



## CHAPTER 8

# Bank of New England Corporation

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|-----------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Name of Institution:</b> | Bank of New England Corporation                                                                                                                           |
| <b>Subsidiary Banks:</b>    | Bank of New England, N.A., Boston, Massachusetts<br>Connecticut Bank & Trust Company, N.A., Hartford, Connecticut<br>Maine National Bank, Portland, Maine |
| <b>Date of Resolution:</b>  | January 6, 1991                                                                                                                                           |
| <b>Resolution Method:</b>   | Formation of Bridge Banks                                                                                                                                 |
| <b>Date of Resolution:</b>  | July 12, 1991                                                                                                                                             |
| <b>Resolution Method:</b>   | Sale of Bridge Banks by Dissolution and<br>Purchase and Assumption Transaction                                                                            |

### Introduction

The January 6, 1991, failure of the Bank of New England (BNE), Boston, Massachusetts, and its two sister banks, Connecticut Bank & Trust Company (CB&T), Hartford, Connecticut, and Maine National Bank (MNB), Portland, Maine, was the largest since the 1989 collapse of MCorp and the 1988 collapse of the First Republic Bank Corporation, both of Dallas, Texas. All three banks were owned by Bank of New England Corporation (BNE Corp.). The failures received a lot of news media attention because 45 credit unions without federal deposit insurance had been closed in nearby Rhode Island on New Year's Day.<sup>1</sup>

In addition to being very large, the resolution of the BNE Corp. banks is notable because the FDIC, considering the region's financial conditions, decided to protect all depositors (except those affiliated with BNE Corp.), including those whose total deposits exceeded the \$100,000 insurance limit. Of the approximately \$19.1 billion on deposit in the three banks, more than \$2 billion were in accounts larger than \$100,000. Then-FDIC Chairman L. William Seidman stated, "It was clear to us that to protect the stability of the system, we should protect all depositors."<sup>2</sup>

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1. L. William Seidman, *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas* (New York: Times Books, 1993), 165.

2. Stephen Labaton, "U.S. Is Taking Over a Group of Banks to Head Off a Run," *The New York Times* (January 7, 1991), A1.

The FDIC again used its bridge bank powers in the resolution of Bank of New England, Connecticut Bank & Trust Company, and Maine National Bank, and the FDIC used its cross guarantee assessment authority to assess MNB for the FDIC's costs associated with the BNE failure. As part of the transaction, the FDIC injected \$750 million of capital into the bridge banks. A small trust company, BNE Trust Company, West Palm Beach, Florida, that was also owned by the holding company, BNE Corp., did not fail.

### General Description of the Bank

BNE, based in Boston, was one of the largest banks in the commonwealth of Massachusetts and at the time of its failure was the 33rd largest bank in the United States. CB&T, based in Hartford, was the second largest bank in the state of Connecticut. These two banks, along with a sister bank, MNB, had \$21.8 billion in total assets and 117 branch locations throughout New England. They also held more than \$19 billion in deposits at the time of their failure.

### Background

For many years, BNE profited from the booming economy in the Northeast and from a series of acquisitions that greatly increased its size. The lending problems emerged in early 1990 when, after a bank examination, BNE announced a \$1.23 billion loss for the fourth quarter of 1989. As bad loans mounted, the bank set aside reserves for loan losses that amounted to about \$650 million in 1990.

#### *Economic Conditions*

While the southwestern portion of the United States in the 1980s was suffering from problems with oil and gas loans, as well as huge real estate losses, the Northeast had continued to grow. Real estate prices, and the economy in general, grew by nearly 20 percent annually for several years. But, by 1990, real estate values in the Northeast were falling. Vacancy rates for both residential and commercial properties were rising.<sup>3</sup> The condominium market, particularly Connecticut's, was overflowing, with some areas having more than a two-year supply of vacant units.<sup>4</sup> The state of the real estate market was felt by the banking industry in the region.

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3. National Association of Realtors, "Home Sales," vol. 5, no. 11 (November 1991), 10, 13, 19; CB Commercial Torto/Wheaton Research, "The Office Outlook Report," vol. 1 (September 1993).

4. Katherine Morrall, "Weakening Northeast Real Estate Market Raises Concerns," *Savings Institutions*, vol. 111, no. 4 (April 1990), 11-14, as provided in extract available from ProQuest.

During 1990, the number of FDIC insured problem banks declined from 1,109 to 1,046, but the volume of assets in those institutions increased dramatically. The problem banks had \$408.8 billion in assets in 1990, nearly double the \$235.5 billion in assets in 1989. By the end of 1990, 2.9 percent of all commercial banking assets were classified as troubled.<sup>5</sup> For all FDIC insured banks, troubled assets increased by \$23.5 billion in 1990, or nearly three times the previous year's increase of \$8.2 billion. Net charge-offs for banks nationwide rose to a record \$29 billion, compared with the previous high of \$23 billion in 1989.<sup>6</sup>

BNE was not the only bank in the region with problems. Forty percent of all banks in the Northeast reported negative income for 1990. Nonperforming assets at Northeast banks peaked at 5 percent of total assets, and nonperforming loans accounted for more than 8 percent of all loans.

