CHAPTER 8

The FDIC's Role as Receiver

Introduction

The Federal Deposit Insurance Corporation (FDIC) has three main responsibilities: (1) to act as an insurer, (2) to act as a supervisor, and (3) to act as a receiver.[1] The roles of insurer and receiver require that the FDIC play an active role in resolving failing and failed FDIC insured institutions. To maintain confidence in the banking system and to maintain stability of the financial system, the federal statutory framework governing the resolution of failed depository institutions was designed to promote the efficient, expeditious, and orderly liquidation of failed banks and thrift institutions. The interactions between the FDIC as insurer and the FDIC as receiver are important in ensuring that those objectives are achieved.

As a rule, the FDIC's role as receiver is independent of its corporate roles as supervisor and insurer.[2] The FDIC's corporate role as insurer is important in the receivership process. That role helps ensure the stability of the financial system by guaranteeing the timely funding of deposit insurance and consequent faith in the banking system in times of stress. The FDIC's role as receiver is also important. When a depository institution fails, the FDIC has statutory responsibility to the creditors of the receivership to recover for them, as quickly as it can, the maximum amount possible on their claims. Just as importantly, the FDIC's insurance fund becomes a major creditor, paying insured depositors the full amount of their claims. When acting as receiver, the FDIC, through

1. The FDIC is the primary federal banking regulator of all state nonmember banks. In that regard, the FDIC performs safety and soundness examinations, visitations, and investigations.

2. The courts have long recognized the FDIC's legal ability to operate in different capacities, with its different capacities conducting arms' length transactions with each other.

acts of Congress, uses broad statutory authority and protections that enable it to fulfill its mission.

Why the FDIC Acts as Receiver

To understand why Congress gave the FDIC receivership powers, it is necessary to go back to the FDIC's beginnings and look at the structure of the banking industry and the economic conditions at that time. The FDIC was created in 1933 to halt a banking crisis. Nine thousand banks—a third of the banking system in the United States—failed in the four years before the FDIC was established. The failure of one bank would set off a chain reaction, bringing about other failures. Sound banks frequently failed when large numbers of depositors panicked and demanded to withdraw their deposits, leading to "runs" on the bank. The behavior of depositors was not irrational. They had learned from hard experience that if they kept their money in banks, it might not be available when they needed it, and they might lose it all, or a large portion of it.

Before the creation of the FDIC, national bank liquidations were supervised by the Office of the Comptroller of the Currency (OCC), who had authority to appoint the receiver and had a permanent staff of bank liquidation specialists.[3] Liquidations of state chartered banks varied considerably from state to state, but most were handled under the state code provisions for general business insolvencies. By 1933, most state banking authorities had at least some control over state bank liquidations. The increased incidence of national bank failures from 1921 through 1932, however, created a shortage of experienced receivers. Furthermore, there was some concern in Congress that receiverships, both national and state, had been doled out as political plums, with the recipients attempting to make as much commission as possible and to keep the work going as long as possible.

In general practice, between 1865 and 1933, depositors of national and state banks were treated in the same way as other creditors; they received funds from the liquidation of the bank's assets *after* those assets were liquidated. On average, it took about six years at the federal level to liquidate a failed bank's assets, pay the depositors, and close the bank's books—although in at least one case, it took 21 years. Even when depositors ultimately received their funds, the amount was significantly less than what they had put into the bank. From 1921 through 1930, more than 1,200 banks failed and were liquidated. From those liquidations, depositors at banks chartered by the states received, on average, 62 percent of their deposits. Depositors at banks chartered by the federal government received an average of 58 percent of their deposits. Given the long delays and the significant risk in getting their deposits, anxious depositors understandably

3. Authority to appoint a receiver for a national bank originated in the National Bank Act of 1864; authority to appoint a conservator for a national bank subsequently originated in the Bank Conservation Act of 1933.

