CHAPTER 9

Southeast Banking Corp.

Name of Institution: Southeast Banking Corporation
Subsidiary Banks: Southeast Bank, N.A., Miami, Florida
Southeast Bank of West Florida, Pensacola, Florida
Date of Resolution: September 19, 1991
Resolution Method: Purchase and Assumption Transaction

Introduction

Southeast Banking Corporation (Southeast) was a two-bank holding company located in Miami, Florida. Although the resolution of Southeast's two banks is notable for several reasons, the primary reason is that it was one of the first times the Federal Deposit Insurance Corporation (FDIC) used a transaction known as loss sharing.[1] The loss sharing agreement for the two Southeast banks was a part of a purchase and assumption (P&A) transaction in which the acquiring institution, First Union National Bank of Florida (First Union), Jacksonville, Florida, a subsidiary of First Union Corporation (First Union Corp.), Charlotte, North Carolina, purchased $10.1 billion of the failed banks' assets. First Union then managed and liquidated the assets under a loss sharing agreement that required the FDIC as receiver to reimburse First Union for a substantial portion of its losses on purchased assets[2] for a period of five years.[3] The program was successful, and the FDIC recovered all of its principal expenditure for the resolution of the two banks.

The lead bank in the holding company, Southeast Bank, N.A. (Southeast Miami), Miami, Florida, was closed on September 19, 1991, when it was unable to repay a loan from the Federal Reserve Bank of Atlanta (Federal Reserve). The other bank in the holding company, Southeast Bank of West Florida (Southeast Pensacola), Pensacola, Florida,

1. See Part I, Resolution and Asset Disposition Practices, Chapter 7, Loss Sharing.

2. The FDIC agreed to reimburse First Union for a period of five years for 85 percent of net charge-offs on all assets other than certain consumer debts. The credit card debts and home equity loans loss reimbursement percentage declined in 5 percent increments from 85 percent in the first year to 65 percent in the fifth year. See the section of this chapter titled "A New Transaction Structure" for further information.

3. FDIC, *1991 Annual Report,* 20-21.

failed when the FDIC exercised its cross guarantee authority and demanded payment for expected losses incurred in the resolution of Southeast Miami.

General Description of the Institution

Southeast Miami and Southeast Pensacola had total assets of $10.5 billion and total deposits of $7.6 billion at the time of their failure. Most of the assets were with Southeast Miami; Southeast Pensacola had less than $100 million in assets. Southeast Miami had 218 offices and Southeast Pensacola had 6, for a total of 224 offices. Together, they had approximately 6,200 employees. The parent corporation, Southeast, operated exclusively in Florida.

Background

The First National Bank of Miami was founded on December 1, 1902, and was the largest bank in Florida in 1946. It was one of only two banks in Florida to survive the Great Depression of the 1930s.[4] The bank changed its name to Southeast Bank in 1969, under the leadership of Charles Zwick, former U.S. budget director during the Lyndon B. Johnson administration.

In the 1960s and 1970s, Southeast Miami was the biggest bank in Florida. It had a good reputation and was occasionally referred to as "the Morgan of the South."[5] Although some regional economic problems started weakening Southeast Miami in the early 1980s, it was still highly regarded in the Florida banking industry. In 1982, a hostile shareholder attempt to take control of the bank was rebuffed at a cost of $148 million. Southeast Miami watched Barnett Banks, Inc. (Barnett), Jacksonville, Florida, pass it by as the largest bank in Florida in 1983. In 1987, Southeast Miami lost $87 million on loans to lesser developed countries, and in 1988 Southeast Miami bought First Federal Savings and Loan, Jacksonville, Florida, an acquisition that turned out to be unprofitable.