### *Problems at Bank of New England*

A new management team, headed by Lawrence K. Fish, was installed in BNE early in 1990. In February and April 1990, BNE, CB&T, and MNB all consented to cease and desist orders with the Office of the Comptroller of the Currency (OCC) that required them to, among other things, improve their real estate lending procedures and tracking systems and to increase capital. BNE Corp. presented a recapitalization plan to the Federal Reserve Bank of Boston (Federal Reserve) that proposed the sale of its Maine and Rhode Island subsidiaries for \$189 million and would have allowed the banking subsidiaries to repurchase \$344 million of their debt at a substantial discount. Overall, the plan would have increased equity by \$185 million. The Federal Reserve did not approve the plan as presented.<sup>7</sup>

By September 1990, almost half the loans BNE had made for construction projects, and nearly 20 percent of its mortgage loans for commercial projects, were delinquent.<sup>8</sup> It was thought, however, that the solid consumer branch networks of BNE and CB&T would be enough to pull BNE Corp. through the problems.<sup>9</sup> The press indicated that proposals by BNE Corp. bondholders to exchange their bonds for stock were actively discussed in late December 1990, but no transactions were completed.<sup>10</sup> On Friday, January 4, 1991, BNE Corp. indicated that it had lost up to \$450 million in the fourth quarter of 1990, mostly as a result of losses on its delinquent real estate loans.<sup>11</sup> (See table II.8-1.)

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5. Troubled assets were defined as loans that were 90 days or more past due, loans no longer earning interest, and owned real estate.

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

7. Thomas E. Cimeno, Jr., Senior Vice President, Federal Reserve Bank of Boston, letter addressed to Edward Lane-Reticker, Secretary, Bank of New England Corporation (June 20, 1990).

8. Cimeno, letter, June 20, 1990.

9. Comptroller of the Currency, News Release (January 6, 1991).

10. Michael Quint, "A Success Story Turns Sour in New England," *The New York Times* (January 7, 1991), D8.

11. "BNEC Projects Fourth Quarter Results," *PR Newswire Association, Inc.* (January 4, 1991), Financial News Section.

Table II.8-1

**Bank of New England Corporation Institutions  
Information as of September 30, 1990**

(\$ in Millions)

|                    | Assets          | Liabilities     | Equity       | Income        |
|--------------------|-----------------|-----------------|--------------|---------------|
| BNE                | \$13,172        | \$13,062        | \$110        | -\$174        |
| CB&T               | 7,711           | 7,477           | 234          | -5            |
| MNB                | 1,050           | 983             | 66           | 4             |
| <b>BNE Corp. *</b> | <b>\$23,042</b> | <b>\$22,787</b> | <b>\$255</b> | <b>-\$203</b> |

\* Bank subsidiary figures will not equal the holding company's totals because of other holding company assets that are not reflected in these figures.

Source: Comptroller of the Currency, News Release (January 6, 1991).

*Preparation for Resolution*

BNE and BNE Corp. bondholders who owned more than \$700 million in BNE securities had proposed a rescue plan for the bank in December 1990. On January 3, 1991, bank management offered a revision to that plan under which the bondholders would swap all of their debt securities for about 95 percent of new BNE common stock. The transaction would have erased about \$700 million of debt from the books of BNE Corp., and its offsetting equity would have been an increase in the capital of the bank. The plan also proposed raising an additional \$100 million through a shareholder rights offer, but it depended on the FDIC's contribution of at least \$200 million.<sup>12</sup> Bank executives worked on the plan throughout the following weekend, but were unable to complete it before the bank failed.

On Saturday, January 5, 1991, the FDIC Board of Directors met to discuss BNE's financial condition. The governor of nearby Rhode Island had recently closed 45 credit unions and, because of the insolvency of that state's deposit insurance fund, the insured depositors in those credit unions were unable to retrieve their money. Publicity surrounding that event, coupled with BNE Corp.'s announcement of loss, was contributing to public fears for the safety and soundness of BNE and its affiliates. As Comptroller of the Currency Robert L. Clarke stated later, "Clearly, we were thinking about Rhode Island." Even though the problems with the credit unions were unrelated to BNE, Clarke said, ". . . it makes people real nervous. People who are not familiar with these things don't always make distinctions. All they know is they can't get their money."<sup>13</sup>

12. Peter G. Gosselin and Doug Bailey, "Last Ditch Rescue Plan Fell Short," *The Boston Globe* (January 7, 1991), 1.

13. Peter G. Gosselin and Doug Bailey, "US Takes Over the Bank of N.E.; \$750M To Be Pumped into Broke Institution," *The Boston Globe* (January 7, 1991), 1.

### *Essentiality Test of Deposits In Excess of the Insurance Limit*

The FDIC identified the major categories of customers with deposits in excess of the insurance limit in the event that only insured deposits were passed to an acquirer and determined that the effect of that action on the community at large outweighed the benefits of paying insured deposits only. Both the Federal Reserve and the Treasury Department supported the idea that all depositors be protected. “It was clear to us that to protect the stability of the system, we should protect all depositors,” said Chairman Seidman.<sup>14</sup>

### **The Resolution—January 6, 1991**

The OCC closed both BNE and CB&T on Sunday, January 6, 1991, and appointed the FDIC as receiver. The FDIC exercised its cross guarantee authority and ordered the payment of \$1,015,000 by the affiliated MNB. The OCC then declared MNB insolvent and closed that bank as well.<sup>15</sup>

