CHAPTER 11

CrossLand Savings, FSB

Name of Institution:	CrossLand Savings, FSB Brooklyn, New York
Date of Interim Resolution:	January 24, 1992
Resolution Method:	Conservatorship
Date of Final Resolution:	August 12, 1993
Resolution Method:	Public Offering of Stock to Institutional Investors

Introduction

The Office of Thrift Supervision (OTS) closed CrossLand Savings, FSB (CrossLand), Brooklyn, New York, and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on January 24, 1992. CrossLand is memorable for several reasons. First, CrossLand, with total assets of $7.3 billion, owned 98 subsidiary corporations, including a savings and loan association and a mortgage company. Second, the FDIC placed CrossLand into a conservatorship, which was used much like a bridge bank, for approximately 18 months until the institution could be downsized, simplified, and marketed to the private sector.[1] This is the only instance in which the FDIC used a pass-through receivership and acted as a conservator in a manner similar to that of the Resolution Trust Corporation (RTC). Third, placing the institution into conservatorship generated criticism that the FDIC had not taken the least costly approach when it resolved CrossLand. Many banking analysts were of the opinion that the FDIC had taken the path of least resistance that would eventually cost the FDIC much more than a quick resolution of the bank's problems.

1. The Competitive Equality Banking Act (CEBA) of 1987 gave the FDIC in either its corporate or receivership capacity authority to establish a bridge bank. The FDIC has used this authority when an insured bank was or might be closed and timing and marketing constraints would make it more cost effective not to implement an immediate resolution. Because the FDIC does not have the authority to bridge a failing thrift institution, the FDIC can use a pass-through receivership that involves chartering a new mutual savings institution through OTS that OTS then places under FDIC conservatorship to provide the same interim resolution achieved by the use of a bridge bank.

General Description of the Institution

CrossLand was headquartered in Brooklyn, New York, had 44 branches in the New York City metropolitan area, and was the second largest savings bank on the East Coast. Included in CrossLand's nationwide operations were two large subsidiaries headquartered in Salt Lake City, Utah: CrossLand Mortgage Corporation (CrossLand Mortgage) and a savings and loan association named CrossLand Savings, FSB (CrossLand Utah), with 42 branch offices nationwide. CrossLand's New York branches averaged more than $100 million in deposits, with some branches having deposits exceeding $300 million. Before it was closed, the savings bank served approximately 400,000 customers with approximately $7.3 billion in assets and total deposits of $5.6 billion. CrossLand and CrossLand Utah together had 86 branches, with $8.6 billion in assets and $6.7 billion in deposits.

Background

Beginning in the mid-1980s, CrossLand began to invest heavily in the New York commercial real estate market by financing new apartment buildings, office towers, and stores. On December 21, 1990, the OTS issued a capital directive to CrossLand as a result of its deteriorating capital position over the past several years and its over-concentration (49.1 percent as of year-end 1990) of high-risk real estate investments and loans for acquisition, development, and construction (ADC) loans. The OTS directive restricted lending, investment, growth, and operating activities.

On a national level, the United States was still involved in the Persian Gulf War in 1991, and the nation's economy as a whole had negative growth. Regional problems continued to mount in the Northeast, as evidenced by the 52 bank failures in that area of the country that year. Among those failures were the Bank of New England, Boston, Massachusetts, and Goldome, Buffalo, New York. The Northeast banking industry continued to struggle with depressed real estate markets. More than 23 percent (208) of the Northeast's insured financial institutions were considered problem institutions.[2]

On September 30, 1991, CrossLand had a negative $80 million in equity (negative $306 million in tangible equity). By December 31, 1991, the bank had approximately $1.5 billion of nonperforming assets, and $2.2 billion of classified assets, the nine largest of which represented more than 30 percent of the total classified assets. Included in the inventory of problem loans were 80 loans with principal balances exceeding $10 million. The bank lost $308.5 million during 1991 alone. During that time, it obtained much-needed cash by paying significantly above-market interest rates for deposits. This reckless