withdrew their savings when there was any hint of problems. With the wave of bank failures that began in 1929, it became widely recognized by the federal government that the lack of funding that resulted from the process for resolving bank failures was contributing significantly to the economic depression in the United States.[4]

To deal with the economic crisis, the federal government focused on returning the financial system to stability by restoring and maintaining the confidence of depositors in the banking system. When it created the FDIC, Congress addressed that problem by (1) allowing for the FDIC to provide deposit insurance, initially up to $2,500, but now up to $100,000; (2) giving the FDIC special powers to resolve failed banks; and (3) requiring the appointment of the FDIC as receiver for all national banks. Congress believed that the appointment of the FDIC as receiver would simplify procedures, eliminate duplication of records, and vest responsibility for liquidation in the largest creditor whose interest is to obtain the maximum possible recovery. For state chartered banks, Congress preferred that the FDIC be receiver, but did allow each state to appoint a receiver according to state law. By 1934, 30 states had provisions by which the FDIC could be appointed receiver but, in practice, most often they did not do so. It would be the rare exception today if the FDIC were not appointed receiver, however, and most states now require that the FDIC be appointed receiver.

How the FDIC Becomes Receiver

An institution's chartering authority typically closes a bank when it becomes critically undercapitalized or unable to meet deposit outflows. The Prompt Corrective Action (PCA) provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 require that an institution be closed by its primary regulator or the FDIC within a prescribed period of time after the regulator determines that the institution is critically undercapitalized (a situation that was defined as tangible equity capital of 2 percent or less) and does not have an adequate plan to restore the capital to the required levels.[5]

Following certain procedural requirements, the FDIC may be appointed as receiver for any insured depository institution if any of the following conditions exist:

- The institution's assets are less than its deposit and administrative obligations (insolvency);
- The institution's assets or earnings have been substantially dissipated because of a violation of a statute or regulation, or because of any unsafe or unsound practice;
- The institution is operating in an unsafe or unsound condition;

4. C.D. Bremer, *American Bank Failures* (New York: Columbia University Press, 1935), chapters IV and V.

5. The prescribed timing is 90 days; however, if warranted, the time can be extended by the primary regulator with concurrence of the FDIC.

- The institution has willfully violated a final cease and desist order;
- The institution's books, papers, records, or assets have been concealed, or the institution has refused to submit its books, papers, records, or affairs for inspection by an appropriate regulatory authority;
- The institution is unable to pay its obligations or meet its depositors' demands in the normal course of business;
- The institution has incurred or is likely to incur losses that will deplete all or substantially all of its capital, with no reasonable prospect for the institution to become adequately capitalized without federal assistance;
- The institution has violated any law or regulation, or has engaged in an unsafe or unsound practice, that is likely to (a) cause insolvency or substantial dissipation of assets or earnings, (b) weaken the institution's condition, or (c) seriously prejudice the interests of depositors or the deposit insurance fund;
- The institution, by resolution of its board of directors or shareholders, consents to the appointment;
- The institution ceases to be an insured institution;
- The institution is undercapitalized and (a) has no reasonable prospect of becoming adequately capitalized, (b) fails to become adequately capitalized when required to do so, (c) fails to submit an acceptable capital restoration plan to the appropriate regulatory authority, or (d) materially fails to implement a capital restoration plan submitted and accepted;
- The institution is critically undercapitalized or otherwise has substantially insufficient capital; or
- The institution has been found guilty of money laundering under federal law.

