in the plan, 22 required no further assistance and eventually extinguished their net worth certificates. Seven savings banks required additional assistance from the FDIC; four repaid all assistance, and three merged into healthy institutions with FDIC assistance.¹¹ (See table I.3-2 for a list of the 29 institutions that were in the Net Worth Certificate Program. See charts I.3-6 and I.3-7 for the

11. Federal Deposit Insurance Corporation, Office of Research and Statistics, "Open Bank Assistance: A Study of Government Assistance to Troubled Banks from the RFC to the Present," (May 1990), 12.

number of institutions and volume of assets that were involved in the NWCP by year.)

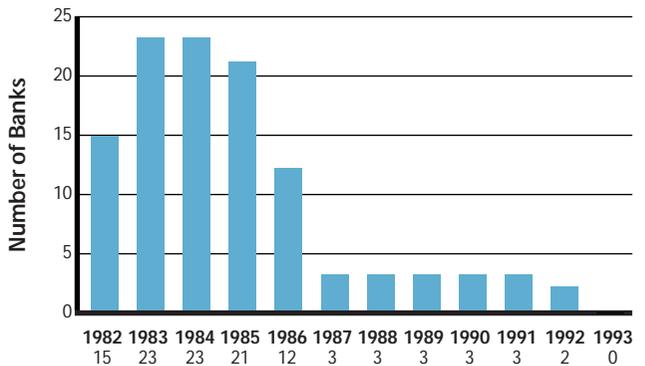
Insured Deposit Transfers

In 1983, the FDIC introduced a new type of transaction, the insured deposit transfer (IDT). In contrast to a straight deposit payoff, an IDT involves the transfer of insured deposits and secured liabilities of the failed bank to a healthy institution that agrees to act as the FDIC's agent. The agent bank makes available to the depositors of the failed bank a "transferred deposit" account, which the depositor may continue to maintain at the agent bank. Alternatively, the depositor may withdraw the balance and close the account. In an insured deposit transfer, the FDIC as receiver retains all the assets and the uninsured and unsecured liabilities of the failed institution. As part of the transaction, the FDIC makes a cash payment matching the amount of the transferred liabilities to the assuming bank. Often times, the bank acting as agent will use some of that cash to purchase some of the failed bank's assets from the FDIC. The IDT reduces the disruption caused by a deposit payoff to insured depositors and to the local community. It also reduces the FDIC's administrative costs in handling the failures because the agent bank acts as the paying agent for the FDIC and disburses insured funds to depositors.¹²

From 1983, when they were first used, through 1994, there were 176 insured deposit transfers. (See chart I.3-8.) With

Chart I.3-6

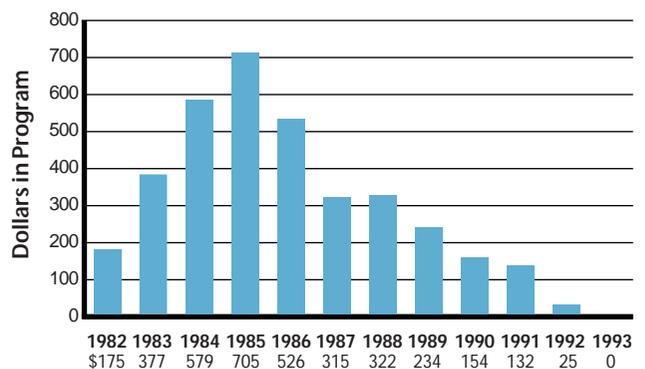
Number of Banks in Net Worth Certificate Program 1982-1993



Sources: FDIC annual reports 1982-1993.

Chart I.3-7

Dollars in Net Worth Certificate Program 1982-1993
(\$ in Millions)



Sources: FDIC annual reports 1982-1993.

12. FDIC, 1983 Annual Report, 12.

Table I.3-2

Net Worth Certificate Program

(\$ in Millions)

Bank Name	Location	Assets at Entry	Certificates (Max. Held)	Date Retired
Auburn Savings Bank*	Auburn, NY	\$125.6	\$1.6	Retained by Syracuse S.B. in 1983–Assisted Merger
Beneficial Mutual	Philadelphia, PA	1,628.7	18.9	1991
Bowery Savings Bank*	New York, NY	4,999.4	220.1	1992
Cayuga County Savings Bank	Auburn, NY	190.0	.8	1986
Colonial Mutual Savings Bank	Philadelphia, PA	70.7	.8	1984–Acquired
Dime Savings Bank of NY, FSB	New York, NY	6,393.7	72.1	1986
Dime S.B. of Williamsburgh	New York, NY	573.8	3.6	1987
Dollar Dry Dock Savings Bank†	New York, NY	4,972.8	41.3	1986
Dry Dock Savings Bank*	New York, NY			See Dollar Dry Dock S.B.‡
East River Savings Bank, FSB	New York, NY	1,777.5	26.4	1987
Eastern Savings Bank	New York, NY	786.0	13.7	1986–Merger
Elizabeth Savings Bank	Elizabeth, NJ	31.7	.3	1983–Merger
Emigrant Savings Bank	New York, NY	2,968.5	90.0	1991
Greater New York Savings Bank	New York, NY	1,816.8	23.1	1987
Home Savings Bank	White Plains, NY	427.4	5.6	1986–Assisted Merger
Inter-County Savings Bank	New Paltz, NY	123.4	1.6	1986
Lincoln Savings Bank, FSB	New York, NY	2,090.3	65.9	1987
National S.B. of the City of Albany	Albany, NY	391.2	1.1	1985

Table I.3-2

Net Worth Certificate Program

(\$ in Millions)

Continued

Bank Name	Location	Assets at Entry	Certificates (Max. Held)	Date Retired
Niagara County Savings Bank	Niagara Falls, NY	291.9	.4	1986–Merger
Orange Savings Bank	Livingston, NJ	531.1	3.5	1984–Assisted Merger
Oregon Mutual Savings Bank	Portland, OR	260.0	1.5	1983–Assisted Merger
Rochester Community Savings Bank	Rochester, NY	1,371.3	5.0	1986
Roosevelt Savings Bank	New York, NY	858.9	5.8	1986
Sag Harbor Savings Bank	Sag Harbor, NY	203.6	1.4	1987
Savings Fund Society of Germantown	Bala Cynwyd, PA	1,373.1	17.8	1987
Seamen's Savings Bank, FSB†	New York, NY	1,825.5	31.3	1986
Skaneateles Savings Bank	Skaneateles, NY	136.1	.5	1986
Syracuse Savings Bank*	Syracuse, NY	1,180.5	See Auburn S.B.§	1987–Assisted Merger
Williamsburgh Savings Bank	New York, NY	2,215.1	64.0	1987–Merger
Totals	29 Institutions	\$39,614.6	\$718.1	

* Failed or assisted while in Net Worth Certificate Program (NWCP).

† Failed after NWCP participation.

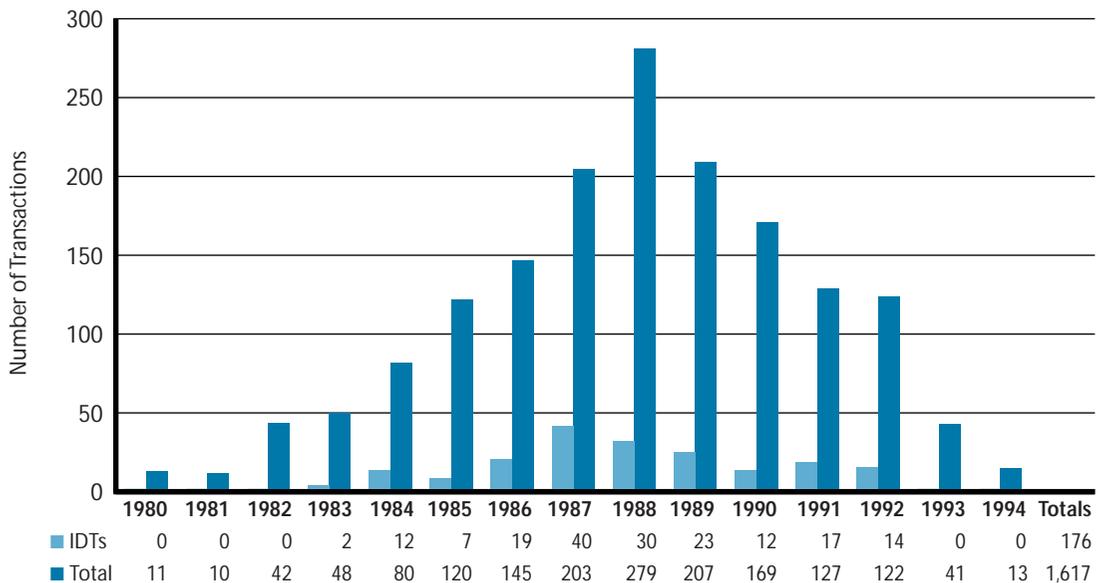
‡ Certificates issued to Dry Dock S.B. were retained when acquired by Dollar S.B. Subsequently, Dollar Dry Dock acquired additional certificates.

§ Certificates issued to Auburn S.B. were retained when acquired by Syracuse S.B. Syracuse S.B. failed in 1987.

Source: FDIC, "The Mutual Savings Bank Crises," *History of the Eighties—Lessons for the Future: An Examination of the Banking Crises of the 1980s and Early 1990s* (Washington, D.C.: Federal Deposit Insurance Corporation, 1997).

Chart I.3-8

Insured Deposit Transfers Compared to All Failures and Assistance Transactions 1980–1994



Source: FDIC Division of Research and Statistics.

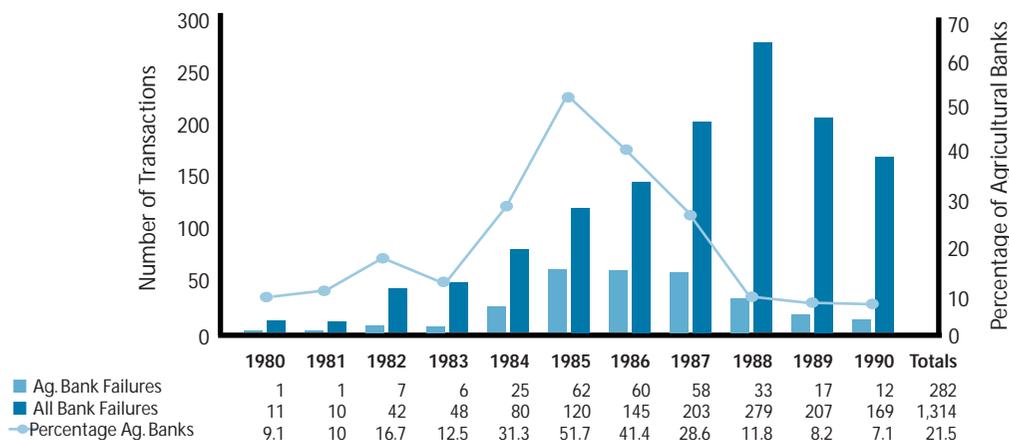
deposits totaling \$9.5 billion, the failed banks for which the FDIC used IDTs were relatively small, representing only 4 percent of the total deposits of banks that failed from 1980 to 1994. (See chart I.3-4.)