2. FDIC, *History of the Eighties—Lessons for the Future: An Examination of the Banking Crisis of the 1980s and Early 1990s*, (Washington D.C.: Federal Deposit Insurance Corporation, 1997), 362.

expansion later led Representative Charles Schumer, (D-NY), to call the bank "a case study of what is wrong with our banking system, with institutions soaking up insured deposits and using them to fund high-risk, speculative loans."[3]

CrossLand's insolvency was due primarily to its large dollar volume of nonperforming assets. Asset deterioration was compounded by the decline in the New York area real estate market, especially in the commercial sector. At its closure, the bank had 21.5 percent of its assets classified as substandard or lower by regulators. It had about $2 billion of loans that were not expected to be repaid in full or that had already been foreclosed, and another $2.5 billion of loans that were current but were collateralized by risky real estate projects. CrossLand lost approximately $729 million in the 21 months before it was closed by the OTS.

Marketing the Institution

In April 1991, the FDIC received notice from the OTS that CrossLand likely would fail, and began preparing for its resolution. On July 29, 1991, CrossLand signed a consent agreement with the OTS, which called for CrossLand to be placed in conservatorship or receivership status. Three days later, on August 2, 1991, the FDIC held an informational meeting for investors and bankers that might be interested in purchasing CrossLand. Although 65 investor groups had been invited, only 10 attended the meeting. This lack of interest might have been caused by the poor regional economy or by the fact that 90 percent of CrossLand's $310 million in time deposits had terms of one year or less, which might have made the franchise less attractive to investors seeking a strong core deposit base. The FDIC believed, however, that CrossLand still contained some franchise value as it retained good branch locations in New York and its original core business of home mortgage lending in the New York area was sound.

The FDIC promoted a wide variety of potential resolution structures, including (1) a discounted sale of the whole bank, (2) a purchase and assumption (P&A) transaction with loss sharing, (3) an asset sale with putback provisions, (4) a separation of CrossLand and CrossLand Utah, and (5) the transfer to the FDIC of all classified assets to be administered in a separate pool. However, there remained little interest in CrossLand. Only three of the 10 investor groups attending the informational meeting completed due diligence on CrossLand.

During the marketing period, it became clear that no investor group was interested in purchasing the assets of CrossLand. One of the three potential acquirers dropped out of the process because of a lack of capital, and only two buyers were interested in acquiring any or all of the deposit base. Accordingly, the FDIC developed contingency plans to deal with CrossLand's failure.

3. Michael Quint, "CrossLand Is Seized by the U.S.," *The New York Times* (January 25, 1992), sec. 1, 37.

First, in the event that only the bank's deposits were sold, the FDIC selected an outside asset management company that would handle the servicing of the nonperforming loans on an interim basis. The FDIC also made plans to market CrossLand's portfolio of securities (approximately $547 million) and its performing loan portfolio (approximately $5 billion) as soon as the bank failed, and to use the resulting sale proceeds, in part, to pay CrossLand's approximately $2 billion in debt to the Federal Home Loan Bank. The securities and mortgages had been pledged as collateral for the debt.

Second, if no adequate bids were received for the transfer of the deposits, the FDIC planned to organize and capitalize a new institution that would operate in FDIC conservatorship, culminating in the bank's return to the private sector. This second plan included hiring a new management team that would return CrossLand to its core business of making mortgage loans in the New York area. The new management team also would develop a business plan that would include selling subsidiaries and branches outside the New York market area. The FDIC then intended to remarket the bank after 18 to 24 months, at which time it was hoped that the economy in the area would have improved.