A depository institution's charter determines which state or federal regulatory agency will appoint a conservator or a receiver for a failing institution. For federal savings associations and national banks, the Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency, respectively, are the chartering authorities responsible for determining when appointment of a receiver is necessary.[6] The FDIC must be appointed as receiver for insured federal savings associations and national banks. For state chartered savings and loan associations or banks, the FDIC may accept appointment as receiver by the appropriate state regulatory authority, but it is not

6. The same authority would appoint the FDIC as conservator for the institution if the imposition of a conservatorship were determined to be the appropriate strategy for dealing with a failing institution. However, the FDIC has never been appointed conservator by the OCC or state regulatory authority and may decline the appointment if tendered; the FDIC was appointed conservator once by the OTS.

required to do so. Today, state regulatory authorities virtually always request the appointment of the FDIC when a receiver is appointed. In the case of state chartered banks that are members of the Federal Reserve System, the Federal Reserve Board also may appoint the FDIC as receiver. In certain limited instances, the FDIC may appoint itself as receiver for insured depository institutions. Congress provided the FDIC that additional authority in 1991 out of concern that the FDIC depended on the judgment of individual state chartering authorities or that of other federal chartering authorities and that it needed an independent basis to protect the insurance fund in a timely manner. Since receiving that power from Congress in 1991, however, the FDIC has closed an institution and appointed itself as receiver only once, in the 1994 failure of The Meriden Trust & Safe Deposit Company, Meriden, Connecticut.

General Overview of the FDIC's Role as Receiver

Congress has entrusted the FDIC with complete responsibility for resolving failed federally insured depository institutions and has conferred expansive powers to ensure the efficiency of the process. The FDIC as receiver is not subject to the direction or supervision of any other agency or department of the United States, or of any state, in the operation of the receivership. Those congressional provisions allow the receiver to operate without interference from executive agencies and to exercise its discretion in determining the most effective resolution of the institution's assets and liabilities. In exercising that authority, the FDIC is expected to maximize the return on the assets of the failed bank or thrift and to minimize any loss to the deposit insurance fund.

As receiver, the FDIC succeeds to the rights, powers, and privileges of the institution and its stockholders, officers, and directors. It may collect all obligations and money due to the institution, preserve and liquidate its assets and property, and perform any other function of the institution consistent with its appointment.

The FDIC as receiver is also responsible for liquidating the failed institution's assets and using the proceeds to pay proven creditors. Typically, creditor claims are paid through periodic dividend distributions from the receiver to the extent that liquidation proceeds are available after expenses and obligations. To promote the rapid return of liquidity to creditors, including depositors and the banking system, the FDIC is able to declare "advance" or "accelerated" dividends based on an estimate of recoveries on the assets retained in receivership.[7]

As receiver, the FDIC also has the power to merge a failed institution with another insured depository institution and to transfer its assets and liabilities without the consent or approval of any other agency, court, or party with contractual rights. Furthermore, the

7. For further information on the payment of dividends, see Chapter 10, Treatment of Uninsured Depositors and Other Creditors.

FDIC may form a new institution, known as a bridge bank, to take over the assets and liabilities of the failed institution, or it may sell or pledge the assets of the failed institution to the FDIC in its corporate capacity.[8]

In many respects, the powers of a receiver and a conservator are similar. Many of the statutory powers of a receiver, however, are expressly conferred upon a conservator, while certain powers are limited to the receiver. The guiding principle is to grant to the FDIC acting in either capacity those powers and obligations most consistent with performance of its statutory role. A conservatorship is designed to operate the institution for a period of time in order to return the institution to a sound and solvent operation. [9] While in conservatorship, the institution remains subject to the supervision of the appropriate state or federal banking agency. The conservator's goal is to preserve the "going concern" value of the institution. For example, a conservator, like a receiver, is empowered to dishonor or repudiate contracts such as leases, but it may decline to do so if the contracts would benefit the open institution's business.

FDIC's Closing Function

When a bank or thrift is closed by its chartering authority and the FDIC is appointed receiver, the first task is to take custody of the failed institution's premises and all of its records, loans, and other assets. After taking possession of the premises, the FDIC posts notices to explain the action to the public. It changes locks and combinations as soon as possible. Then, it notifies correspondent banks and other appropriate parties of the closing.