The FDIC also developed a variation of the insured deposit transfer in which uninsured depositors were issued an advance dividend based on a conservative estimate of the recovery value of the failed bank's assets.¹³ That type of transaction, known as a modified payoff, provided uninsured depositors with greater liquidity without eliminating the need for them to exercise market discipline before making deposits in an institution with higher risks.

13. An advance dividend is a payment made to uninsured depositors immediately after a bank fails; it is based on the estimated value of the receivership's assets.

Chart I.3-9

**Agricultural Bank Failures versus All Bank Failures
1980–1990**



Source: FDIC, Chapter 8, "Banking and Agricultural Problems of the 1980s," *History of the Eighties—Lessons for the Future: An Examination of the Banking Crises of the 1980s and Early 1990s* (Washington, D.C.: Federal Deposit Insurance Corporation, 1997).

Resolution Responses to Bank Failures from 1984 to 1986

Banks with a concentration of assets, mainly loans, in the energy and agricultural sectors began appearing on the FDIC’s problem bank list in 1982 and were being resolved by 1984. Agricultural and energy banks were defined as banks having 25 percent or more of their loans in agricultural or energy loans. A total of 345 banks, most with deposits of \$30 million or less, either failed or received FDIC assistance between 1984 and 1986. Of that total, 147, or 42.6 percent, were agricultural banks.¹⁴ (See chart I.3-9.)

“Put” Options

Another approach the FDIC took in responding to the new wave of bank failures was the modification of its treatment of assets under the P&A transaction. In earlier years, the FDIC passed a limited portion of the failed bank’s assets to an acquiring institution. Generally, only cash, federal funds sold, and securities were passed to the acquirer. As the number of bank failures increased, however, the FDIC began to consider methods and incentives for passing more of the failed bank’s assets to the acquirer.

14. No records could be found that would indicate the number of energy banks that failed during this period.

To a certain extent acquirers were willing to take more assets, but not necessarily as many as the FDIC would have liked, given the sudden increase in the number of bank failures. To induce an acquirer to purchase additional assets, the FDIC would offer a “put” option on certain assets that were transferred. Two option programs for purchasing assets that the FDIC typically offered to acquirers in clean bank transactions were the “A Option,” which passed all assets to the acquirer and gave them either 30 or 60 days to put back those assets they did not wish to keep, and the “B Option,” which gave the acquirer 30 or 60 days to select desired assets from the receivership. The number of days offered under each option depended on the complexity of the asset portfolio. Structural problems existed, however, with both of the option programs, because an acquirer was able to “cherry pick” the assets, choosing only those with market values above book values or assets having little risk while returning all other assets. Also, acquirers tended to neglect assets during the put period before returning them to the FDIC, which adversely affected their value.

In late 1991, the FDIC discontinued the put structure as a resolution method and replaced it with the loss sharing structure and loan pool structure. During the mid-1980s, however, the put option was seen as a way to preserve the liquidity of the insurance fund by passing more assets to acquirers, thus lowering the amount of cash payments to assuming banks.

Forbearance Programs

A resolution strategy the FDIC used was forbearance, which exempted certain distressed institutions that had been operating in a safe and sound manner from capital requirements. The first formal forbearance program was the Net Worth Certificate Program, established in 1982. Under the Garn–St Germain Act, insured institutions could apply for capital assistance in the form of net worth certificates. Under the program, institutions received FDIC promissory notes representing a portion (between 50 percent and 70 percent) of current period operating losses in exchange for certificates that were considered part of regulatory capital. A total of 29 savings banks participated in the program, of which 22 required no further assistance and 7 required additional assistance. Of the 29, 26 eventually repaid all assistance and the remaining 3 merged into healthy institutions. The Net Worth Certificate Program is described in more detail earlier in this chapter.

Forbearance also was used in March 1986 when federal regulators issued a joint policy allowing the temporary Capital Forbearance Program for agricultural banks and banks with a concentration of energy credits. The program was directed at well-managed, economically sound institutions with concentrations of 25 percent or more of their loan portfolios in agricultural or energy loans. Eligible banks were required to have a capital ratio of at least 4 percent, and their weakened capital position had to be a result of external problems in the economy and not a result of mismanagement, excessive operating expenses, or excessive dividends. Ultimately, a total of 301 agricultural and energy

Table I.3-3

Results of the Capital Forbearance Programs* Agricultural and Energy Sector Banks

	Regulatory Joint Policy	CEBA Loan Loss Amortization
Number of Banks in Program	301	33
Assets (\$ in Billions)	\$13.0	\$0.5
Avg. Size of Bank (\$ in Millions)	\$43.2	\$15.2
Number of Banks that Survived†	236	29
Number of Banks that Failed	65	4

* Banks that participated in both programs are included only in the regulators' program.

† Banks that left programs as independent institutions or were merged without assistance.

Source: FDIC Division of Research and Statistics.

sector institutions with assets of approximately \$13 billion participated in the regulatory forbearance program. Overall, the capital ratio and return on assets of the banks improved by year-end 1989, a trend that mirrored improving economic conditions in the agricultural and energy markets. However, 65 of the banks in the regulatory forbearance program subsequently failed.

In 1987, Congress provided additional relief to agricultural lenders by permitting banks serving predominantly agricultural customers to defer accounting recognition of agricultural-related loan losses. The Loan Loss Amortization Program, adopted as part of the Competitive Equality Banking Act (CEBA) of 1987, allowed banks to amortize those losses over a seven-year period. Only institutions with less than \$100 million in total assets and with at least 25 percent of their total loans in qualified agricultural credits were eligible for the program. Qualified institutions were judged to be economically viable and fundamentally sound, except for needing additional capital to carry the weak agricultural credits. Congress's intent with the agricultural Loan Loss Amortization Program was to allow "fundamentally sound banks to weather (the current) storm."¹⁵ A total of 33 banks participated in the program. Of those, 27 had survived as independent institutions a year after leaving it, while 2 merged and 4 failed.

See table I.3-3 for a summary of the regulatory and legislative forbearance programs.

15. *Congressional Record*, 100th Congress, 2d sess., March 26, 1987, S.3941.

Open Bank Assistance

The failure of Penn Square in 1982 caused wide-ranging repercussions throughout the banking industry. The most serious result was the subsequent resolution of Continental Illinois National Bank and Trust Company (Continental), Chicago, Illinois, in 1984. In the years preceding its insolvency, Continental had followed a high-risk expansion strategy based on the rapid growth of its loan portfolio funded by volatile, short-term liabilities. The bank developed extensive international operations; established divisions to render specialized services to the bank's oil, utility, and finance company customers; and developed a separate real estate department to make commercial and home loans. At its peak in 1981, Continental was the largest commercial and industrial lender in the United States. As of March 31, 1984, shortly before its resolution, the bank held approximately \$40 billion in assets.

Because of the many energy loan participations Continental had purchased from Penn Square, the Oklahoma City institution's failure had a disastrous effect on Continental. The participation loans contributed significantly to the more than \$5.1 billion in nonperforming loans held by Continental as of year-end 1982. Following the shock of Penn Square, management was unable to reverse the adverse asset quality and income trends, and confidence in Continental was severely shaken. As a result, a rapid and massive electronic deposit run began in May 1984.

The FDIC decided that a payoff of Continental could cause panic in the financial and banking markets. Irvine Sprague, a former chairman of the FDIC who was a member of the FDIC's Board of Directors at that time, wrote about Continental:

Insured deposits were then estimated at about \$4 billion, barely 10 percent of the bank's funding base. At first glance, a payoff might have seemed a temptingly cheap and quick solution. The problem was there was no way to project how many other institutions would fail or how weakened the nation's entire banking system might become. Best estimates of our staff. . . were that more than two thousand correspondent banks were depositors in Continental and some number—we talked of fifty to two hundred—might be threatened or brought down. . . . The only things that seemed clear were not only that the long-term cost of allowing Continental to fail could not be calculated, but also that it might be so much as to threaten the FDIC fund itself.¹⁶

As part of the FDIC's initial response to the crisis, and in a significant departure from its approach to failed bank resolutions, the FDIC announced that all depositors, both insured and uninsured, would be protected in any subsequent resolution of Continental. The open bank assistance transaction that ultimately was used to resolve Continental sparked a policy debate about whether certain banks were truly "too big to

16. Irvine H. Sprague, *Bailout* (New York: Basic Books, 1986), 155.

fail” and whether they were deserving of special treatment not available to smaller institutions.¹⁷

While the term “open bank assistance” gained national recognition with the Continental transaction, the FDIC has been authorized to provide OBA since 1950.¹⁸ Since the Continental transaction, OBA has been transformed by the legislative process and public policy.¹⁹ Open bank assistance occurred when a distressed financial institution remained open with government financial assistance.²⁰ 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. The FDIC also had used OBA to facilitate the acquisition of a failing bank or thrift by a healthy institution and provided financial help in the form of loans, contributions, deposits, asset purchases, or the assumption of liabilities. Generally, the majority of a failing institution's assets remained intact. Because minimizing cost to the insurance fund is the ultimate goal, the FDIC structured OBA in several ways. Major critics of OBA, however, claimed that shareholders of failing institutions benefited from government assistance, even though most of the OBA transactions required the shareholders of the failing institutions to significantly dilute their ownership interests.

The FDIC's authority to provide open bank assistance has changed over time because of legislative and policy concerns; authority was broadened in the 1980s and then restricted in the 1990s. Since passage of FDICIA, before the FDIC could provide OBA, it had to establish that the assistance was the least costly to the insurance fund of all possible methods for resolving the institution. The FDIC could deviate from the least cost requirement only to avoid systemic risk to the banking system. The appropriate federal banking agency or the FDIC also had to determine that the institution's management was competent; had complied with all applicable laws, rules, and supervisory directives and orders; and had never engaged in any insider dealings, speculative practices, or other abusive activities. Finally, the FDIC could not use insurance funds to benefit shareholders of the failing institution.

From 1980 through 1994, the FDIC provided OBA to 133 institutions out of 1,617 total failures and assistance transactions, or about 8 percent of the total. (See chart I.3-10.) Nearly 75 percent of all OBA transactions were completed in 1987 and 1988. Beginning with 1989, the FDIC moved away from providing OBA and entered into only seven OBA transactions from 1989 to 1992. There have been no OBA transactions to date since 1992.

17. See Part II, Case Studies of Significant Bank Resolutions, Chapter 4, Continental Illinois National Bank and Trust Company.