Also during 1988, Southeast Miami began losing its deposit base to competitors. By June 30, 1990, it had fewer offices in Florida (246) than either First Union (390) or SunTrust Bank, (SunTrust) Atlanta, Georgia (369), and far fewer than Barnett (548). Although Florida was a banking market driven by consumer accounts and its economy was powered by small businesses, Southeast Miami was viewed as a bank that wanted to do business only with large companies.[6] Southeast Miami had developed a large Latin

4. Robert Trigaux, David Dahl, John Craddock, and Helen Huntley, "Southeast Bank Sold to First Union," *St. Petersburg Times* (September 20, 1991), 1A.

5. Gregg Fields, "Government Takeover of Miami's Southeast Bank May Not Have Been Necessary," *The Miami Herald* (October 6, 1997).

6. Gregg Fields, "Government Takeover of Miami's Southeast Bank May Not Have Been Necessary."

American private banking business, and the number of its uninsured deposits was high for a bank of its size. Uninsured deposits made up about 13 percent of all deposits at the end of 1990, and about $760 million, or 10 percent of all deposits, at the time of failure.

Between July 1990 and January 1991, Southeast Miami replaced its president and entered into a formal agreement with the Office of the Comptroller of the Currency (OCC), in which it agreed, among other things, to improve its real estate lending and credit administration procedures. The bank failed to comply with parts of the enforcement action, however, and continued to experience substantial losses. For 1990, Southeast Miami reported losses of $172 million.[7]

Southeast Miami had also experienced significant problems as a result of concentrated lending in commercial real estate and weak underwriting and credit administration practices. As of August 31, 1991, real estate loans at Southeast Miami totaled $3.5 billion, or 45 percent of the bank's total loan and lease portfolio, and nonperforming assets equaled 10 percent of loans.[8] Southeast Miami reported a loss of $116.6 million for the first quarter of 1991 and $139 million for the second quarter of 1991.

The announcement of the huge 1991 losses caused more depositors to withdraw their funds, and the bank's liquidity problems grew worse. Total deposits declined from $11.2 billion at year-end 1990 to $8 billion at the end of August 1991; deposits fell more than $1 billion in July and August alone. In September 1991, Southeast Miami started offering above-market-rate certificates of deposit in an effort to generate liquidity.[9] The Federal Reserve had agreed with Congress only a few months earlier that it would limit its lending to undercapitalized banks to a period of 60 days out of any 120-day period, and the bank was unable to obtain private funding to meet its daily cash needs.[10]

From June through early September 1991, Southeast Miami struggled to put together a proposal for open bank assistance (OBA) from the FDIC. Southeast Miami officials worked closely with the FDIC in arranging for due diligence teams from Barnett; First Union; NCNB Corporation (NCNB), Charlotte, North Carolina; SunTrust; and a private investor group. Southeast Miami's President Douglas Ebert reported, however, that hopes "really dimmed" when a New York investment firm that could have provided additional capital broke off negotiations on September 13, 1991.[11]

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7. "OCC [Office of the Comptroller of the Currency] Declares Southeast Bank Insolvent," *PR Newswire* (September 19, 1991), Financial News section.

8. "OCC Declares Southeast Bank Insolvent," Financial News section.

9. Robert Trigaux and Helen Huntley, "Banking's Changing of the Guard," *St. Petersburg Times* (September 21, 1991), 1B.

10. Barbara A. Rehm and Kenneth Cline, "First Union Bid Wins Ailing Bank in Miami," *American Banker,* (September 20, 1991), 1.

11. Kenneth Cline, "First Union Deal Breaks New Ground; Stock Market Signals That It Likes Pact," *American Banker* (September 23, 1991), Special Report section, " The Rescue in Miami," 1.