The FDIC created three bridge banks: New Bank of New England, N.A. (New BNE), Boston, Massachusetts, with assets of approximately \$8 billion; New Connecticut Bank & Trust Company, N.A. (New CB&T), Hartford, Connecticut, with assets of approximately \$6.4 billion; and New Maine National Bank (New MNB), Portland, Maine, with assets of approximately \$800 million.<sup>16</sup>

All three bridge banks were opened for business on Monday, January 7, 1991. The Federal Reserve announced that it was prepared, in accordance with customary arrangements, to meet any unusual liquidity needs of the banks.<sup>17, 18</sup>

The FDIC fully protected all deposits of all three failed banks, including those deposits exceeding the \$100,000 insurance limit. All deposits were transferred to the new banks. Liabilities to trade creditors, employees, and qualified financial contracts such as foreign exchange contracts and interest rate swaps, also were transferred to the bridge banks.<sup>19</sup> Not all creditors were offered full protection. Instead, the FDIC

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14. Labaton, “U.S. Is Taking Over a Group of Banks to Head Off a Run,” A1.

15. The cross guarantee authority discourages multi-bank holding companies from transferring losses that occurred at their better-capitalized institutions into troubled sister institutions. Without the cross guarantee authority, losses might be transferred to weak banks that are then allowed to fail, and the deposit insurance fund would have to bear the losses, rather than the holding companies.

16. FDIC News Release, PR-61-91, “FDIC to Sell Bank of New England Franchise to Fleet/Norstar” (April 22, 1991).

17. A Federal Reserve Bank customarily makes loans that are “secured to the satisfaction of such Federal Reserve Bank.” Irvine H. Sprague, *Bailout* (New York: Basic Books, 1986), 213.

18. FDIC News Release, PR-3-91, “FDIC Establishes Three New Banks to Assume Deposits of Bank of New England, N.A., Boston, Massachusetts, Connecticut Bank & Trust Company, N.A., Hartford, Connecticut, and Maine National Bank, Portland, Maine” (January 6, 1991).

19. FDIC News Release, PR-3-91.

Table II.8-2

**Bridge Banks**

|          | <b>Total Assets</b> |
|----------|---------------------|
| New BNE  | \$13.9 billion      |
| New CB&T | 7.1 billion         |
| New MNB  | 1.0 billion         |

Source: FDIC News Release, PR-61-91, "FDIC to Sell Bank of New England Franchise to Fleet/Norstar" (April 22, 1991).

announced that other nonsubordinated creditors (those affiliated with BNE Corp.) would share pro rata with the FDIC in the receivership estates of the failed banks. Neither did the new banks assume any of the liabilities of the parent holding company, BNE Corp., or its creditors.<sup>20</sup>

The bridge banks were set up with \$750 million in capital to continue operating the bridge banks.<sup>21</sup> The capital was distributed as follows: \$450 million to New BNE and \$250 million to New CB&T and \$50 million to New MNB.<sup>22</sup> Lawrence K. Fish was named chairman of the three bridge banks.

*Selection of the Winning Bidder*

The three bridge banks were marketed and, on April 22, 1991, the FDIC Board of Directors approved the bid of Fleet/Norstar Financial Group (Fleet), Providence, Rhode Island, for all three of the bridge banks.<sup>23</sup> The FDIC entered into an interim management agreement with Fleet to manage the bridge banks until the purchase and assumption (P&A) transaction could be consummated. The FDIC also entered into a service agreement with Fleet for the servicing of the former banks' problem assets.

The FDIC Board of Directors selected the acquirer by using the "essentiality" exemption from the cost test as provided in the Federal Deposit Insurance Act (FDI Act). The exemption was specifically contained in Section 13(c)(4)(A) of the FDI Act:

No assistance shall be provided under this subsection in an amount in excess of that amount, which the Corporation determines to be reasonably necessary to

20. FDIC News Release, PR-3-91.

21. FDIC News Release, PR-3-91.

22. FDIC, *Equity Investment Portfolio, Bank Insurance Funds* (December 31, 1993), 22-24.

23. FDIC News Release, PR-61-91.

save the cost of liquidating, including paying the insured accounts of, such insured depository institution, except that such restriction shall not apply in any case in which the Corporation determines that the continued operation of such insured depository institution is essential to provide adequate depository services to its community.<sup>24</sup>

This exemption permitted the FDIC to provide assistance without performing an analysis of the cost because it had determined that “the continued operation of [the banks was] essential to provide adequate depository services” in their respective communities. This type of exemption to the cost test was eliminated by the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991, passed later in the year. FDICIA requires the FDIC to always use the least costly resolution method except in the case of systemic risk.