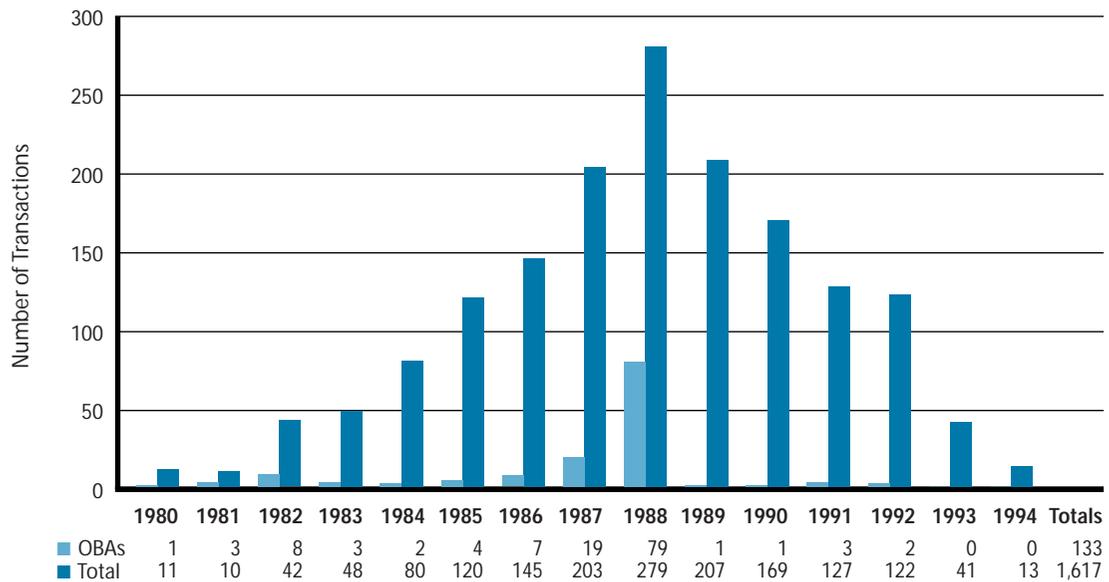
18. Federal Deposit Insurance Act of 1950, *U.S. Code*, volume 12, section 1823(c)(1).

19. See Chapter 5, Open Bank Assistance, for additional information on the FDIC's use of OBA.

20. Several types of “assistance to open banks” include forms of cash and non-cash assistance. To the FDIC, the term “open bank assistance” refers specifically to a resolution method whereby the FDIC gives financial assistance to a troubled bank or thrift to prevent its failure.

Chart I.3-10

Open Bank Assistance Transactions Compared to All Failures and Assistance Transactions 1980–1994



Source: FDIC Division of Research and Statistics.

The Banking Crisis in the Southwest

Between 1987 and 1989, a total of 689 banks either failed or required FDIC assistance. Approximately 71 percent of those failures were in Texas, Oklahoma, and Louisiana, with the majority of the failures in Texas. By 1988, 9 of the 10 largest banking entities in that state required FDIC resolution. The concentration of failures in the Southwest that occurred in the late 1980s has been attributed to several factors.²¹ The first was the volatility of oil prices, which rose sharply between 1973 and 1981, declined moderately between 1981 and 1985, and then fell 45 percent in 1986. The second factor was the explosive growth in real estate development that led to a greater than 25 percent office vacancy rate in Texas's major metropolitan areas between 1986 and 1989. The third factor was the change in composition of commercial banks' loan portfolios. Concentrations in relatively high-risk loans such as land development and commercial and industrial

21. John O'Keefe, "The Texas Banking Crisis: Causes and Consequences, 1980-1989," *FDIC Banking Review* 3, no. 3 (winter 1990), 2, 3.

Table I.3-4

Bank Failures in the Southwest 1980–1994

Year	Total Bank Failures	Bank Failures in the Southwest*	Bank Failures in the Southwest as a Percentage of Total Bank Failures
1980	11	0	0
1981	10	0	0
1982	42	13	31
1983	48	5	10
1984	80	14	18
1985	120	29	24
1986	145	54	37
1987	203	110	54
1988	279	214	77
1989	207	167	81
1990	169	120	71
1991	127	41	32
1992	122	36	30
1993	41	10	24
1994	13	0	0
Totals	1,617	813	50

* The Southwest as defined here includes Arkansas, Louisiana, New Mexico, Oklahoma, and Texas.
Source: FDIC Division of Research and Statistics.

loans increased through the mid-1980s, exposing banks to the effects of falling land prices and diminishing cash flows of borrowers. A fourth factor was the infrequency of bank examinations in the mid-1980s. (See table I.3-4.)

The Southwest banking crisis was qualitatively different from the interest rate driven crisis of the early 1980s. In the earlier crisis, many failing banks actually had high-quality loan portfolios and took advantage of regulatory forbearance to ride out temporarily adverse economic conditions. Forbearance was not a viable option in the new crisis. The FDIC was faced with large numbers of failing banks with high levels of nonperforming real estate loans that demanded quick action. In response to that situation, the FDIC began using two new resolution methods: the bridge bank and the whole bank purchase and assumption transaction. Both methods allowed assets to

remain in private sector hands and minimized the FDIC's cash outlays required to consummate failing bank resolutions.

Bridge Banks

The Competitive Equality Banking Act of 1987 authorized the FDIC to create bridge banks to resolve failing institutions. A bridge bank is a full-service national bank chartered by the Office of the Comptroller of the Currency and controlled by the FDIC. Initially, a bridge bank was operated for two years, with a one-year extension, which later was amended by the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 to provide three one-year extensions. Bridge banks, which provide the FDIC time to arrange a permanent transaction, are especially useful in situations in which the failing bank is large or unusually complex. In general, the FDIC may establish a bridge bank if the board of directors determines it to be cost effective; that is, establishment of a bridge bank 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, 1988, when Louisiana banking authorities closed Capital Bank and Trust Company in Baton Rouge.

A bridge bank may be resolved through a purchase and assumption transaction (the most common method), a merger, or a stock sale. Of the 32 bridge banks resolved, all but 2 were short term, lasting seven months or less. The two long-term bridge banks established to resolve the First RepublicBanks and the MCorp banks technically were resolved within seven months (transactions with acquirers were consummated), but their status as bridge banks lasted beyond the resolution date because the FDIC owned stock in the bridge banks. Bridge bank status terminated when the acquirer bought the FDIC's interest and obtained a regular national bank charter. The change in status occurred after approximately thirteen months with the First RepublicBanks and two-and-one-half years with the MCorp banks.

Preference for Passing Assets

In the 1980s, the FDIC was able to select any available resolution method, as long as the method chosen was less than the estimated cost of paying off the depositors and liquidating the failed bank's assets.²² As the banking crisis became more acute in the second half of the decade, the FDIC tended to choose transactions that allowed a large proportion of a failing bank's assets to pass to the acquirer. That preference was exercised for a variety of reasons.

22. The FDIC developed its cost test in 1951 in response to congressional criticism of the FDIC's preference for facilitating deposit assumptions for failing banks over payoffs. Assumptions resulted in de facto deposit insurance of all depositors, whereas payoffs protected only insured depositors. The cost test was subsequently used to determine whether an assumption (or other transaction) would be cheaper than a payoff.

First, the FDIC became concerned that the accumulation of assets would have a disastrous effect on the insurance fund. Former Chairman L. William Seidman, noting that before this time, emphasis had not been placed on the sale of assets at resolution, wrote:

This was not a serious problem in an agency with very few failed banks, and when the FDIC insurance fund had lots of cash . . . But it could be disastrous as the number of bank failures increased . . . The strategy of holding on to assets would swallow up all our cash very quickly . . . Cash had never been a problem at the FDIC, with billions in premium income on deposit at the Treasury. But my calculations showed that on the basis of the way we were doing things, if you took the FDIC forecast of bank failures from 1985 to 1990, our cash reserve of \$16 billion would be wiped out well before the end of the decade.²³

Second, although there is no empirical evidence, it was generally believed that after an asset from a failing bank was transferred to a receivership, the asset would suffer a loss in value.²⁴ Loans have unique characteristics, and prospective purchasers need to gather information about the loans to properly evaluate them. Such "information cost" is factored into the price that the outside parties are willing to pay for the loans. That cost tends to be greater on assets from failed banks. In addition, a loss in value can occur because of the break in the bank-customer relationship. When a customer values a banking relationship, the customer is willing to work with the bank. However, when a customer merely has an obligation to pay and anticipates no continuance of a business relationship, that customer may not be as willing to pay his debt in full.

Third, as the FDIC began having to manage an extremely large portfolio of failed bank assets caused by the growing number of bank failures in the late 1980s, several logistical problems began to develop, and it therefore became more desirable to pass assets to acquirers rather than incur the added costs of acquiring, maintaining, and subsequently remarketing those assets.

Fourth, the FDIC simply considered it more appropriate for private assets to remain within the private marketplace.

Finally, the FDIC saw the sale of higher percentages of assets at resolution as a way to minimize disruption in the communities in which failing banks were located.

Whole Bank Transactions

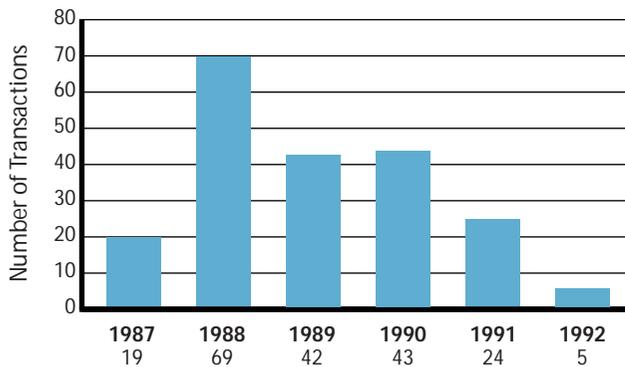
The whole bank purchase and assumption transaction is a variation of the P&A transaction, distinguished by the fact that virtually all the failed bank's assets are passed to the

23. L. William Seidman, *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas* (New York: Times Books, 1993), 100.

24. This loss of value is known as the "liquidation differential." Frederick S. Carns and Lynn A. Nejezchleb, "Bank Failure Resolution: The Cost Test and the Entry and Exit of Resources in the Banking Industry," *The FDIC Banking Review* 5 (fall/winter 1992), 1-14.

Chart I.3-11

Number of Whole Bank Transactions 1987–1992



Source: FDIC Division of Resolutions and Receiverships.

acquirer with the institution's liabilities for a one-time cash payment. Whole bank transactions represent the most dramatic attempt by the FDIC to pass assets from failed banks quickly back into the private sector. Whole bank transactions were perceived to offer certain important advantages over other methods of transactions. Because loan customers of the failed institution continued to be serviced by an ongoing bank, the effect on the local community was minimized. In addition, whole bank transactions slowed the growth in the volume of assets held by the FDIC for liquidation. Starting in 1987, when the FDIC implemented 19 whole bank transactions, the whole bank P&A joined the clean bank P&A, the insured deposit transfer, and the straight deposit

payoff as the FDIC's standard methods for resolving failures. In 1988, 69 of the 279 failed bank resolutions were whole bank transactions. Whole bank transactions were also widely used in 1989, 1990, and 1991, when they constituted 20.3, 25.4, and 18.9 percent of all resolutions, respectively.²⁵ With the introduction of the least cost test, however, the number of successful whole bank bids declined. Because a whole bank bid constitutes a one-time payment from the FDIC, bidders tended to bid very conservatively to cover all potential losses. Conservative whole bank bids could not compete with other transactions on a least cost basis. Overall, the FDIC completed 202 whole bank transactions between 1987 and 1992, or 18.2 percent of the total number of transactions during that period. (See chart I.3-11.) The failed banks handled as whole bank transactions had \$8.2 billion in total assets.

Whole bank bids were almost always offered on an all-deposit basis, requiring any winning bidder to agree to assume both the insured and the uninsured deposits.