When the bids were opened on December 30, 1991, only two parties had submitted offers. Neither bidder wished to purchase any assets from the bank. One bid was for only the deposits from 20 of the 44 New York branches, and the second bid was contingent on the FDIC's providing a long-term note, rather than cash, to fund the deposits. The FDIC's note was to be either a 5- or a 10-year note, at a yield to the acquirer that was much higher than the FDIC's cost of funds. Neither bid was determined to be least costly when compared against the conservatorship alternative and the cost of liquidation. Therefore, the FDIC Board of Directors approved the plan to create a new institution operated under FDIC conservatorship as the least costly resolution method for CrossLand.

The FDIC believed there were several benefits to correcting the savings bank's problems in a conservatorship rather than a liquidation environment. First, the FDIC believed that loans would lose less value if worked out in a banking environment. Second, FDIC staff also thought that more value could be obtained from the nonbanking subsidiaries by selling them over a longer period of time than could be achieved by either a liquidation or a quick sale of the businesses. Third, the FDIC believed that CrossLand's original core savings bank business in the New York area had a value that was not being recognized by the potential bidders at the time of its failure.

The Resolution—January 24, 1992

On January 24, 1992, the OTS closed CrossLand and appointed the FDIC receiver. The FDIC organized CrossLand Federal Savings Bank (CrossLand Federal), a new federal mutual savings bank, with the FDIC as the only member.[4] The OTS chartered

4. A mutual savings bank is organized as a nonstock business. All depositors in a mutual institution have a share in the ownership of the institution, in proportion to the amounts of their deposits. In CrossLand Federal, the FDIC was the only member because of the assistance the FDIC had provided to capitalize the newly chartered institution.

CrossLand Federal and then appointed the FDIC as conservator. Substantially all of the assets and liabilities of CrossLand were acquired and assumed by CrossLand Federal, although certain significant assets and liabilities were retained in the receivership.[5] The FDIC capitalized CrossLand Federal by providing a cash infusion of $1.2 billion in the form of a noninterest-bearing account. Later, the deposit was reallocated as follows: Of the $1.2 billion, $675 million was used to recognize loan losses and to mark down CrossLand Federal's assets to their estimated value, $525 million was booked as equity capital, and a minimal amount was retained in the deposit account.

In its capacity as conservator, the FDIC hired Richard Kraemer as president and chief executive officer of CrossLand Federal, with the objective of managing CrossLand Federal as a full-service institution and preparing it for return to the private sector.[6,7] Mr. Kraemer said CrossLand Federal would concentrate on issuing new home mortgages and steer clear of the commercial real estate business—"where we have more than enough loans to work out before we even think of doing more."[8] At a New York news conference, then-FDIC Chairman William Taylor was quoted as saying, "It is more cost-effective for us to spend on repairs for CrossLand than to rip out its wiring and sell its parts."[9]

A controversial decision made by the FDIC at the time of CrossLand's failure was to protect both the insured and the uninsured depositors. It was estimated that CrossLand held a large portion of uninsured depositors; potentially 3,300 households had an estimated $132 million in uninsured deposits. The FDIC believed that not making all depositors whole would have a materially adverse impact on the franchise value, and that, absent full deposit coverage, the conservatorship would be unable to attract or retain large depositors that could provide liquidity to the franchise. The cost to the insurance fund for covering these uninsured depositors was originally estimated at $18 million; FDIC staff believed that this cost was offset by the loss in potential franchise value that would result from not paying the uninsured.

Shortly after CrossLand was placed into conservatorship, Jonathan R. Macey, a professor at Cornell Law School, had a different opinion: "During the time when CrossLand [sic] was a 'zombie bank,' economically insolvent and kept alive only thanks to regulatory forbearance," he wrote, "it obtained much needed cash by paying significantly above-market interest rates for deposits, further increasing costs to the FDIC, which plans to fulfill these financial obligations. These lucky depositors are delighted

5. The FDIC, as receiver of CrossLand, retained CrossLand's subordinated debt and litigation and approximately $68 million in nonperforming assets and owned real estate.

6. Mr. Kraemer was formerly chief executive of Bowery Savings Bank and Home Savings Bank (subsidiaries of H.F. Ahmanson & Co.).