Fleet’s existing Connecticut and Maine banking entities acquired the assets and liabilities of New CB&T and New MNB; Fleet established a new bank named Fleet Bank of Massachusetts, N.A. (Fleet Boston) to absorb the New BNE assets and liabilities.<sup>25</sup>

Fleet’s bid had originally requested capital assistance from the FDIC, but it was able to raise \$683 million of new capital with the assistance of Kohlberg, Kravis Roberts & Co. (KKR), Merrill Lynch, and Salomon Brothers. Fleet also put \$67 million of its own money into the transaction;<sup>26</sup> KKR provided an additional \$283 million. Chairman Seidman said, “We are delighted to see this new money coming into the banking system.”<sup>27</sup>

The partnership between Fleet and KKR had mutual benefits. Fleet needed the capital provided by KKR to qualify for the right to bid. KKR, however, was unable to bid for a banking entity on its own, because of the provisions of the Bank Holding Company Act that limited ownership of a bank by nonbank institutions to less than 25 percent.<sup>28</sup> In the bid for the bridge banks, KKR assumed a passive role in the transaction. The bid for the bridge banks also marked the first time since the Great Depression that a nonbank investor participated in the acquisition of a failed commercial bank.<sup>29</sup> Chairman Seidman was reported as saying that the Fleet bid had been chosen over the other bidders for one reason: Its bid represented the lowest-cost alternative for the deposit insurance fund.<sup>30</sup>

BNE and CB&T had agreed to sell their corporate trust business to State Street Bank and Trust Company (State Street), Boston, Massachusetts, prior to their failure. After the

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24. See *U.S. Code*, volume 12, section 1823(c)(4)(A).

25. Fleet had acquired the failed Maine Savings Bank, Portland, Maine, which failed on February 1, 1991.

26. Doug Bailey and Peter G. Gosselin, “Fleet, Partner To Buy Bank of N.E.; With \$875M Offer, R.I. Bank and N.Y. Firm Win Bidding War,” *The Boston Globe* (April 23, 1991), 1.

27. FDIC News Release, PR-61-91.

28. Geoffrey Smith, “Right Time, Right Place, Right Price”, *Business Week*, No. 3212 (May 6, 1991), Top of the News Section, 28.

29. Bailey and Gosselin, “Fleet, Partner To Buy Bank of N.E.; With \$875M Offer, R.I. Bank and N.Y. Firm Win Bidding War,” 1.

30. Bailey and Gosselin, “Fleet, Partner To Buy Bank of N.E.; With \$875M Offer, R.I. Bank and N.Y. Firm Win Bidding War,” 1.

Table II.8-3

### Discounts Taken by the FDIC in Calculating the Purchase Price of Assets Put Back

| Period after Commencement Date | Discount Percentage |
|--------------------------------|---------------------|
| 0-365 days                     | 0                   |
| 13-24 months                   | 2                   |
| 25-36 months                   | 4                   |

Source: Assistance Agreement among the FDIC, in its corporate capacity; Fleet/Norstar Financial Group, Inc.; Fleet/Norstar Holding Company, Inc.; and the FDIC as receiver of New Bank of New England, N.A.; New Connecticut Bank and Trust Company, N.A.; and New Maine National Bank (July 12, 1991), 111-112.

failure of those banks, the FDIC, as receiver, transferred the trust business to the bridge banks and disaffirmed the Sale Agreement with State Street. Notwithstanding the disaffirmance, the FDIC, Fleet, and State Street jointly agreed that the sale should proceed. The FDIC completed that transaction on September 3, 1991, with an effective date of July 14, 1991.<sup>31</sup>

### Structure of the Transaction

Three of the characteristics of the purchase and assumption transaction involved shared equity, put back provisions, and a servicing agreement.<sup>32</sup>

- **Shared Equity:** The FDIC received as a premium an issue of preferred stock worth approximately \$100 million, plus a cash premium of \$25 million. The FDIC purchased class I and class II preferred stock from Fleet for both the New BNE and the New CB&T transactions.<sup>33</sup> The proceeds were used as capital to provide Fleet with the capital ratios required for the transaction.
- **Put Options:** Fleet purchased all nonclassified commercial, industrial, and commercial real estate loans. The FDIC provided Fleet with a three-year option to put back to the FDIC any commercial asset that became classified after the date it was acquired by Fleet. The price the FDIC was required to pay for assets put back was discounted over time; in general, the longer the period that Fleet held and managed the assets prior to the put back, the larger the discount taken by the FDIC. All 1-4 family real estate loans with a book value of less than \$191,250 and all other consumer loans with a book value of less than \$100,000 were acquired without any put back provision. Table II.8-3 represents the discounted amount over time.

31. Fleet/Norstar Financial Group, Inc., and Fleet Bank of Massachusetts, N.A., to the FDIC, Letter re: Instrument of Appointment effective as of July 14, 1991, by the FDIC as Receiver of New Bank of New England, N.A., and the New Connecticut Bank and Trust Company, N.A., to State Street Bank and Trust Company (September 13, 1991) and attached Instrument of Appointment (September 3, 1991).

32. FDIC, "Revised Instructions to Bidders" regarding structure of transaction governing assisted acquisitions of New Bank of New England, N.A., New Connecticut Bank & Trust Company, N.A., and New Maine National Bank (March 14, 1991).

33. Refer to the section of this chapter entitled "The Stock Transactions."



- **Service Agreement:** All classified loans and owned real estate of the three banks were owned by the FDIC and placed in a special asset pool. The FDIC and Fleet entered into a five-year service agreement under which Fleet would service and collect loans on behalf of the FDIC. In general, the FDIC reimbursed Fleet for eligible costs actually incurred in servicing the pool of assets. In addition, incentive fees were given based on a percentage of cumulative net collections to gross book value. The graduated incentives are shown in Table II.8-4.