Other Variations of Transaction Structures

Other variations of P&A transactions existed between the clean bank P&A that passed few assets to the acquirer and the whole bank P&A that passed virtually all assets. The modified P&A required the winning bidder to purchase the cash and securities, and usually the installment loans as well as all or a portion of the mortgage loan portfolio.

25. FDIC Division of Finance.

Occasionally, multi-family loans also were included. Typically, between 25 percent and 50 percent of the failed bank's assets were purchased under a modified P&A structure. The loan purchase P&A required the winning bidder to assume a smaller portion of the loan portfolio, usually just the installment loans, in addition to the cash and securities. Typically, a loan purchase P&A transaction would pass between 10 and 25 percent of the failed bank assets. With each of those variations, deposits were treated the same during the 1980s; all of them were protected and passed to the acquirer.

Sequential Bidding

The FDIC's preference for passing assets to acquirers was made corporate policy formally on December 30, 1986.²⁶ The FDIC Board of Directors established an order of priority for six alternative transaction methods on the basis of the amount of assets passed to the acquirer.²⁷

In accordance with the transaction hierarchy established by the board, whole bank purchase and assumption bids were considered first. If any whole bank bids were received that passed the cost test, the remaining bids were not considered and the most cost-effective whole bank P&A bid was selected as the winner. If no whole bank bids were received or passed the cost test, the remaining transactions were considered in the preferential order. When evaluating P&A bids, the FDIC gave priority to those transactions through which the highest volume of assets could be sold. Thus, modified P&As took priority over loan purchase P&As, and loan purchase P&As took priority over clean bank P&As. If any P&A bids passed the cost test, the best P&A bid was selected as the winning bid. If no P&A bids were received or passed the cost test, all the acquirers originally asked to bid would be contacted again and asked to submit a whole bank deposit insurance transfer and asset purchase bid. If none of the preferential transactions were acceptable, the FDIC would make a direct payoff to the insured depositors and liquidate the assets of the failed bank.

The sequential bidding procedures employed by the FDIC accomplished what it set out to achieve: transfer assets back to the private sector and preserve the FDIC's liquidity. By determining the priority order of transactions according to the amount of assets purchased by the assuming institution, the FDIC clearly maximized its transfer of assets to the private sector, reducing its cash outlays and preserving liquidity. That action likely came at the expense of somewhat higher overall resolution costs

26. The policy was called the Robinson Resolution (named after Hoyle Robinson, Executive Secretary of the FDIC from May 7, 1979, to January 3, 1994). The resolution provided delegations to FDIC staff that allowed prioritizing the types of resolutions to be considered. The Robinson Resolution was revised and reissued in July 1992 and May 1997 to reflect the changes mandated by FDICIA.

27. The six transaction types named were, in order of preference, whole bank purchase and assumption, whole bank deposit insurance transfer and asset purchase, purchase and assumption, deposit insurance transfer and asset purchase, deposit insurance transfer, and straight deposit payoff.

than otherwise would have been the result had bidders been able to choose simultaneously from a wider range of bidding options. By 1991 the FDIC abandoned sequential bidding. Indeed, it could no longer have been used even if viewed as desirable given FDICIA and its least cost test.

End of the Nationwide Real Estate Boom

The Tax Reform Act of 1986 removed the favorable tax treatment afforded investments in real estate. Commercial real estate markets throughout the country had been overbuilt in the boom period of the 1980s, resulting in high vacancy rates and falling property values. For those reasons, new construction came to a standstill as the U.S. entered the 1990-91 recession. Banks that had lent heavily in the real estate sector experienced a sharp decline in the credit quality of their loan portfolios. As the 1980s came to a close, the Southwest banking crisis was being eclipsed by severe problems elsewhere, particularly in the Northeast.²⁸ To illustrate, bank failures in Louisiana (an oil patch state) decreased from 21 in 1989 to 5 in 1991, while bank failures in Massachusetts rose from 1 in 1989 to 14 in 1991. Following the pattern set by the Southwest in the 1980s, the regional economy in the Northeast expanded in the 1980s, with many financial institutions growing rapidly through increased lending (particularly in commercial real estate) and/or acquisitions. The subsequent collapse in real estate prices, combined with a regional recession during the late 1980s and early 1990s, led to the failure of many banks in the Northeast.²⁹ Between January 1, 1990, and December 31, 1992, 111 FDIC insured banks with approximately \$83 billion in assets failed in the Northeast. Those failures represented approximately 27 percent of the total number of bank failures, but more significantly, 67 percent of the total assets of failed banks for those years. Losses from northeastern bank failures totaled \$9.6 billion, or 76 percent of total FDIC failure resolution costs. In 1991 alone, 52 Northeast banks with assets of \$48.5 billion (78 percent of total failed bank assets) failed, with a cost to the FDIC of \$5.5 billion (91 percent of total FDIC failure resolution costs). (See chart I.3-12 for a comparison of the number of bank failures in the Northeast and Southwest.)

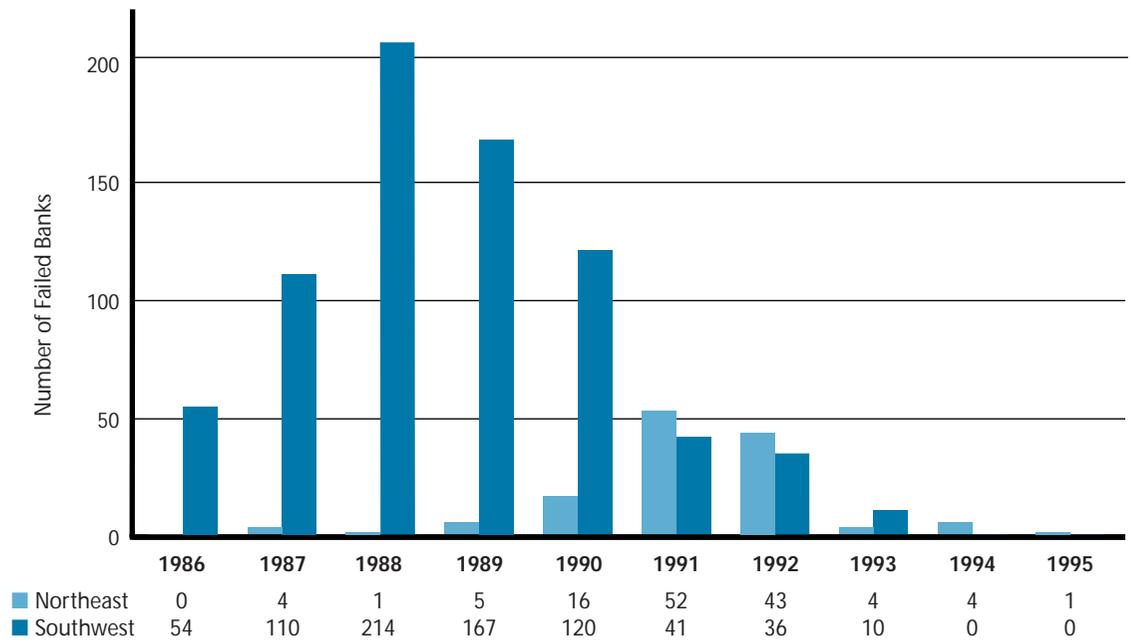
The geographic distribution of bank failures was not the only aspect of the banking crisis that was changing. The volume of assets held by institutions that failed in 1991 totaled \$62.5 billion, a fourfold increase over the 1990 total of \$15.7 billion.

28. The Northeast region as defined here includes the six New England states (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont) plus New Jersey and New York.

29. For more information, see Chapter 10, "Banking Problems in the Northeast," *History of the Eighties—Lessons for the Future: An Examination of the Banking Crises of the 1980s and Early 1990s* (Washington, D.C.: Federal Deposit Insurance Corporation, 1997).

Chart I.3-12

Comparison of Bank Failures in the Northeast and Southwest 1986–1995



Source: FDIC Division of Finance, *Failed Bank Cost Analysis, 1986–1995*.

Furthermore, the total assets of banks on the FDIC's problem bank list at year-end 1991 were \$609.8 billion, a sharp increase over the \$408.8 billion at the previous year end.³⁰

The heavy losses sustained by the banking industry as a result of the widespread real estate problems had a direct influence on the FDIC insurance fund. At year-end 1990, the insurance fund declined to \$4.0 billion. In 1991, for the first time in history, the insurance fund technically dropped below zero, to a negative \$7.0 billion, as the FDIC booked \$16.3 billion of reserves in anticipation of possible future bank failures. Actual cash on hand was \$9.3 billion.

Legislative Responses to the Crisis

In 1989 and 1991, Congress passed two major pieces of legislation in response to the bank crisis: the Financial Institutions Reform, Recovery, and Enforcement Act and the Federal Deposit Insurance Corporation Improvement Act.

30. FDIC, *1991 Annual Report*, 15.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989

While most provisions of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 addressed the savings and loan crisis, the law also addressed losses incurred by the FDIC insurance fund in situations in which an affiliated institution within a multi-bank holding company failed. In 1989, FIRREA added section 5(e) to the Federal Deposit Insurance Act. Section 5(e) was designed to prevent affiliated banks from shifting assets and liabilities in anticipation of 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 law provided for "cross guarantees" to be established among affiliated institutions: The FDIC was empowered to apportion loss among all the banks within the affiliated group in the event that one or more of the related institutions failed. The failure of the MCorp banks, Dallas, Texas, in particular, precipitated the cross guarantee statute. In the resolution of MCorp in March 1989, the holding company refused to agree to contractual cross guarantees. Only 20 of the banks could be closed; the FDIC was unable to force the five viable banks to contribute their value to the resolution. Since the addition of section 5(e) in August 1989, the FDIC, using the cross guarantee provisions, has been able to close affiliated banks that would otherwise have remained open and to sell the entire group of affiliates at the same time. That strategy was used notably in resolving the First City, N.A., Houston, Texas; Bank of New England, N.A., Boston, Massachusetts; and Southeast Bank, N.A., Miami, Florida.³¹

The Federal Deposit Insurance Corporation Improvement Act

In December 1991, President Bush signed into law the Federal Deposit Insurance Corporation Improvement Act. Observers of the financial services industry have described FDICIA as "the most important banking legislation since the Banking Act of 1933."³² While the law touched a wide range of regulatory areas, certain provisions—particularly those pertaining to prompt corrective action (PCA) on failing institutions and to least cost resolutions—had profound effects on the way the FDIC conducted failed bank resolutions.

FDICIA requires federal regulators to establish five capital levels, ranging from well-capitalized to critically undercapitalized, that serve as the basis for prompt corrective action. As an institution's capital declines, the appropriate regulator must take increasingly stringent measures. The sanctions begin with restrictions on deposit gathering for depository institutions that are not well-capitalized and culminate with the closing of institutions that have been critically undercapitalized for a prescribed period. The law is

31. See Part II, Case Studies of Significant Bank Resolutions, Chapter 5, First City Bancorporation of Texas, Inc., Chapter 8, Bank of New England Corporation, and Chapter 9, Southeast Banking Corporation.

32. George G. Kaufman and Robert E. Litan, eds., *Assessing Bank Reform: FDICIA One Year Later* (Washington, D.C.: The Brookings Institution, 1993), 19.

intended to protect the insurance system and the taxpayers by resolving troubled banks while the institutions can still absorb their own losses.