A New Transaction Structure

Because Southeast Miami was located in Florida, which was having fewer economic troubles than the Northeast, the bank attracted the interest of several potential acquirers. The FDIC believed the resolution presented an opportunity to experiment with a new type of transaction it had developed known as "loss sharing." Rather than placing troubled assets into a special pool, as had been done in Texas and the Northeast, the FDIC asked bidders to purchase all of the failing banks' assets other than its real estate owned. In exchange, the FDIC proposed to reimburse the acquirer for 85 percent of all net losses it might have on that portfolio for a period of five years.[12]

By placing all of the failed banks' assets (except for real estate owned) with the acquirer, the FDIC was no longer responsible for 100 percent of losses, as it was when troubled assets were placed in a special asset pool. The acquirer accepted 15 percent of the risk and had a strong incentive to diligently manage the acquired assets. However, the risk of loss was viewed as low enough not to negatively affect the bidding process. Potential acquirers could adjust their bids downward for those projected losses but had to keep their bids competitive to win the franchise. Borrowers benefited from the new process, because they were more readily serviced by a standing financial institution, and the acquirer benefited by being able to retain more credit customers. The loss share agreement was also flexible enough to enable the acquirer to advance funds and restructure credits if it wanted to do so.

To introduce the new type of transaction structure, the FDIC made two accommodations to potential acquirers. First, the FDIC agreed to buffer the cost of carrying nonaccrual assets by accepting a note (the Nonaccrual Assets [NAA] note), rather than cash, from the acquirer in exchange for the nonaccrual assets. The NAA note was to bear interest at the nominal rate of 1/8 of 1 percent per year, and the amount of the note could be increased or decreased on a revolving basis as nonaccrual assets rose or fell over the course of five years.

Second, the FDIC recognized that retaining ownership of troubled assets imposed an additional capital burden on the acquirer, whether or not the assets were earning interest. To ease that situation for the acquirer, the FDIC agreed to purchase $150 million of fixed-rate perpetual preferred stock in the acquiring institution's holding company. The purchase of the stock in the parent corporation, rather than in the acquiring bank, provided the stock with increased marketability if the FDIC needed to sell it.

The FDIC developed a bid structure with four stipulations:

- The acquirer would provide the FDIC with the NAA note in the amount of $639 million at closing;

12. Losses are defined as charge-offs or write-downs of the value of shared loss assets recorded in accordance with criteria used by bank examiners. Recoveries are defined as collections of (1) charge-offs of shared loss assets or (2) assets charged off by the failed bank. Net charge-offs or net losses are charge-offs less recoveries. For credit card debts and home equity loans, the FDIC proposed to reimburse the acquirer a declining percentage of loss over five years; the amount declined in 5 percent increments from 85 percent in the first year to 65 percent in the fifth year.

- The acquirer would pay the FDIC $55.1 million in cash for the amount of earning assets that exceeded the liabilities assumed;
- After taking into consideration the potential loan losses, bidders could either offer premiums for the franchise or submit bids that would require the FDIC to pay them to take over the bank; and
- The FDIC would retain all real estate owned of the failed banks.

The Resolution

On September 19, 1991, the OCC notified the Federal Reserve that Southeast Miami was no longer a viable entity, and the Federal Reserve demanded payment of its $568 million loan. Southeast Miami, with $10.4 billion in assets, was unable to make payment and was closed by the OCC. Southeast Pensacola, with $92.3 million in assets, was closed by the Florida state comptroller after the FDIC asserted its cross guarantee authority and assessed Southeast Pensacola $143 million, the estimated cost of the FDIC's projected loss on Southeast Miami. At the time of its closing, Southeast Miami had approximately $409 million in equity capital and $430 million in loan loss reserves.[13] Loan losses were expected to exceed $1 billion, an amount that was more than twice the $430 million in loan loss reserves and higher than equity capital and loan loss reserves combined.