**Table II.8-4****Incentive Fee Structure for Servicing Agreement**

| <b>Cumulative Net Collections as a Percentage of Gross Pool Value</b> | <b>Incentive Fees as a Percentage of the Cumulative Net Collections</b> |
|-----------------------------------------------------------------------|-------------------------------------------------------------------------|
| Over 0% to and including 20%                                          | 1.5                                                                     |
| Over 20% to and including 31%                                         | 4.0                                                                     |
| Over 31% to and including 39%                                         | 7.5                                                                     |
| Over 39% to and including 46%                                         | 11.0                                                                    |
| Over 46% to and including 50%                                         | 18.5                                                                    |
| Over 50%                                                              | 27.5                                                                    |

*Source:* Service Agreement by and among Fleet/Norstar Financial Group, Inc.; RECOLL Management Corporation; New Bank of New England, N.A.; New Connecticut Bank and Trust Company, N.A.; New Maine National Bank; and the FDIC (June 1, 1991), 18.

As part of the bridge bank resolution, the 108-branch Fleet Bank of Maine would have acquired the 40 branches of New MNB. Even before the purchase, Fleet Bank of Maine was that state's largest financial institution, with \$2.9 billion in deposits or nearly 22 percent of the state's total deposits. The purchase of New MNB by Fleet added another \$1 billion in deposits, or 7.2 percent of the state's deposits. The U.S. Department of Justice viewed this situation as anti-competitive, and on July 5, 1991, Fleet agreed to re-sell six of the Maine branches it was acquiring to settle the antitrust concerns of the U.S. Department of Justice before it could file suit. A spokesman for Fleet stated that Fleet did not consider the sale of the six branches to reduce the value of the New MNB franchise. The six branches sold had a total of \$85 million in deposits.<sup>34</sup>

**The Liquidation**

While Fleet had been managing the bridge banks on an interim basis since April 29, 1991, the servicing agreement with Fleet to manage and dispose of all classified and charged-off assets of the failed banks began on June 1, 1991. Fleet established a wholly owned subsidiary, RECOLL Management Corporation (RECOLL), to manage the

34. Mitchell Zuckoff, "Fleet/Norstar to Sell 6 Branches in Maine to Settle Suit By US," *The Boston Globe* (July 6, 1991, 31).

FDIC's assets. The assets were placed in a separate asset pool that initially consisted of more than 17,000 substandard loans and 500 owned real estate properties with a total book value of \$5.8 billion. Fleet had the right to put back to the FDIC, within a three-year period, any loan from the failed banks that was later classified by Fleet's internal staff and the FDIC's examination staff. Such put backs also were added to the pool serviced by RECOLL.

RECOLL was given limited delegations and was supervised by an oversight committee consisting of two employees from the FDIC and one officer of Fleet. The oversight committee had unlimited delegations except for the authority to grant indemnifications. While RECOLL had operational responsibility for the management and disposition of the pool, it needed the committee's approval on the larger transactions. The oversight committee approved 75 percent (based on the total dollar amount of the pool) of all asset disposition decisions; other decisions were made by lower-level RECOLL committees.

RECOLL's initial assignment was massive, with numerous start-up challenges. RECOLL inherited approximately 360 account officers from BNE's collections and real estate sales departments. In only six months, RECOLL's staff had grown to nearly 1,000 and eventually reached 1,200. The former banks had operated collection offices from five different cities in three different states, and RECOLL merged two of these sites into the remaining offices by the end of 1991. Additionally, the former banks had approximately 30 different data processing systems that had to be converted into one system before adequate management reports could be obtained.

Another problem for RECOLL was the lack of available refinancing opportunities for borrowers with loans in the asset pool. Only six banks had failed in New England during the 1980s, but 88 banks failed in the region from 1990 through 1993. The remaining banks became increasingly conservative, and a "credit crunch" ensued. Small businesses were severely limited in their ability to refinance their debts serviced by RECOLL. A sizable number of loans in the asset pool that required the payment of interest only until the final due date (referred to as interest-only balloon loans) became known as "performing nonperforming" loans. The value of real estate in New England was declining and, even though borrowers were making required payments (performing), some of the balloon loans became classified because the underlying real estate collateral had insufficient value to support the debt amount or had passed their contractual maturity dates (nonperforming). The public perceived that RECOLL, on behalf of the FDIC, was foreclosing and litigating against borrowers whose loans were past maturity and technically delinquent, but whose only real fault was being in an economic environment where third-party refinancing was not available.

Some borrowers complained that RECOLL's account officers were being too aggressive in their collection tactics, and elected officials in the New England states took an active role in investigating RECOLL's practices. In response, RECOLL and the FDIC began holding town meetings in September 1991 to better communicate their mission to the public and to attempt to resolve individual borrower issues. RECOLL set up a

Borrower Review Office in October 1991 to investigate borrower complaints. In October 1991, the FDIC and Fleet began negotiating the repurchase of these borderline credits by Fleet, subject to a full buy-back guarantee by the FDIC. By the end of January 1992, Congressional hearings were scheduled in both Portland, Maine (February 1, 1992), and Boston, Massachusetts (February 3, 1992), to hear testimony from RECOLL borrowers, to review RECOLL's loan collection procedures, and to discuss the larger issue of the New England credit crunch.

The FDIC worked with officials of Fleet and RECOLL to address the complaints of borrowers and elected officials. Loan foreclosures were temporarily halted to put in place steps to review all loans in foreclosure or litigation, and the authority within RECOLL to initiate litigation was restricted. The FDIC conducted a site visitation to review litigation, and RECOLL subsequently revised its policies and procedures regarding the initiation of legal action. RECOLL staff received additional training in their policies and procedures.