One of the aspects of PCA that most directly affects the FDIC's approach to resolutions prescribes mandatory measures for critically undercapitalized institutions (those banks with a ratio of tangible equity to total assets equal to or less than 2 percent). FDICIA requires that, not later than 90 days after an institution falls into the critically undercapitalized category, a conservator or receiver must be appointed. 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.

Under FDICIA, if the FDIC does not liquidate a failing institution (conduct a deposit payoff), then it must 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. As discussed earlier, FDICIA compelled the FDIC to consider more transaction options than in the past to make certain that all plausible least cost structures are offered.

Responses to FDICIA: Resolution Strategies, 1992 to 1996

The passage of FDICIA in 1991 had a significant effect on the FDIC's resolution practices. In addition to eliminating the FDIC's preference for passing assets, it also eliminated the automatic assumption that all deposits were to be passed to acquirers. After FDICIA, all-deposit transfer bids were at a relative disadvantage compared to insured deposit transfer bids. FDICIA also influenced the FDIC to reduce its resolution cost by allowing the FDIC to sell asset pools to banks that were not assuming the deposits, selling a failed bank's branches to different banks, and entering into loss sharing agreements on certain asset pools.

"Insured Deposits Only" Bidding

Under the various P&A asset purchase structures offered post-FDICIA, the FDIC gave bidders the option of bidding on insured deposits only. Previously, P&A bids required that the acquirer assume all the failed institution's deposits. Because an insured deposits only bid does not have to compensate the FDIC for the additional cost of covering 100 percent of the uninsured depositor's claim, it is easier for an insured deposits only bid to pass the least cost test. Additionally, as the FDIC began offering that option on an increasingly regular basis, acquirers discovered that the effects of not covering the uninsured depositors were less detrimental than they had once thought. The results of the change on acquirer bidding behavior are immediately apparent. (See chart I.3-13 for the number of failed banks in which the uninsured depositors were both protected and unprotected from 1986 through 1995.) On average, 82 percent of all banks failing between 1992 and 1995 were resolved in a manner that did not provide full protection

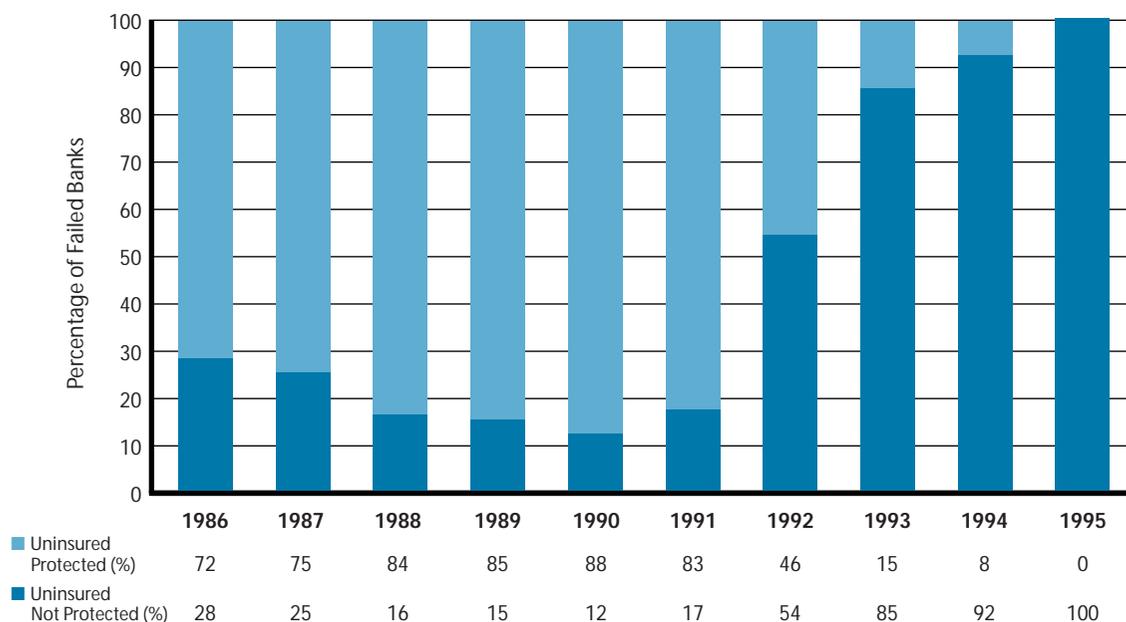
to uninsured depositors, compared with 17 percent between 1986 and 1991. Perhaps more significantly, 85 percent of all the deposits in banks that failed between 1986 and 1991 were in banks in which all deposits were protected compared to only 15 percent of the deposits in failed banks between 1992 and 1995.

Asset Pools

In addition to allowing bidders the option of choosing between an all-deposit or an insured deposit bid, the FDIC was also seeking ways to provide more flexibility for the purchase of assets. Potential acquirers often were reluctant to assume large loan portfolios that did not fit their current business strategies. As a result, FDIC officials decided that for banks with a diverse loan mix, it would be preferable to separate the loan portfolio into pools of homogeneous loans and to market those loans separately from the deposit franchise. The individual asset pools were smaller than the asset pools offered under the loan purchase or modified P&A options, and they included loans of similar collateral, term, and structure. Moreover, the FDIC structured the pools according to the preferences of acquirers within a given geographic location. It often grouped

Chart I.3-13

Uninsured Depositor Treatment 1986–1995



Source: FDIC Division of Finance, *Failed Bank Cost Analysis, 1986–1995*.

nonperforming loans, other real estate, and other loans that did not conform with one of the established pool structures into a single pool, which, depending on the overall quality of the pool, might be offered for sale. In transactions offering asset pools, the FDIC gave acquirers the option of linking their bids for the asset pools with their franchise bids. The linked bid was evaluated as one all or nothing bid. Such a strategy was intended to provide an additional level of flexibility. While certain acquirers did not wish to purchase the assets of the failed bank, for others it was in fact essential to acquire a substantial portion of the assets. In some acquisitions, banks bid on deposit franchises substantially larger than their current deposit bases. For those institutions, it was more difficult to reinvest a large cash payment received from the FDIC, and they therefore needed to acquire a large portion of the performing assets to maintain a positive net interest margin. In fact, for transactions completed between 1992 and 1994, virtually all the assets passed to acquirers were part of asset pool bids, which were made contingent on the selection of the bank as the winning franchise bidder.

Branch Breakups

Sometimes acquirers were unwilling to assume all the deposits of a multi-bank or multi-branch operation. At other times, the FDIC could obtain a better price for the franchise by selling each branch separately rather than marketing the institution in one transaction. The FDIC used this branch breakup method occasionally in the 1970s and early 1980s, usually when competition for the entire franchise was expected to be limited. Later in the 1980s it began marketing some of the institutions' branches individually when it was determined that there was an opportunity to increase the price of the franchise or sell more of the assets of the former bank through the resolution process.

Certain disadvantages exist with branch breakup transactions. Electronic data processing costs are generally higher than in whole franchise deals, and it is more difficult to complete transactions within the required timeframes. Further, branch breakups require one of the acquiring institutions to be "lead" acquirer and provide backroom operations for all the other acquirers during the transition period. Failing institutions with little franchise value or with geographically concentrated branches are considered poor candidates for branch breakup resolutions.

By offering failing institutions on both a whole franchise and branch breakup basis, the FDIC expanded the universe of potential bidders by allowing smaller institutions to participate along with larger institutions interested in only certain branches or markets. The number of successes the FDIC experienced with completing branch breakups shows that, generally, that method results in more bidders and higher premiums.

Loss Sharing Transactions

In 1991, the FDIC developed loss sharing transactions as another variation of the purchase and assumption transaction. Loss sharing was originally designed to (1) transfer 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 aligns the interests and incentives of the acquiring bank and the FDIC. The loss sharing transaction evolved into a vehicle that allowed the FDIC to successfully resolve the unique problems associated with marketing large banks. Large banks can be more difficult to market, because they typically have sizeable commercial and commercial real estate loan portfolios. In the past, acquiring institutions had been extremely reluctant to acquire commercial assets in FDIC transactions for several reasons. First, the time allowed to perform due diligence was usually very limited. Often, the FDIC had to accommodate numerous potential acquirers who wished to perform due diligence at the target institution, and all acquirers had to complete their reviews before the bid submission date. That requirement allowed very little time for a given acquirer to perform more than a cursory review of loans in the commercial portfolio. In addition to that limitation, many acquirers did not wish to purchase large portfolios of commercial loans that they did not underwrite. In many cases, the underwriting criteria of the failed bank were extremely poor before failure, and acquirers wished to avoid the additional costs associated with completing workouts of large commercial loans that became a problem. Finally, before 1992, almost every region of the U.S. had been experiencing declining markets for commercial real estate, and even when acquiring banks were willing to acquire the commercial real estate portfolios, their bids were usually too low, because they had incorporated a large discount into their bids to compensate for the potential risk.

Loss sharing was designed to address those concerns by limiting the downside risk associated with acquiring large commercial loan portfolios, which was accomplished by—

- providing for the FDIC to cover 80 percent of any losses on commercial and commercial real estate loans purchased by the acquirer;
- reimbursing acquiring institutions 80 percent of all expenses, except for overhead and personnel expenses, incurred in relation to the disposition or collection of shared loss assets; and
- providing catastrophic loss coverage on a 95 percent basis beyond a “transition amount” if the acquirer ultimately had losses that exceeded the FDIC’s estimate of the overall loss on shared loss assets.³³

Shared loss assets consist primarily of commercial and commercial real estate loans, although some earlier agreements included additional loan categories. By limiting an acquirer’s exposure to a maximum of 20 percent, the FDIC hoped to pass most of the failed bank’s assets to an acquirer while still receiving a substantial bid premium for the deposit franchise. The loss share transaction was employed generally for failing banks

33. For further details, see Chapter 7, Loss Sharing.

Table I.3-5

FDIC Loss Share Transactions**1991–1994**

(\$ in Millions)

Transaction Date	Failed Bank*	Location	Total Assets	Resolution Costs	Resolution Cost as Percentage of Total Assets
09/19/91	Southeast Bank, N.A†	Miami, FL	\$10,478	\$0	0.00
10/10/91	New Dartmouth Bank	Manchester, NH	2,268	571	25.19
10/10/91	First New Hampshire	Concord, NH	2,109	319	15.14
11/14/91	Connecticut Savings Bank	New Haven, CT	1,047	207	19.77
08/21/92	Attleboro Pawtucket S.B.	Pawtucket, RI	595	32	5.41
10/02/92	First Constitution Bank	New Haven, CT	1,580	127	8.01
10/02/92	The Howard Savings Bank	Livingston, NJ	3,258	87	2.67
12/04/92	Heritage Bank for Savings	Holyoke, MA	1,272	21	1.70
12/11/92	Eastland Savings Bank‡	Woonsocket, RI	545	17	3.30
12/11/92	Meritor Savings Bank	Philadelphia, PA	3,579	0	0.00
02/13/93	First City, Texas-Austin, N.A.	Austin, TX	347	0	0.00
02/13/93	First City, Texas-Dallas	Dallas, TX	1,325	0	0.00
02/13/93	First City, Texas-Houston, N.A.	Houston, TX	3,576	0	0.00
04/23/93	Missouri Bridge Bank, N.A.	Kansas City, MO	1,911	356	18.62
06/04/93	First National Bank of Vermont	Bradford, VT	225	34	14.97
08/12/93	CrossLand Savings, FSB	Brooklyn, NY	7,269	740	10.18
Totals/Average			\$41,384	\$2,511	6.07

* The banks listed here are the failed banks or the resulting bridge bank from a previous resolution; however, it is the acquirer that enters into the loss sharing transaction with the FDIC.