Barnett, First Union, and SunTrust all submitted bids for the failed banks, and the bid from First Union was determined to be the least costly to the Bank Insurance Fund (BIF). The FDIC Board of Directors approved two purchase and assumption transactions with First Union, which paid a premium of $81 million to take over the failed banks' franchises. All depositors were protected because the FDIC determined that transferring all deposits to First Union resulted in the lowest cost transaction for the BIF. The transaction made First Union the second largest banking entity in Florida, behind Barnett,[14] and the 16th largest banking company in the United States.[15]

The two P&A agreements had the following basic parameters:

- First Union agreed to assume all deposit accounts, both insured and uninsured, totaling about $7.6 billion in 1.1 million deposit accounts at Southeast Miami and $85 million in 13,000 deposit accounts at Southeast Pensacola. First Union paid a net premium of $81 million.
- First Union also agreed to purchase all of the failed banks' assets except their premises, real estate owned, subsidiaries, and other assets. The FDIC agreed that First

13. "OCC Declares Southeast Bank Insolvent," Financial News Section.
14. Rehm and Cline, "First Union Bid Wins Ailing Bank in Miami," 1.
15. Trigaux, Dahl, Craddock, and Huntley, "Southeast Bank Sold to First Union." 1A.

Union could occupy and pay rent on any of the premises and gave First Union a 120-day option to purchase banking property at fair market value. Total assets purchased were approximately $10.1 billion, composed of $7.1 billion in performing assets (including $435 million in cash and equivalents and $1.7 billion in securities and other obligations), $1.6 billion in performing problem loans, $800 million in credit card loans, and $639 million in nonperforming loans.

- The FDIC agreed to buffer the cost of carrying nonaccruing loans by accepting from First Union the NAA note in lieu of cash. The FDIC earned nominal interest on the note of 1/8 of 1 percent per year. The amount of the note could have been increased or decreased as the amount of nonaccruing assets rose or fell during the five-year period, but after six months First Union elected to "cap" the note at $639 million. At maturity, First Union paid the principal of the note to the FDIC.
- The FDIC retained approximately $205 million in real estate owned, $151 million in bank subsidiaries, $232 million in bank premises, and other assets, for a total of $624 million. The FDIC also paid off the Federal Reserve debt of $568 million.

On September 20, 1991, one day after the failure of its two banks, Southeast Miami's holding company, Southeast, filed for liquidation under Chapter 7 of the U.S. bankruptcy code.[16]

The Loss Sharing Agreement

The Southeast transaction was the FDIC's first large resolution involving the use of loss sharing. First Union purchased the failed banks' problem loans, but not real estate owned, and no fee was paid to First Union for managing the loans. First Union also purchased Southeast Miami's large credit card operation, which had $800 million in book value as of June 30, 1991. For those loans, the loss sharing payments were paid on a declining scale. Borrowers' cards were not canceled, which meant that "new" advances to credit card customers could increase the FDIC's liability. In the past, the FDIC had normally tried to sell credit card portfolios outright, either at the closing or immediately thereafter, to eliminate potential increased liabilities. In the Southeast transaction, the FDIC accepted the additional liability because it believed that cutting off credit and attempting to collect outstanding balances in a liquidation mode would result in greater gross losses than would allowing the acquirer to manage the credits.

Under the loss sharing structure, First Union had the flexibility to affirm previous loan commitments, restructure problem loans, and even extend limited amounts of additional credit as part of loan workouts. Then-FDIC Chairman L. William Seidman

16. George Graham, "Southeast Reopened by New Owner," *Financial Times* (September 21, 1991), International Companies and Finance section, 10.

said the loss sharing arrangement "should help reduce the insurance fund's losses significantly and greatly reduce the typical hardships suffered by loan customers at failed banks."[17] Banking analysts were not immediately convinced. "It'll be interesting to see what the loss really is on the FDIC side for this deal," said Cynthia Mahoney, a bank analyst with Duff & Phelps in New York.[18]

The loss sharing arrangement was designed to reduce costs to the BIF because (1) a forced liquidation of the problem loans would be avoided, (2) the FDIC's administrative expenses would be lower than under a servicing agreement, and (3) the failed banks' franchise value would be better preserved.[19] However, the FDIC took on additional risk in a loss sharing agreement. It had no oversight of the acquirer's activities, and the FDIC's savings depended on an acquirer's doing a good job of managing bad assets, which was a job in which "good" banks might not have had as much experience or expertise as would an outside asset management company. If an acquirer failed in its collection efforts or if the economy worsened, the FDIC losses could have been higher than they would have been if the loans had been assigned to an asset management company for liquidation.