In January 1992, Fleet announced that it would repurchase a package of approximately \$500 million of performing nonperforming loans from the special asset pool. Purchased loans had to have the following characteristics:

- Less than 30 days past due under original note terms or an existing workout or restructure agreement,
- Loan-to-value ratio of 125 percent or less,
- No related credit in the special asset pool,
- No pending litigation, and
- Cooperative borrower and optimistic recovery.

The sale contained two unusual provisions. First, the FDIC agreed that Fleet would have the right to return any of the loans for any reason until July 1994, allowing time for borrowers to establish a business relationship with the operating bank. Second, the FDIC also protected additional extensions of credit by Fleet to the affected borrowers up to a maximum of 10 percent of the amount of the loan purchased. Loans not purchased by Fleet would be offered to other financial institutions with the same terms and conditions.

After the public hearings, the FDIC issued a press release on February 13, 1992, clarifying its national liquidation and supervision policies.<sup>35</sup> In short, the FDIC stated the following:

- Borrowers current on their payments could continue according to the terms of their loans, and the FDIC would not foreclose or initiate litigation with current borrowers.
- When a current loan matured and the borrower was unable to refinance at another institution, the FDIC would work with the borrower to restructure the loan so that it could be sold to another financial institution.

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35. FDIC News Release, PR-21-92, "FDIC Clarifies Liquidation and Supervision Policies" (February 13, 1992).

- Bank examiners would not adversely classify loans (sold to another financial institution) that had loss protection by the FDIC.
- The press release also referenced the recently announced sale of loans to Fleet and indicated that borrowers with current loans managed by RECOLL who believed their loans should have been included in the package of loans purchased by Fleet were to write to the FDIC for a review of their situation.

The sale generated positive reviews from some of those who previously had been critical of the FDIC's handling of loans in New England. Massachusetts Representative Joseph P. Kennedy was quoted as saying, "The FDIC is not only recognizing that the credit crunch exists, but alleviating some of the lack of liquidity that banks have felt with regard to these troubled loans."<sup>36</sup> John Kyte, vice president of legislative affairs of the New England Council, a consortium of 500 businesses, said, "This is the first significant ray of hope I've seen. It offers the businessperson with temporary cash flow problems and capital shortages something to get over the hump."<sup>37</sup> But at the time of the sale there were still critics. "It reminds me of the strategy the big banks took in Latin America in the early 1980s," said Karen Shaw, president of the Institute for Strategy Development. "It seems like they're solving a different problem than the one they say they have."<sup>38</sup>

The FDIC viewed the loan sale as having achieved its goal. As the economy improved, more than two-thirds of the loans purchased were worked out in an open bank environment, which gave borrowers an opportunity to establish a financial relationship with an open institution instead of being liquidated. Fleet purchased 2,667 loans valued at approximately \$1.1 billion under the sale. As loans deteriorated, or as borrowers defaulted, Fleet would return the loans to the FDIC, which would repurchase them as required under the terms of the sale agreement. During the course of the contract, the FDIC repurchased 1,054 loans (40 percent of the loans sold) valued at approximately \$314 million (27 percent of value sold).

In addition, several years later, there remained \$834 million in loans still eligible for the July 1994 repurchase by the FDIC. These were loans in which the borrowers were able to continue making their interest payments but were still unable to obtain refinancing at other banks. Rather than return the loans, in 1994, the FDIC and Fleet negotiated an amendment to the loan purchase agreement that released the FDIC from its repurchase obligation in exchange for a percentage of the maximum repurchase price. Because of this agreement, the FDIC and Fleet were able to terminate the five-year servicing agreement approximately six months early.

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36. Debra Cope and Jim McTague, "Loan Gambit By FDIC Gets Cheers, Jeers," *American Banker* (February 7, 1992), 1.

37. Cope and McTague, "Loan Gambit By FDIC Gets Cheers, Jeers," 1

38. Cope and McTague, "Loan Gambit By FDIC Gets Cheers, Jeers," 1

Despite early problems, RECOLL effectively disposed of one of the largest and most complex asset pools of the FDIC. For the four and one-half year contract, RECOLL achieved book value reductions of \$6.5 billion, gross collections of \$4.2 billion, and net collections of \$3.6 billion, for an overall recovery rate (net collections to book value reductions ratio) of 55 percent. The collections were achieved within the four and one-half year period. The original contract term was shortened by six months to December 1995, and the FDIC absorbed the remaining assets into its other Northeast offices.

### The Stock Transactions<sup>39</sup>

#### *New BNE*

On January 6, 1991, the FDIC acquired 4,500,000 shares of class I preferred stock in the bridge bank through the note purchase agreement for an investment of \$450 million. The bridge bank stock was redeemed on July 12, 1991, for \$450 million to record the assistance agreement with Fleet.

*Class I Preferred Stock—Fleet Boston.* On July 16, 1991, as part of the premium for the bridge banks, Fleet gave the FDIC 560,000 shares of class I preferred stock in Fleet Boston; the stock had a value of \$56 million. No dividends were ever received on the class I preferred stock. In March 1992, Fleet Boston redeemed 140,435 shares of the class I preferred stock for \$14.5 million, which represented a gain to the FDIC of \$0.5 million. On March 31, 1993, Fleet redeemed the remaining shares of class I preferred stock for \$45.3 million, which represented a gain to the FDIC of \$3.3 million. In all, the total gain to the FDIC on the class I preferred stock was \$3.8 million.