† Represents loss sharing agreements for two banks: Southeast Bank, N.A., and Southeast Bank of West Florida.

‡ Represents loss sharing agreements for two banks: Eastland Savings Bank and Eastland Bank.

Source: FDIC Division of Research and Statistics.

with commercial loan portfolios in excess of \$100 million. (See table I.3-5 for a summary of loss share agreements from 1991 to 1994.)

Resolution Costs

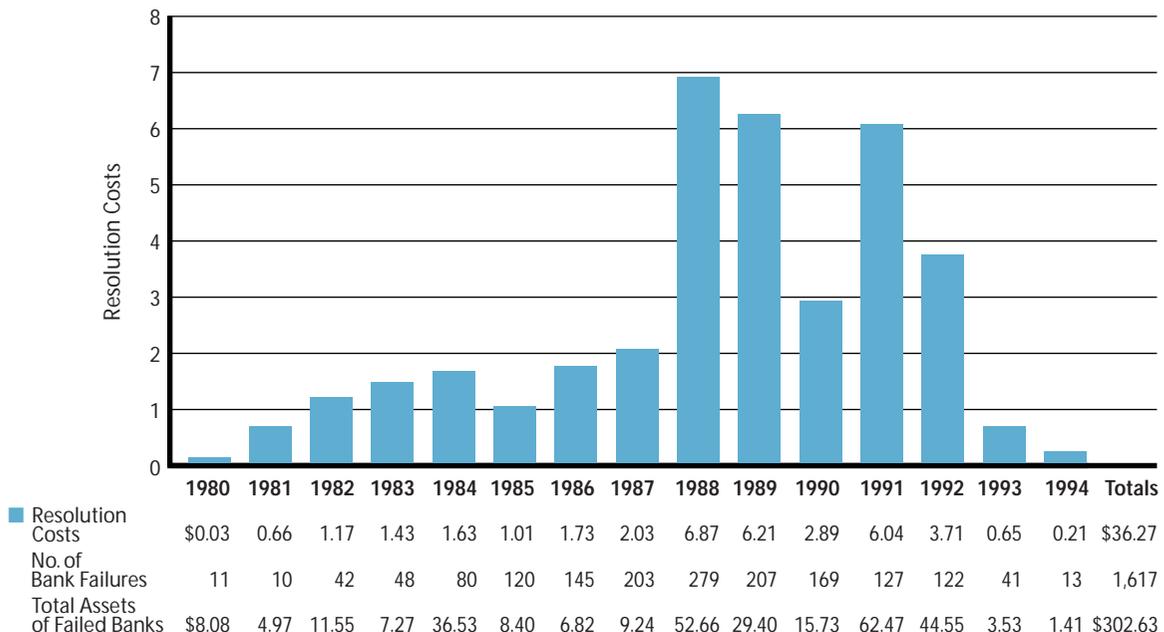
The 1,617 banks that failed (or required open bank assistance) between 1980 and 1994 had \$302.6 billion in assets. The FDIC's cost for handling the failures was \$36.3 billion, or about 12 percent of the assets in the banks that required FDIC financial assistance.

The FDIC's annual failure resolution costs steadily grew during the 1980s, along with the rise in bank failures. The years between 1987 and 1992 were exceptionally costly. The FDIC's failure resolution costs exceeded \$2 billion in each of those years. In 1988, the costs peaked at \$6.87 billion. Costs exceeded the \$6 billion mark in 1989 and 1991 as well. (See chart I.3-14.) To put the costs in perspective, FDIC insured commercial banks,

Chart 1.3-14

Resolution Costs by Year of Failure 1980–1994

(\$ in Billions)



Costs are as of December 31, 1995. The amounts are routinely adjusted with updated information from new appraisals and asset sales that ultimately affect the asset values and projected recoveries from active receiverships.

Figures include open bank assistance transactions.

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

the group that pays the insurance premiums to cover those costs, earned an average of \$18.2 billion a year during 1987 to 1992. During the same period, the FDIC's bank failure costs averaged \$4.6 billion, or 25 percent of the industry's total earnings.

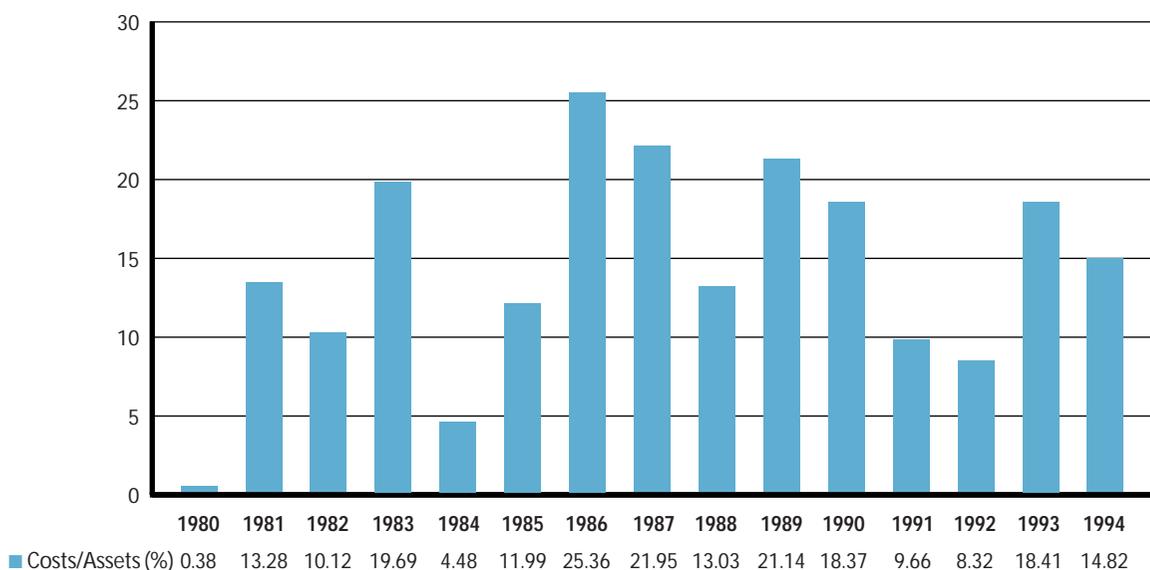
Looking at the FDIC's annual resolution costs as a percentage of failed bank assets shows no clear pattern. (See chart I.3-15.) Because of the dominance of the Continental OBA transaction in 1984, the ratio is a relatively low 4.48 percent in that year. The late 1980s show relatively high cost-to-asset ratios, exceeding 20 percent in 1986, 1987, and 1989. In those years, in spite of a large number of failures and a weak economy, few dominant, sizeable failures pulled down the averages. The 1990s, with its gradually improving economy, proved to be less costly than the 1980s.

A strong correlation exists between bank asset size and failure resolution costs as a percentage of assets. Chart I.3-16 shows that for smaller bank failures, those of banks with less than \$500 million in total assets, the overall failure resolution cost is about 20 percent of assets during 1980 to 1994. As bank asset size increases, the ratio steadily declines, reaching 6 percent for banks with more than \$5 billion in assets.

The economies of scale associated with handling larger bank failures make it difficult to discern trends over time in the FDIC's cost for handling the "typical" bank

Chart I.3-15

**Resolution Costs as a Percentage of Total Assets
1980–1994**



Figures include open bank assistance transactions.

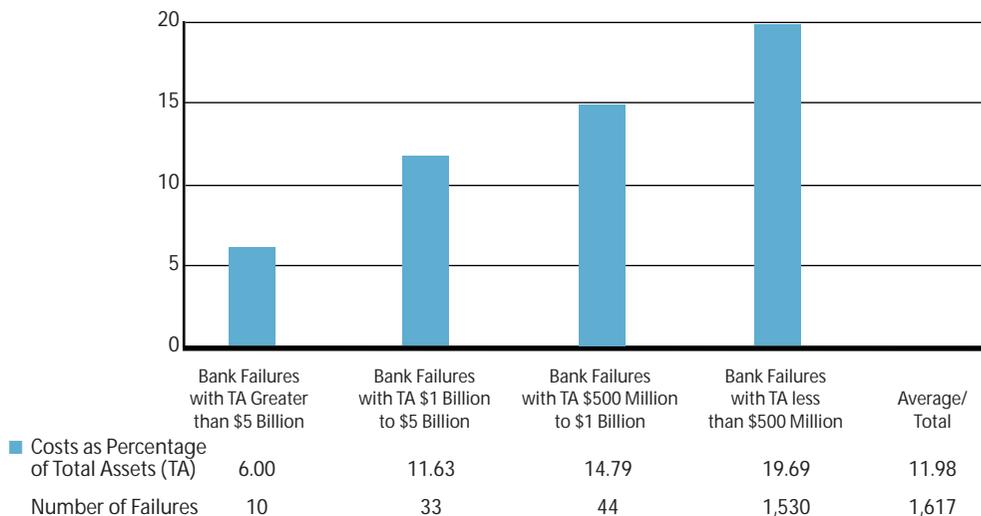
Sources: FDIC Division of Research and Statistics and FDIC annual reports.

failure. One way to look at possible trends without the dominant influence of the larger bank failure is to look at the median of the FDIC's bank resolution costs over time. (See chart I.3-17.) A look at the median FDIC resolution cost shows a dramatic jump in the 1983 to 1985 timeframe, when the economy was weakening and the steady increase in the annual number of bank failures was beginning. During 1984 and 1985, the median cost rose to over 30 percent of failed bank assets. The ratio declined for the remainder of the 1980s, but it was still above 20 percent in each of those years. During the 1990s, the ratio dropped further, into the teens.

Another way of looking at resolution costs is by transaction method. (See tables I.3-6 through I.3-9 for annual trends in the FDIC's failure resolution costs by transaction method.) This review by transaction method reveals a relatively high cost of deposit payoffs, whether they are straight deposit payoffs or insured deposit transfers. In addition, OBA transactions were less costly than P&A transactions. It is difficult, however, to draw firm conclusions from that type of comparison. Historic bidding procedures generally did not allow for open competition among transaction methods. Open bank assistance was used for a greater percentage of larger bank resolutions, so they cannot be directly compared to the others. Because of the FDIC's preference for P&A transactions over deposit payoffs, it is difficult to draw any conclusions there as well. The FDIC used

Chart I.3-16

**Resolution Costs by Asset Size
as a Percentage of Total Assets
1980–1994**



Sources: FDIC Division of Research and Statistics and FDIC annual reports.