The original package of assets eligible for loss sharing in the Southeast transaction was $7.9 billion.[20] At the time of the agreement, the FDIC estimated that total loss sharing payments would be $854 million. Because the payments would be made over time, FDIC staff calculated the present value of the payments to compare them to other resolution alternatives and determined that the present value of the payments at the time of the banks' closings was $647 million. The FDIC's actual payments over the five-year term of the agreement were $450 million net of recovery payments, or 52.7 percent of the original estimate of $854 million.

The Stock Transactions

The $150 million in preferred stock contained an 11 percent dividend rate and was redeemable at par within one year.[21] The stock was redeemed quickly, with two million of the shares being redeemed within two months and the remaining shares redeemed in less than seven months, at no gain or loss to the FDIC. During the one-year period, the FDIC received $6.8 million in dividends.[22] A summary of the stock transactions is included in table II.9-1.

17. Graham, "Southeast Reopened by New Owner."

18. Trigaux and Huntley, "Banking's Changing of the Guard," 1B.

19. FDIC News Release, "FDIC Approves Assumption of Deposits of Southeast Bank, N.A., Miami, and Southeast Bank of West Florida, Pensacola," PR-137-91 (September 19, 1991).

20. FDIC, *Summary of Loss Sharing Assistance Agreements Through March 31, 1997* (June 26, 1997).

21. FDIC, *1991 Annual Report,* 20-21.

22. FDIC, *Equity Investment Portfolio: Bank Insurance Fund* (December 31, 1993), 25.

Table II.9-1

Transaction with First Union National Bank of Florida
A Summary of the FDIC's Stock Transactions in the Southeast Miami/Southeast Pensacola Purchase and Assumption

($ in Thousands)

Date	Transaction	Beginning Number of Shares	Shares Sold, Written Down, Converted	FDIC Stock/ Equity Investment	FDIC Proceeds from Sales	FDIC Book Value of Transaction	Gain or Loss on Trans- action	FDIC Dividend Income
		Series A Cumulative Perpetual Class A Preferred Stock						
09/27/91	Original purchase	6,000,000		$150,000				
11/21/81	Dividends							$856
11/21/91	Redemption		(2,000,000)		$50,000	$50,000	$0	
12/ /91	Dividends							2,903
03/31/92	Dividends							2,750
04/10/92	Redemption		(4,000,000)		100,000	100,000	0	
04/10/92	Dividends							275
06/25/92	Dividends							61
	Totals	**6,000,000**	**(6,000,000)**	**$150,000**	**$150,000**	**$150,000**	**$0**	**$6,845**

Source: FDIC, *Equity Investment Portfolio, Bank Insurance Fund.*

FDIC Resolution Costs

When the two Southeast banks were closed, the FDIC entered into an assistance agreement with First Union, under which First Union agreed to assume the liabilities, including $7.6 billion of deposits, of the two banks. The FDIC in its corporate capacity funded First Union's assumption of the deposits by borrowing or using the Southeast banks' assets to satisfy its funding obligation.

First Union purchased all $10.1 billion of the failed banks' assets other than bank premises, real estate owned, subsidiaries, and other assets, and the FDIC afforded First Union loss protection on all loans. Over the life of the agreement the FDIC's total loss sharing payments totaled approximately $450 million. By retaining 85 percent of the risk on the bank assets being sold to the acquirer, the FDIC received an $81 million premium for the bank franchises.