*Class II Preferred Stock—Fleet Boston.* In December 1991, the FDIC purchased 280,000 shares of class II preferred stock in Fleet Boston for \$28 million. Dividends were received on the class II preferred stock as follows: \$0.4 million in September 1992; \$0.7 million on December 30, 1992; \$0.7 million on March 9, 1993; and \$0.5 million on May 12, 1993. Total dividends were \$2.3 million. On May 12, 1993, Fleet redeemed the 280,000 shares of class II preferred stock for \$29.8 million, which represented a gain to the FDIC of \$1.8 million. Dividends plus gain on redemption totaled \$4.1 million.

For all Fleet Boston stock, the FDIC received \$2.3 million in dividends and \$5.6 million in gains at redemption, for a total to the FDIC of \$7.9 million.

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39. All information relating to the stock transactions is taken from FDIC, *Equity Investment Portfolio, Bank Insurance Fund* (December 31, 1993), 22-24.

### *New CB&T*

On January 6, 1991, the FDIC acquired 2,500,000 shares of class I preferred stock in the bridge bank through the note purchase agreement for an investment of \$250 million. The bridge bank stock was redeemed on July 12, 1991, for \$250 million to record the assistance agreement with Fleet.

*Class I Preferred Stock—Fleet Hartford.* On July 12, 1991, as part of the premium for the bridge banks, Fleet gave the FDIC 440,000 shares of class I preferred stock in Fleet Hartford; the stock had a value of \$44 million. No dividends were ever received on the class I preferred stock. On March 31, 1993, Fleet redeemed all 440,000 shares of class I preferred stock for \$47.5 million, which represented a gain to the FDIC of \$3.5 million.

*Class II Preferred Stock—Fleet Hartford.* In December 1991, the FDIC purchased 220,000 shares of class II preferred stock in Fleet Hartford for \$22 million. Dividends were received on the class II preferred stock as follows: \$0.3 million in September 1992; \$0.6 million on December 30, 1992; \$0.5 million on March 9, 1993; and \$0.4 million on May 12, 1993. Total dividends were \$1.8 million. On May 12, 1993, Fleet redeemed the 220,000 shares of class II preferred stock for \$23.4 million, which represented a gain to the FDIC of \$1.4 million. Dividends plus gain on redemption totaled \$3.2 million.

For all Fleet Hartford stock, the FDIC received \$1.8 million in dividends and \$4.9 million in gains at redemption, for a total to the FDIC of \$6.7 million.

### *New MNB*

On January 6, 1991, the FDIC acquired 500,000 shares of class I preferred stock in the bridge bank through the note purchase agreement for an investment of \$50 million. The bridge bank stock was redeemed on July 12, 1991, for \$50 million to record the assistance agreement with Fleet. The FDIC never received stock in Fleet Portland.

On the sale of the three banks, the FDIC recovered \$14.6 million plus the \$100 million value of the original stock obtained as a part of Fleet's premium for the bridge banks.

## **FDIC Resolution Costs**

The FDIC infused capital into the bridge banks and purchased stock in Fleet Boston and Fleet Hartford. The FDIC also absorbed approximately \$270.7 million in bridge bank operating losses.

In early termination of the servicing agreement, RECOLL returned the MNB assets with a book value of \$5 million to the FDIC in April 1995, and the CB&T assets with a book value of \$28 million were returned to the FDIC at the end of August that same

year. The remaining BNE assets of approximately \$250 million were returned to the FDIC in December 1995.

Total resolution costs for Bank of New England, Connecticut Bank & Trust, and Maine National Bank were approximately \$889 million as of December 31, 1995, or about 4.1 percent of the total assets. See table II.8-5 for a summary of resolution costs.

### Lessons Learned

Because the FDIC protected all depositors in the BNE Corp. banks, the failures resulted in little disruption among the banks' depositors. In contrast to the situation in Rhode Island, where 45 credit unions without federal deposit insurance had failed only days earlier, depositors in the BNE Corp. banks were fully protected. Public confidence in the banking system and in the FDIC remained high.

**Table II.8-5**

### **BNE Corp. Banks Resolution Costs**

*(\$ in Thousands)*

|                                           | BNE              | CB&T             | MNB            | Total              |
|-------------------------------------------|------------------|------------------|----------------|--------------------|
| <b>Expenses</b>                           |                  |                  |                |                    |
| Stock purchase                            | \$28,000         | \$22,000         | \$0            | \$50,000           |
| Bridge bank losses                        | 103,010          | 103,001          | 2,137          | 208,148            |
| Losses on qualified financial contracts   | 62,506           | 0                | 0              | 62,506             |
| Allowance for receivership losses         | 580,810          | 152,497          | 0              | 733,307            |
| <b>Total FDIC expenses</b>                | <b>\$774,326</b> | <b>\$277,498</b> | <b>\$2,137</b> | <b>\$1,053,961</b> |
| <b>Recoveries</b>                         |                  |                  |                |                    |
| Sale of stock received as premium         | \$56,000         | \$44,000         | \$0            | \$100,000          |
| Gain on sale of stock received as premium | 3,757            | 3,436            | 0              | 7,193              |
| Sale of stock purchased                   | 28,000           | 22,000           | 0              | 50,000             |
| Gain on sale of stock purchased           | 1,820            | 1,430            | 0              | 3,250              |
| Dividends on stock                        | 2,318            | 1,821            | 0              | 4,139              |
| <b>Total FDIC Recoveries</b>              | <b>\$91,895</b>  | <b>\$72,687</b>  | <b>\$0</b>     | <b>\$164,582</b>   |
| <b>Total Resolution Cost</b>              | <b>\$682,431</b> | <b>\$204,811</b> | <b>\$2,137</b> | <b>\$889,379</b>   |