The FDIC closing staff, working in conjunction with employees of the failed institution, bring all accounts forward to the closing date and post all applicable entries to the general ledger, making sure that everything is in balance. The FDIC then creates two complete sets of inventory books containing an explanation of the disposition of the failed institution's assets and liabilities, one set for the assuming institution (if there is one) and one for the receivership.

The FDIC's Receivership Functions

A receiver steps into the shoes of an insolvent party with the goal of liquidating the entity. Federal law grants the FDIC additional special powers. Through those powers,

8. While the FDIC in either its corporate or receivership capacity can establish a bridge bank, to date all bridge banks have been established by the FDIC in its corporate capacity.

9. Resolution Trust Corporation (RTC) conservatorships differed in their purpose. Instead of operating institutions with the objective of returning them to a sound position, the RTC downsized and stabilized the operations of the failed institutions until a more permanent solution could be found.

the FDIC can minimize the receivership estate's exposure to loss, thereby increasing the amount available for reimbursement to the FDIC and other creditors. Many reasons for the special powers include the provision of common standards and uniform expectations of creditors, shareholders, and the public.

The FDIC's role and responsibilities when serving as receiver are defined by specific statutory provisions contained in the Federal Deposit Insurance Act (FDI Act) of 1950. Those additional powers enable the FDIC to maintain confidence in the national banking system by expediting the liquidation process for banks and thrifts and preserving a strong deposit insurance fund by maximizing the cost-effectiveness of the receivership process. The FDIC as receiver is not subject to court supervision, but its decisions are subject to limited judicial review. The most significant of the additional powers fall into five broad categories: determining claims, repudiating contracts, placing litigation on hold, avoiding fraudulent conveyances, and using special defenses.

Determining Claims

The receiver has the power to determine whether to allow or disallow claims. Section 11(d) of the FDI Act sets forth the mechanisms and deadlines for claims against commercial banks and thrift institutions in receivership.

Two basic types of unsecured claims are in a receivership: uninsured deposit claims and general creditor claims. Uninsured deposit claims are those that may be filed by depositors who had deposits over the federally insured limit. Uninsured deposit claims (as well as insured deposit claims) are second only to administrative claims in the priority of creditors.

General creditor claims comprise all other unsecured claims against the receiver for the failed institution. Those include claims from vendors, suppliers, and contractors of the failed institution; claims arising from leases; claims arising from employee obligations; and claims asserting damages from business decisions of the failed institution or receiver.

Promptly after its appointment as receiver, the FDIC publishes a notice to the failed institution's creditors, generally in a local newspaper, that they must present their claims by a specified date (the bar date). All claimants, including those who may have been suing the failed institution, must then file proof of their claims with the receiver by the bar date. Failure to submit a claim by the bar date results in a final disallowance of the claim. After a claim has been filed, the receiver has 180 days from the date of filing the claim to determine if the claim should be allowed or disallowed.

The payment of any claim (other than claims of secured creditors) depends on the availability of assets in the receivership estate from which to pay the claim and on whether the claim is provable to the satisfaction of the receiver. The receiver is authorized, in its discretion and to the extent funds are available, to pay such claims. The receiver also has the authority, in its sole discretion, to pay dividends on any proven claim at any time. Even if no funds are currently available for distribution, the receiver will provide the proven claimant with a receivership certificate evidencing entitlement to a pro rata share in the receivership estate.

Since August 10, 1993, the priority for paying allowed claims against a failed depository institution has been determined by federal law. On that date President Clinton signed the Omnibus Budget Reconciliation Act of 1993, which amended section 11(d)(11) of the FDI Act to establish a national priority scheme for the distribution of assets from failed insured depository institutions. That amendment, known as the National Depositor Preference Amendment, provided payment priority to depositors, including the FDIC as subrogee, over general unsecured creditors. The statute applies to all receiverships established on or after its enactment. For receiverships established before that date, distribution of the assets is still determined according to the law of the chartering jurisdiction, either state or federal.