The FDIC had other costs as well. To facilitate the assistance transaction with First Union, the FDIC accepted a $639 million note with a nominal interest rate to offset the acquirer's loss of interest on the nonaccruing assets. The FDIC also purchased $150 million of preferred stock in First Union. The FDIC paid off the Federal Reserve debt of $568 million, and it directly managed and sold $624 million in real estate owned, bank premises, subsidiaries, and other assets.

The Southeast receiverships recovered more than the total of principal claims against them, largely because the losses in the loss share agreement were not as great as had been expected. As it became apparent that the FDIC's costs would not be as great as had been anticipated, the FDIC on March 30, 1994, officially announced that all creditors with valid claims against the receiverships would receive the full principal amount of their claims. The FDIC also projected a surplus of $27 million that would be used to pay a portion of interest on the claims. The surplus was primarily the result of the significant improvement in the Florida economy, especially the real estate markets. That improvement increased the value of the assets retained by the FDIC as well as the assets held by the acquirer and covered by loss sharing.

In November 1996, the Southeast Miami receivership declared a 72.21 percent dividend on allowed claims for postinsolvency interest, and Southeast Pensacola declared a 100 percent dividend on allowed claims for postinsolvency interest. Ultimately, the Southeast Pensacola receivership was terminated, and a final dividend of cash and assets totaling $8.1 million was returned to the bankruptcy trustee. The FDIC's liability for the loss share portion of the assistance agreement ended after five years, on June 30, 1997. After taking into consideration contingent and unpaid claims against the receiverships, it was estimated that the receiverships had $31.8 million in funds available for distribution.

Settlement of Litigation

The holding company for the failed banks had filed for liquidation under Chapter 7 of the U.S. bankruptcy code on September 20, 1991. In March 1993, the trustee for the holding company's estate, William A. Brandt, Jr., filed suit in the southern district of Florida against the FDIC as receiver of the Southeast banks. The suit alleged fraudulent and preferential transfers because in 1990 the OCC had required the holding company to assign a mortgage subsidiary, Southeast Mortgage Company (SEMCO), to Southeast, because the bank needed to increase its equity. That suit was amended in March 1994, alleging that the FDIC's issuance of a cross guarantee assessment against Southeast Pensacola after the failure of Southeast Miami was unconstitutional because it was a taking of property that violated Southeast Pensacola's right to due process. In November 1996, the suit was amended a second time to add a count challenging the FDIC's entitlement to recover postinsolvency interest on its subrogated deposit claim against the Southeast receivership estates because such a recovery violated the National Bank Act of

1864. The FDIC's $7.6 billion deposit claim against the Southeast receiverships accrued more than $304 million in postinsolvency interest between September 1991 and March 1994. During roughly the same period, the FDIC in its corporate capacity also paid more than $183 million in interest to the Southeast receiverships on its "borrowing" of receivership assets used to fund First Union's assumption of the failed banks' deposits.

The bankruptcy trustee filed a second lawsuit in November 1995, while he and the FDIC were in the middle of negotiations. The suit challenged the FDIC's overall administration of the Southeast receiverships, including the decision not to pursue litigation against Southeast's former directors and officers, failure to allocate portions of professional liability settlements to the Southeast receiverships, and payment of indirect liquidation expenses to the FDIC in its corporate capacity from the receivership estates.

The issues raised by the bankruptcy trustee were similar to those raised in the litigation filed against the FDIC by First City Bancorporation of Texas, Inc. (First City). The 1992 resolution of 20 First City failed banks also involved the issuance of cross guarantee assessments and a surplus in the receiverships. The FDIC had settled the First City claims in 1995, and the FDIC's experience in that matter helped guide the FDIC's actions in settling the Southeast litigation.