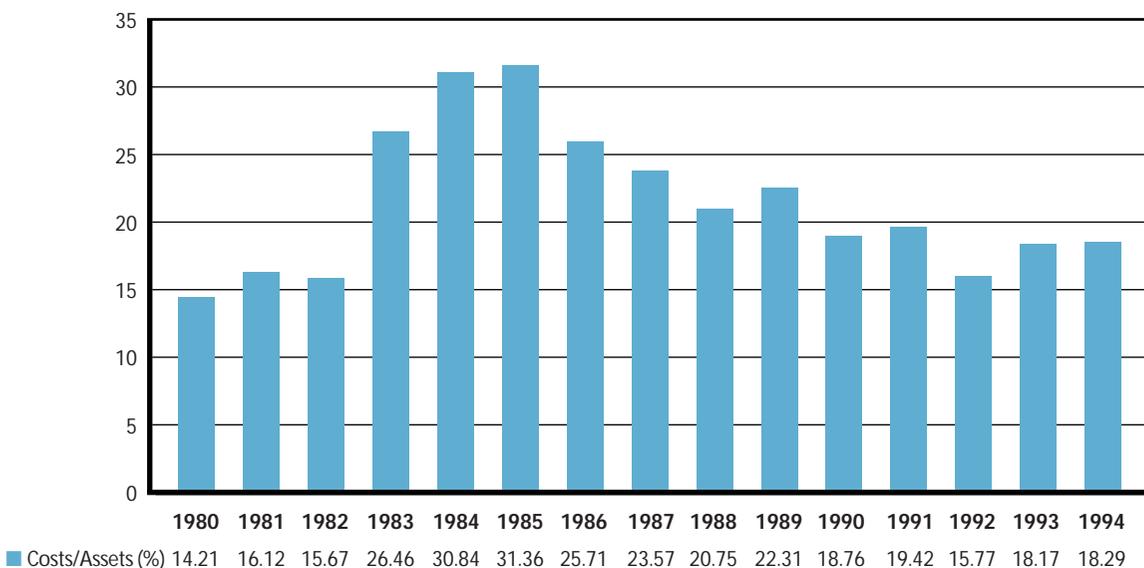
deposit payoffs in the worst situations, those where no one really wanted the failed bank franchise in a P&A transaction.

The P&A transaction, the most frequently used method, shows high costs (in excess of 20 percent of failed bank assets) from 1980 through 1987, except in 1982 when the cost-to-asset ratio was only 6.6 percent. (See table I.3-6.) The 1982 ratio, however, is an aberration caused by one large bank failure that had zero cost to the insurance fund. From 1988 through 1994, those costs were below 20 percent of assets, dropping to single digits in 1991 and 1992. During those two years, the FDIC handled several larger banks (Bank of New England, Southeast, Goldome, and CrossLand Savings Bank) at relatively low costs.

Table I.3-7 shows the relatively low costs for open bank assistance transactions. As previously stated, the lower costs are due in part to the larger average size of the banks handled by this method rather than to any inherent advantage of the method itself. This effect of the larger asset size can be seen in the Continental transaction, which, with \$33.6 billion in assets, was 40.7 percent of the total assets of all OBA transactions; yet Continental's cost-to-asset ratio was only 3.3 percent of assets. Factors other than size also are relevant. The average cost of the OBA transactions for banks with less than \$500

Chart I.3-17

**Median Bank Resolution Costs as a Percentage of Total Assets
1980–1994**



Figures include open bank assistance transactions.

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

million in assets was only 7.8 percent, which is well below the cost for other types of small bank transactions. This lower cost suggests that handling those institutions relatively early helped to hold down their overall costs.

The costs associated with straight deposit payoffs (see table I.3-8) and insured deposit transfers (see table I.3-9) as a percentage of failed bank assets peaked later in the 1980s when the economy was weak and the country experienced the largest number of bank failures. Those banks often were unmarketable institutions that no one would purchase. In 1989, the average cost of the nine deposit payoffs was 44 percent of the failed banks' assets.

Table I.3-6

Costs for Purchase and Assumption Transactions

1980–1994

(\$ in Millions)

Year	Number of P&As	Assets at Resolution	Deposits at Resolution	Costs as of 12/31/95	Costs/Assets (%)
1980	7	\$114.4	\$195.7	\$28.4	24.83
1981	5	30.1	52.5	7.9	26.25
1982	27	1,195.6	1,026.7	79.4	6.64
1983	36	4,211.1	2,920.0	1,334.9	31.70
1984	62	1,567.8	1,400.6	431.5	27.52
1985	87	1,894.7	2,030.1	535.7	28.27
1986	98	4,791.9	4,710.9	1,213.0	25.31
1987	133	4,255.4	3,927.5	1,161.0	27.28
1988	164	37,802.8	23,967.9	4,840.9	12.81
1989	174	27,001.7	20,952.9	5,325.6	19.72
1990	148	13,241.6	11,578.9	2,148.4	16.22
1991	103	60,803.2	47,826.1	5,547.5	9.12
1992	95	42,481.7	36,565.6	3,196.8	7.53
1993	36	3,217.3	2,905.4	552.6	17.18
1994	13	1,405.1	1,233.6	208.3	14.82
Totals/ Average	1,188	\$204,014.4	\$161,294.4	\$26,611.9	13.04

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

Table I.3-10 shows the FDIC's costs for the more significant types of purchase and assumption transactions. The 202 whole bank P&A transactions conducted between 1987 and 1992 cost the FDIC \$1.4 billion, or 16.7 percent of total assets. The 24 failed banks resolved through loss share transactions conducted between 1991 and 1993 cost the FDIC \$2.3 billion, or 5.5 percent of total assets. The 962 other P&A transactions accounted for \$22.9 billion in cost, a 14.9 percent cost-to-asset ratio.

It is difficult to draw any strong conclusions from the charts and graphs shown in the resolution costs section other than to point to the fact that larger banks cost less to resolve on a cost-to-asset basis than do smaller institutions. Many factors determine the overall recovery rate of each bank that fails, including the selected method of resolution,

Table I.3-7

**Costs for Open Bank Assistance Transactions
1980–1994**

(\$ in Millions)

Year	Number of OBAs	Assets at Resolution	Deposits at Resolution	Costs as of 12/31/95	Costs/Assets (%)
1980	1	\$7,953.0	\$5,300.0	\$ 0.00	0.00
1981	3	4,886.3	3,729.0	653.9	13.38
1982	8	9,770.0	8,373.3	1,018.2	10.42
1983	3	2,890.0	2,420.7	71.3	2.47
1984	2	34,147.9	17,945.0	1,111.3	3.25
1985	4	5,895.9	5,510.4	359.1	6.09
1986	7	718.8	585.6	97.4	13.55
1987	19	2,515.6	2,118.0	160.2	6.37
1988	79	13,539.0	11,501.2	1,594.5	11.78
1989	1	5.7	6.4	2.3	40.35
1990	1	15.9	15.6	2.3	14.47
1991	3	83.8	80.4	3.1	3.70
1992	2	34.9	33.5	0.6	1.72
1993	0	0	0	0	0.00
1994	0	0	0	0	0.00
Totals/ Average	133	\$82,456.8	\$57,619.1	\$5,074.2	6.15

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

the bank's financial condition at the time of failure, and the economic conditions of the region. In the middle to late 1980s, when the economy was weaker and fewer banks were interested in purchasing the franchise of a failed institution, the costs of the resolutions were higher. As the economy improved in the 1990s, fewer banks failed and the costs decreased.

Conclusion

In the banking industry, the 1980s began with only a few bank failures but ended with an average of more than 200 a year. Likewise, in the early 1980s, the FDIC had little experience in handling more than an occasional small bank failure. By 1994, however,

Table I.3-8

Costs for Straight Deposit Payoffs 1980–1994

(\$ in Millions)

Year	Number of SDPs	Assets at Resolution	Deposits at Resolution	Costs as of 12/31/95	Costs/Assets (%)
1980	3	\$16.1	\$15.0	\$2.3	14.29
1981	2	54.2	48.0	1.1	2.03
1982	7	581.3	536.1	71.0	12.21
1983	7	129.7	123.1	12.0	9.25
1984	4	334.4	306.4	19.7	5.89
1985	22	279.9	247.1	78.7	28.12
1986	21	555.0	513.5	203.7	36.70
1987	11	337.7	302.2	116.3	34.44
1988	6	130.5	122.6	38.3	29.35
1989	9	580.9	499.3	257.5	44.33
1990	8	844.3	731.2	250.9	29.72
1991	4	65.9	59.4	18.4	27.92
1992	11	1,136.2	1,013.0	279	24.56
1993	5	309.5	270.7	101.9	32.92
1994	0	0	0	0	0.00
Totals/ Average	120	\$5,355.6	\$4,787.6	\$1,450.8	27.09

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

the FDIC had gained considerable experience in handling failed and failing banks. In fact, from 1980 to 1994, the FDIC's successful adjustment to constantly changing circumstances in the arena of bank failures led to security for insured depositors: no insured depositor lost any money, and in every case, insured deposits were paid promptly. Such actions meant that, unlike the experience of the early 1930s, the public maintained its confidence in the banking system, and financial stability was preserved.

As the resolution process evolved, the FDIC devised new resolution methods for adjusting to the changing environment. On the asset side, the FDIC's resolutions methods evolved from passing few failed bank assets with little risk to an acquiring institution to passing most failed bank assets and sharing the risk with the acquiring institution. As special circumstances arose, such as the mutual savings bank failures in the early 1980s,

Table I.3-9

Costs for Insured Deposit Transfers

1980–1994

(\$ in Millions)

Year	Number of IDTs	Assets at Resolution	Deposits at Resolution	Costs as of 12/31/95	Costs/Assets (%)
1980	0	\$0	\$0	\$0	0.00
1981	0	0	0	0	0.00
1982	0	0	0	0	0.00
1983	2	43.1	43.6	13.9	32.25
1984	12	481.6	455.4	72.7	15.10
1985	7	331.9	285.8	34.0	10.24
1986	19	748.2	688.9	213.6	28.55
1987	40	2,129.2	1,810.2	590.0	27.71
1988	30	1,210.4	1,130.8	392.5	32.43
1989	23	1,814.1	1,553.7	629.4	34.69
1990	12	1,627.5	1,465.1	487.4	29.95
1991	17	1,520.6	1,256.4	467.6	30.75
1992	14	897.9	831.3	231.2	25.75
1993	0	0	0	0	0.00
1994	0	0	0	0	0.00
Totals/ Average	176	\$10,804.5	\$9,521.2	\$3,132.3	28.99

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

the agricultural bank failures in the mid-1980s, and the larger commercial real estate-induced bank failures in the late 1980s and early 1990s, the FDIC handled each situation in a manner that allowed most of the institutions' assets to remain in the private sector. Overall, from 1980 to 1994, the FDIC was able to pass 76 percent of failed bank assets to the acquiring institutions. That action not only preserved liquidity for the FDIC, but also assisted significantly in the economic recovery of the local communities.

On the liability side, the FDIC devised new methods to ensure that depositors of failed banks would receive their funds quickly, thus minimizing any disruption to the financial system. The FDIC's purchase and assumption transactions gave depositors virtual immediate access to their money. In those instances in which a P&A transaction was not attainable, the FDIC developed the insured deposit transfer and paid advance dividends to expedite the return of funds to depositors. That approach resulted in minimizing the disruption to the depositors and local communities.