Under the National Depositor Preference Amendment, after payment of secured claims, claims are paid in the following order of priority:[10]

1. Administrative expenses of the receiver;
2. Deposit liability claims (the FDIC claim takes the position of all insured deposits);[11]
3. Other general or senior liabilities of the institution;
4. Subordinated obligations; and
5. Shareholder claims.

Inasmuch as most liabilities of a failed institution are deposit liabilities, the practical effect of depositor preference in most situations is to eliminate any recovery for unsecured general creditors.[12]

Repudiating Contracts

To wind up the institution's affairs efficiently, a receiver may repudiate contracts of the depository institution that it deems burdensome. Financial institutions often enter into contractual or lease arrangements that at the time of bank or thrift receivership are burdensome in terms of duration or cost, or in terms of need to the receiver. The power to disaffirm or repudiate a contract simply permits the receiver to terminate the contract, thereby ending any future obligations imposed by the contract. The receiver must decide to repudiate a contract within a "reasonable period" or lose its right to do

10. Secured creditors have their claims paid to the extent of the collateral; if they are undersecured, they then have a claim as a general creditor for the excess over the collateral.

11. Because of the manner in which the FDI Act defines a "deposit," foreign deposits do not obtain the benefit of this priority and are paid with the other general or senior liabilities of the institution.

12. For further information on the payment and priority of claims, see Chapter 10, Treatment of Uninsured Depositors and Other Creditors.

so.[13] In addition, the receiver may be liable for some damages resulting from the repudiation of a contract; however, those damages are limited to actual, direct compensatory damages determined as of the date of the receiver's appointment.[14]

Placing Litigation on Hold

Following its appointment as receiver, the receiver is responsible for litigation pending against the failed bank or thrift. However, because the receiver needs time to assess and evaluate the facts of each case to decide whether and how to proceed, the law permits the receiver to put litigation on hold, or to "stay" it. That power also extends to litigation filed after the institution's failure. The receiver must request the stay for it to become effective. The courts, however, cannot decline to issue the stay once the receiver has filed its request.[15]

When litigation resumes after a stay is lifted, the receiver is generally entitled to have the controversy resolved in either state or federal court. Typically, when the litigation is before a state court, the FDIC has the added flexibility to either keep it in state court or to "remove" it to federal court.

A special statute of limitations exists for actions brought by a receiver. Under the statute, the receiver has up to six years to file a contract claim and up to three years to begin a tort suit.[16]

Avoiding Fraudulent Conveyances

A receiver has the power to avoid certain fraudulent conveyances. Under federal banking law, a receiver may avoid a security interest in a property, even if perfected, in which the security interest is taken in contemplation of the institution's insolvency or with the intent to hinder, delay, or defraud the institution or its creditors. The receiver may avoid any transfers made by obligors within five years of the appointment of the receiver. Those rights are superior to any rights of a trustee or any other party.

13. In giving those powers to the FDIC and the RTC, Congress specifically elected not to impose a particular time limitation within which the receiver might properly repudiate. Thus, whether the receiver has repudiated within a reasonable time depends on the circumstances of the case.

14. A different standard of damages applies in the case of qualified financial contracts.

15. A receiver may obtain a stay for 90 days; a conservator is allowed 45 days.

16. Tort actions are lawsuits that seek compensation for a civil wrong (as opposed to a crime) committed by someone against another person. They include lawsuits for personal injury or property damage due to negligence, as well as suits for libel, false arrest, and other disputes.

Using Special Defenses

Over the years, both common law and federal statutes have provided certain special defenses—such as "improperly documented agreements are not binding on the receiver" and "courts may not enjoin the receiver"—to the FDIC in its role as receiver to allow for the efficient resolution of the failed institution's affairs.