In August 1997, the FDIC reached a tentative settlement with the Southeast bankruptcy trustee. The basic terms of the settlement were as follows:

- The settlement of all pending litigation at a discount, including the challenge to the FDIC's cross guarantee statute;
- The settlement of the FDIC's claim against the Southeast receiverships for approximately $221.4 million in postinsolvency interest;
- The retention by the FDIC of approximately $47 million in indirect receivership expenses;
- A transfer of the remainder of the Southeast receivership estate to the Southeast bankruptcy trustee; and
- The indemnification of the FDIC in its corporate capacity by the Southeast bankruptcy estate for claims submitted by First Union under the indemnification provisions of First Union's agreement with the FDIC.

Ultimately, all creditors received 100 percent of principal plus interest. The FDIC received 100 percent of the principal it expended, including its liquidation costs, plus $221.4 million in postinsolvency interest in the settlement with the trustee in the Southeast bankruptcy. The litigation settlement was based on the recognition that the FDIC in its corporate capacity was legally obligated either to pay insured depositors or to arrange for the assumption of the failed banks' deposits by a third party.

Overall, the settlement agreement provided an appropriate conclusion to the resolution of the failed institutions. The settlement allowed the FDIC to settle all pending litigation at a discount, with no further expenditures from the BIF. All receivership claims were paid and/or settled with the payment of the appropriate interest, and the FDIC returned approximately $120 million in receivership assets to the Southeast bankruptcy estate.

Lessons Learned

The resolution of the Southeast banks was viewed as successful, and the lessons learned center on (1) the loss sharing agreement between the FDIC and First Union and (2) the cross guarantee assessed against Southeast Pensacola. The FDIC was able to pay all receivership claims in full and still receive $221.4 million in postinsolvency interest. The shareholders also received approximately $120 million in assets from the estate.

By placing all of the Southeast assets (except for real estate owned, bank premises, subsidiaries, and other assets) with First Union, the FDIC was no longer responsible for 100 percent of losses, as it was when troubled assets were placed with an asset management contractor. First Union accepted 15 percent of the risk and had a stronger incentive to diligently manage the acquired assets.

Since the Southeast transaction through 1997, loss sharing has been successful for the FDIC in 15 instances. The primary benefits include keeping the FDIC's inventory of assets at a minimum level, keeping failed bank assets in the private sector to maintain their value, and allowing borrowers of failed banks to continue doing business with open financial institutions. As the FDIC gained experience with loss share transactions, later agreements were modified to focus on the commercial loans of the failing institution. The FDIC determined that tracking small assets was more costly than taking them into inventory for liquidation and that a ready secondary market existed in which they could be quickly sold. The performing loans, such as consumer and single-family mortgages, generally could be sold at par to the acquirer without the FDIC's having to accept liability for losses for a five-year period.

The loss sharing agreement with First Union was also successful in a nonmonetary sense. The FDIC's experience with asset management contractors' working the assets of failed banks in the Northeast was not altogether favorable. Although collections were satisfactory, borrowers experienced some problems in the region. Because real estate values had decreased quickly, large numbers of loans were classified and placed in asset pools because of diminishing collateral values. Many borrowers complained that being placed in the bad asset pools unjustly labeled them as poor credit risks and caused them to be shut out from other lenders that may have been able to assist them. Without credit, many smaller businesses failed that otherwise might have been able to survive. Also, since the FDIC retained ownership of the assets, mistakes made by its asset management firms reflected poorly on the FDIC as a government agency. With the Southeast transaction, however, by having the assuming bank retain the ownership, borrowers were treated fairly to protect the reputation of the new acquirer. The loss share agreement also made it easier for the acquirer to continue advances on lines of credit, which kept a lot of businesses from having cash flow problems.

Effect on Future Resolutions

The resolution of the two Southeast banks, especially the introduction of loss sharing, led to changes in the way the FDIC handles failing institutions. Including the two Southeast banks and throughout all of 1992 and 1993, the FDIC resolved 203 banks. Of that number, 24 were resolved in 16 loss sharing arrangements. This practice has resulted in the FDIC's keeping in the private sector $18.5 billion in assets that otherwise might have been placed in the FDIC's inventory of assets for liquidation.

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