Given the magnitude of the problem, the FDIC's flexibility with assets and liabilities helped resolve 1,617 failed and failing banks at arguably a relatively low cost to the insurance fund. The overall resolution cost to the FDIC of \$36.3 billion was about 12 percent of the failed and failing banks' assets. When compared to the savings and loan crisis, those costs were low, not only in absolute terms but also on a per asset basis.

During this period, the FDIC also learned some important lessons that are relevant to the future: (1) Bridge banks, loss sharing, asset pools, cross guarantees, branch breakups, advance dividends, and insured deposit transfers all appear to have been useful developments; (2) open bank assistance, sequential bidding, put options, income maintenance agreements, and net worth certificate programs all served a purpose for the situations in which they were used; and (3) it became clear that, to have an adequate source of liquidity, the insurance funds need to be strong. Although minor when compared to the liquidity shortages in the savings and loan situation, the FDIC's lack of liquidity in the late 1980s and early 1990s influenced certain resolution decisions. For example, designing put options and sequential bidding helped put assets back into the private sector quickly, thereby preserving the FDIC's liquidity. In retrospect, however, those methods may not have minimized the overall cost to the insurance fund. Such unintentional consequences, while perhaps minor when put in perspective, nonetheless are of some concern.

Table I.3-10

Costs for Different Types of Purchase and Assumption Transactions

1980–1994

(\$ in Millions)

Year	Whole Bank P&A Transactions				P&A Transactions with Loss Sharing				Other P&A Transactions			
	No. of Trans.	Assets at Reso- lution	FDIC's Costs	Costs/ Assets (%)	No. of Trans.	Assets at Reso- lution	FDIC's Cost	Costs/ Assets (%)	No. of Trans.	Assets at Reso- lution	FDIC's Costs	Costs/ Assets (%)
1980	0	\$0	\$0	0	0	\$0	\$0	0	7	\$114	\$28	24.56
1981	0	0	0	0	0	0	0	0	5	\$30	8	26.67
1982	0	0	0	0	0	0	0	0	27	1,196	79	6.61
1983	0	0	0	0	0	0	0	0	36	4,211	1,335	31.70
1984	0	0	0	0	0	0	0	0	62	1,568	432	27.55
1985	0	0	0	0	0	0	0	0	87	1,895	536	28.28
1986	0	0	0	0	0	0	0	0	98	4,792	1,213	25.31
1987	19	570	90	15.79	0	0	0	0	114	3,685	1,071	29.06
1988	69	2,931	551	18.80	0	0	0	0	95	34,872	4,290	12.30
1989	42	1,339	276	20.61	0	0	0	0	132	25,663	5,050	19.68
1990	43	2,314	299	12.92	0	0	0	0	105	10,928	1,850	16.93
1991	24	903	137	15.17	10	15,903	1,098	6.90	69	43,997	4,312	9.80
1992	5	102	8	7.84	13	25,256	1,188	4.70	77	17,124	2,000	11.68
1993	0	0	0	0	1	225	33	14.67	35	2,992	520	17.38
1994	0	0	0	0	0	0	0	0	13	1,405	208	14.80
Totals/ Aver- ages	202	\$8,159	\$1,361	16.68	24	\$41,384	\$2,319	5.60	962	\$154,472	\$22,932	14.85

Sources: FDIC Division of Research and Statistics and FDIC Division of Finance.

Table I.3-11

Bank Failures by Location
Ranked by Number of Bank Failures
1980–1994
(\$ in Thousands)

Location	Number of Failed Banks	Total Bank Assets	FDIC's Resolution Costs	Costs/Assets (%)	Cumulative Percentage of Failures
Texas	599	\$92,973,964	\$13,612,645	14.64	37.04
Oklahoma	122	5,504,937	1,460,113	26.52	44.59
California	87	5,445,302	1,061,335	19.49	49.97
Louisiana	70	4,401,121	1,088,554	24.73	54.30
Kansas	69	1,561,223	347,580	22.26	58.57
Colorado	59	989,252	277,217	28.02	62.21
Massachusetts	43	26,124,470	3,375,599	12.92	64.87
Missouri	41	3,075,528	535,963	17.43	67.41
Iowa	40	721,125	116,627	16.17	69.88
Florida	39	14,965,281	920,709	6.15	72.29
Minnesota	38	1,579,218	196,940	12.47	74.64
Tennessee	36	2,331,813	778,258	33.38	76.87
New York	34	49,108,444	5,115,311	10.42	78.97
Illinois	33	34,302,370	1,213,368	3.54	81.01
Nebraska	33	343,342	71,151	20.72	83.06
Connecticut	32	17,685,983	2,415,691	13.66	85.03
Wyoming	20	375,109	117,122	31.22	86.27
Oregon	17	575,551	66,382	11.53	87.32
Arizona	17	434,486	88,904	20.46	88.37
New Hampshire	16	4,908,983	1,014,347	20.66	89.36
New Jersey	14	6,658,401	470,659	7.07	90.23
New Mexico	11	714,363	183,713	25.72	90.91
Arkansas	11	191,678	42,711	22.28	91.59
Utah	11	446,839	80,564	18.03	92.27
Montana	10	209,164	40,392	19.31	92.89
Indiana	10	291,556	33,422	11.46	93.51
North Dakota	9	107,903	18,869	17.49	94.06

Table I.3-11

**Bank Failures by Location
Ranked by Number of Bank Failures
1980–1994**

(\$ in Thousands)

Continued

Location	Number of Failed Banks	Total Bank Assets	FDIC's Resolution Costs	Costs/Assets (%)	Cumulative Percentage of Failures
Alabama	9	\$285,516	\$21,975	7.70	94.62
Alaska	8	2,862,202	615,834	21.52	95.11
South Dakota	8	659,667	16,887	2.56	95.61
Kentucky	7	120,678	21,947	18.19	96.04
Virginia	7	284,769	40,691	14.29	96.47
Puerto Rico	5	336,849	111,926	33.23	96.78
Ohio	5	140,193	4,067	2.90	97.09
District of Columbia	5	2,285,178	351,803	15.39	97.40
Pennsylvania	5	13,705,317	43,803	0.32	97.71
West Virginia	5	77,174	13,743	17.81	98.02
Washington	4	758,588	54,119	7.13	98.27
Rhode Island	3	1,140,025	48,945	4.29	98.45
Georgia	3	88,003	20,383	23.16	98.64
Michigan	3	129,832	22,994	17.71	98.82
Mississippi	3	286,729	28,160	9.82	99.01
North Carolina	2	70,760	6,863	9.70	99.13
Wisconsin	2	74,129	3,259	4.40	99.26
Maryland	2	55,771	7,777	13.94	99.38
Maine	2	2,224,770	5,614	0.25	99.51
Hawaii	2	11,798	1,762	14.93	99.63
Vermont	2	260,755	44,706	17.14	99.75
Idaho	1	61,231	17,244	28.16	99.81
Delaware	1	612,745	249	0.04	99.88
South Carolina	1	62,790	20,879	33.25	99.94
Nevada	1	8,789	0	0.00	100.00
Totals/Averages	1,617	\$302,631,664	\$36,269,776	11.98	

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

Table I.3-12

**Bank Failures by Location
Ranked by Resolution Costs
1980–1994**

(\$ in Thousands)

Location	Number of Failed Banks	Total Bank Assets	FDIC's Resolution Costs	Costs/Assets (%)	Cumulative Percentage of Total Costs
Texas	599	\$92,973,964	\$13,612,645	14.64	37.53
New York	34	49,108,444	5,115,311	10.42	51.64
Massachusetts	43	26,124,470	3,375,599	12.92	60.94
Connecticut	32	17,685,983	2,415,691	13.66	67.60
Oklahoma	122	5,504,937	1,460,113	26.52	71.63
Illinois	33	34,302,370	1,213,368	3.54	74.97
Louisiana	70	4,401,121	1,088,554	24.73	77.97
California	87	5,445,302	1,061,335	19.49	80.90
New Hampshire	16	4,908,983	1,014,347	20.66	83.70
Florida	39	14,965,281	920,709	6.15	86.24
Tennessee	36	2,331,813	778,258	33.38	88.38
Alaska	8	2,862,202	615,834	21.52	90.08
Missouri	41	3,075,528	535,963	17.43	91.56
New Jersey	14	6,658,401	470,659	7.07	92.86
District of Columbia	5	2,285,178	351,803	15.39	93.83
Kansas	69	1,561,223	347,580	22.26	94.78
Colorado	59	989,252	277,217	28.02	95.55
Minnesota	38	1,579,218	196,940	12.47	96.09
New Mexico	11	714,363	183,713	25.72	96.60
Wyoming	20	375,109	117,122	31.22	96.92
Iowa	40	721,125	116,627	16.17	97.24
Puerto Rico	5	336,849	111,926	33.23	97.55
Arizona	17	434,486	88,904	20.46	97.80
Utah	11	446,839	80,564	18.03	98.02
Nebraska	33	343,342	71,151	20.72	98.21
Oregon	17	575,551	66,382	11.53	98.40
Washington	4	758,588	54,119	7.13	98.55

Table I.3-12

**Bank Failures by Location
Ranked by Resolution Costs
1980–1994**

(\$ in Thousands)

Continued

Location	Number of Failed Banks	Total Bank Assets	FDIC's Resolution Costs	Costs/Assets (%)	Cumulative Percentage of Total Costs
Rhode Island	3	\$1,140,025	\$48,945	4.29	98.68
Vermont	2	260,755	44,706	17.14	98.80
Pennsylvania	5	13,705,317	43,803	0.32	98.93
Arkansas	11	191,678	42,711	22.28	99.04
Virginia	7	284,769	40,691	14.29	99.15
Montana	10	209,164	40,392	19.31	99.27
Indiana	10	291,556	33,422	11.46	99.36
Mississippi	3	286,729	28,160	9.82	99.44
Michigan	3	129,832	22,994	17.71	99.50
Alabama	9	285,516	21,975	7.70	99.56
Kentucky	7	120,678	21,947	18.19	99.62
South Carolina	1	62,790	20,879	33.25	99.68
Georgia	3	88,003	20,383	23.16	99.73
North Dakota	9	107,903	18,869	17.49	99.79
Idaho	1	61,231	17,244	28.16	99.83
South Dakota	8	659,667	16,887	2.56	99.88
West Virginia	5	77,174	13,743	17.81	99.92
Maryland	2	55,771	7,777	13.94	99.94
North Carolina	2	70,760	6,863	9.70	99.96
Maine	2	2,224,770	5,614	0.25	99.97
Ohio	5	140,193	4,067	2.90	99.99
Wisconsin	2	74,129	3,259	4.40	99.99
Hawaii	2	11,798	1,762	14.93	100.00
Delaware	1	612,745	249	0.04	100.00
Nevada	1	8,789	0	0.00	100.00
Totals/Average	1,617	\$302,631,664	\$36,269,776	11.98	

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

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FIRREA created the RTC on August 9, 1989. The RTC headquarters were established in Washington, D.C.



The sheer volume of assets, combined with the funding issues and the changing economy, significantly affected the evolution of the RTC's resolution strategies.