Improperly documented agreements are not binding on the receiver. Like bank regulators, the receiver must be able to rely on the books and records of the failed financial institution to evaluate its assets and liabilities accurately. For the receiver, the ability to rely on the failed institution's records in resolving the institution's affairs is critical in completing cost-effective resolution transactions, such as the sale of assets to third parties, and in effectively collecting debts due to the failed bank or thrift.

As a result, both common law (*D'Oench Duhme*) and the FDI Act, *U.S. Code,* volume 12, sections 1823(e) and 1821(d)(9)(A), recognize that, unless an agreement is properly documented in the institution's records, it cannot be enforced against the receiver either to make a claim or to defend against a claim by the receiver. Therefore, an argument by an obligor on a promissory note that an undocumented, unrecorded side agreement changes or releases the duty to repay the loan generally will be barred. The FDIC has issued a policy statement on the use of D'Oench Duhme and similar statutes.[17]

Courts may not enjoin the receiver. Congress has provided the FDIC as receiver with additional protection by prohibiting courts from issuing injunctions or similar equitable relief to restrain the receiver from completing its resolution and liquidation activities. For example, the FDI Act bars an injunction to prevent foreclosures or asset sales. Similarly, courts are prohibited from issuing any order to attach or execute upon any assets in the possession of the receiver. Those statutory provisions, however, do not bar the recovery of monetary damages.

Settlement with the Assuming Institution

The FDIC and the assuming institution handle most of their post-closing activities through the "settlement" process. The settlement date may be from 180 days to 360 days after the bank or thrift closing, depending on the failed institution's size. Adjustments made between the institution's closing date and the settlement date reflect (1) the exercise of options by the acquirer, (2) any repurchase of assets needed by the receiver or "put back" of assets to the receiver by the assuming institution, and (3) the valuation of assets sold to the acquirer at market prices.

17. See *Federal Register 5984* (February 10, 1997).

Management and Accounting for Receiverships

Each receivership is operated as a separate entity. During the peak years of 1990 to 1992, the FDIC actively managed nearly 1,000 receiverships and terminated on average 110 receiverships each year. In addition, at its peak in 1992, the Resolution Trust Corporation (RTC) actively managed about 650 receiverships. Both the FDIC and the RTC had to develop and maintain separate accounting for each of those receiverships. As a result, the agencies developed allocation methods to distribute income and expenses among the various receiverships.

Professional Liability Claims

The FDIC conducts an investigation into each failed institution to determine if negligence, misrepresentation, or wrongdoing was committed. Any funds recovered from those investigations are returned to the receivership.[18]

Terminating a Receivership

Receivership termination represents the final process of winding up the affairs of the failed institution. All significant issues must be resolved before termination. The duration of a receivership varies depending on individual circumstances, such as type of closing; volume and quality of assets retained by the receivership; and the existence of defensive litigation, environmentally impaired assets, employee benefit plans, and professional liability claims.

Conclusion

The FDIC as receiver helps ensure the stability of the financial system in times of stress by providing for the timely resolution of failed institutions. This stability helps promote public confidence in the system and restores liquidity to the economy by quickly returning assets of the failed banks to the private sector. In addition, cost-effective receivership management helps ensure strong insurance funds.

The FDIC's roles of insurer and receiver have allowed it to make payments to insured depositors almost immediately after their institution fails and to make subsequent payments to uninsured depositors in a timely manner. This action has minimized the disruption to depositors, mitigated the adverse economic effects of financial

18. For further information, see Chapter 11, Professional Liability Claims.

institution failures, and promoted public confidence in the banking system during a time of severe stress in the banking industry. No insured depositor has ever lost any funds in an FDIC insured institution.

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On July 5, 1934, Mrs. Lydia Lobsiger received the first federal deposit insurance disbursement, following the failure of the Fond Du Lac State Bank, East Peoria, Illinois.

Although the insurance coverage amount is simple to understand, the process for determining the insurance coverage is complex and time-consuming. The FDIC has to identify and define ownership rights and capacitities according to statutes.