Source: FDIC Division of Finance, *The Cost of Large Resolution Transactions* (March 12, 1996).

Some of the borrowers of the failed banks were not as happy with the resolution. The FDIC learned from its experience with RECOLL that contracted asset management firms can sometimes be overly aggressive in their attempts to collect loans for the FDIC, resulting in complaints from borrowers and elected officials in the area. That issue, along with the costs associated with the FDIC's ownership of failed bank assets, resulted in the FDIC's overall review of asset management contracting. At the same time, the FDIC analyzed the January 1992 sale of performing nonperforming loans to Fleet, in which the FDIC protected Fleet against loss. Nearly 70 percent of the loans sold to Fleet were worked out either by Fleet or by an outside source, and the borrowers were able to establish new, ongoing financial relationships that they could use in future dealings.

The FDIC used its cross guarantee authority to assess MNB for the FDIC's estimated costs of resolving BNE. The cross guarantee authority was granted to the FDIC in 1989 when Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA). Cross guarantee authority allows the FDIC to assess other banks within a holding company for losses incurred or expected to be incurred in resolving troubled banks within the same holding company. This authority discourages multi-bank holding companies from transferring losses at any of their institutions into troubled sister institutions and then allowing them to fail so that the deposit insurance fund would have to bear the losses rather than the holding companies. The cross guarantee authority was also significant in the later resolutions of First City Bancorporation of Texas, Inc., and Southeast Banking Corp. and has been a factor in reducing costs of resolving financial institutions.<sup>40</sup>

### Effect on Future Resolutions

In the 1980s, the most famous example of "too big to fail" was the resolution of Continental Illinois National Bank and Trust Company (Continental), Chicago, Illinois.<sup>41</sup> On occasion, BNE and its affiliates were also referred to (inaccurately) as "too big to fail." The BNE Corp. banks did fail and were actually closed.

"Too big to fail" is, however, occasionally used to refer to the disparate treatment afforded to uninsured depositors in very large banks. It is true that from Continental's assistance through the resolution of the BNE Corp. banks, the average asset size of institutions resolved by straight deposit payoff and liquidation was approximately \$65 million. This compared unfavorably to those banks resolved through either open bank assistance or purchase and assumption transactions in which uninsured depositors were protected, the average size of which was about \$200 million.<sup>42</sup> Those resolutions include

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40. Refer to Chapter 5, First City Bancorporation of Texas, Inc., and Chapter 9, Southeast Banking Corp.

41. Refer to Chapter 4, Continental Illinois National Bank and Trust Company.

42. FDIC, *Failed Bank Cost Analysis 1986-1995* (1996), 11; FDIC, *History of the Eighties—Lessons for the Future: An Examination of the Banking Crisis of the 1980s and Early 1990s* (Washington, D.C.: FDIC, 1997), 248.



First City Bancorporation of Texas, Inc., with total assets of \$11.8 billion; First RepublicBank Corporation with total assets of \$33.4 billion; and MCorp with total assets of \$15.8 billion.<sup>43</sup>

The perception of unfairness to depositors in small banks undoubtedly had an impact on the provisions of FDICIA, passed by Congress later in the year after the BNE Corp. banks failed. Some members of Congress wanted to prohibit the protection of uninsured depositors, but others argued to retain the FDIC's flexibility in dealing with unusual situations. In some large banks, all depositors would need to be protected, said Federal Reserve Board Chairman Alan Greenspan, "in the interests of macroeconomic stability," but there would "also be circumstances in which large banks fail with losses to uninsured depositors but without undue disruption to financial markets."<sup>44</sup>

FDICIA placed some limits on the FDIC, but still left it the ability to protect all depositors in certain instances. The FDIC was required to evaluate all resolutions on the basis of which alternative caused the least cost to the deposit insurance fund, and the FDIC was prohibited from protecting any uninsured deposits or nondeposit bank debts whenever that protection would increase losses to the deposit insurance fund. The FDIC could not provide open bank assistance to any institution unless it was the least expensive method of resolution. The only exception to the requirement of least cost resolution was in the event of systemic risk. Such cases require the approval of the secretary of the Treasury after consultation with the president of the United States and at least a two-thirds vote of both the FDIC Board of Directors and the Board of Governors of the Federal Reserve.<sup>45</sup>

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43. Refer to Chapters 5, 6, and 7, First City Bancorporation of Texas, Inc., First RepublicBank Corporation, and MCorp, respectively.

44. *Congressional Quarterly* (May 11, 1991).

45. See *U.S. Code*, volume 12, section 1823(c)(4)(G) for further information and a description of the systemic risk exception.

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