7. FDIC, News Release, PR-8-92, "FDIC Establishes New Savings Bank as Successor to CrossLand Savings Bank, FSB, Brooklyn, N.Y." (January 24, 1992).

8. Quint, "CrossLand Is Seized by the U.S.," 37.

9. Quint, "CrossLand Is Seized by the U.S.," 37.

that the FDIC has nationalized CrossLand, since now they will continue to enjoy receiving above-market rates on certificates of deposit bought before the changeover."[10]

The decision to place the institution into conservatorship and run it until it could be sold also drew fire from Professor Macey, as well as from banking analysts in the private sector. Referring to FDIC Chairman Taylor, Professor Macey wrote: "Disdaining the term 'socialism,' Mr. Taylor has dubbed his scheme the 'bank hospital' plan. The plan . . . is simply reverse-privatization. First the FDIC assumes control of an insolvent bank, then it pumps in enough FDIC funds to keep it afloat, and finally it installs its own top management to run the bank."[11]

Professor Macey further criticized the least cost decision of the FDIC. "The FDIC's plan appears inconsistent with the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991. The inconsistency stems from the fact that, under the FDICIA, the FDIC is required to adopt the failure resolution strategy that imposes the lowest cost on the FDIC," he wrote. "First, it apparently assumed that the real estate market in New York will rebound quickly so that the FDIC can profit from holding onto CrossLand's assets, which are mostly in the form of real estate investments. Otherwise there is no way it could conclude that holding and 'managing' CrossLand's assets is a superior strategy to limiting the FDIC's exposure to its current level by simply liquidating the thrift."[12]

Other analysts agreed that CrossLand simply should have been closed, and compared the takeover of CrossLand to the strategy of the Federal Savings and Loan Insurance Corporation (FSLIC). The FSLIC allowed troubled thrifts to remain open, which gave them the ability to grow, make more loans, and take on more high-rate deposits. Professor Macey and the other banking analysts did not understand that the FDIC's intent in establishing the conservatorship was to control CrossLand and shrink it back to its core business to restore its value.

The Conservatorship

CrossLand Federal was operated as a full-service, going concern, with the goal of shrinking the savings bank to its core franchise (that is, a consumer-oriented savings bank), reducing costs, closing down unprofitable branches, and cleaning up the bad assets. In August 1993, approximately 18 months later, CrossLand Federal was returned to the private sector, with the following accomplishments:

- Operations: CrossLand Federal sold or closed 41 branches—8 in New York, 1 in Utah, and 32 in Florida. The bank also significantly reduced noninterest expense by $50 million on an annual basis and reduced staff by approximately 1,200 employees.

10. Jonathan R. Macey, "Needless Privatization at the FDIC," *The Wall Street Journal* (February 14, 1992), 1.

11. Macey, "Needless Privatization at the FDIC," 1.

12. Macey, "Needless Privatization at the FDIC," 1.

- Assets: CrossLand Federal sold two major operating subsidiaries for significant gains over their marked-to-market values (CrossLand Mortgage and an insurance premium finance subsidiary, CrossLand Premium Funding). Mortgage-backed securities were sold, reducing the balance from $883.7 million to $391.4 million over the same period. Net loans were reduced by $1.5 billion, which allowed CrossLand Federal to decrease its allowance for loan losses from $324.6 million in January 1992 to $216.4 million in March 1993. Overall, the conservatorship (CrossLand Federal and CrossLand Utah together) was reduced from $8.6 billion to $5.3 billion in assets, from $6.7 billion to $4.2 billion in deposits, and from 86 to 45 branches.

As conservator of CrossLand Federal, the FDIC provided operating guidelines for the savings bank and established reporting requirements for approval of strategies and business transactions, such as the disposition of assets. The FDIC approved the pay of the chief executive officer and that of other CrossLand Federal executives consistent with market studies of comparable financial institutions. The FDIC required the institution's management to prepare a business plan specifying how the institution would operate profitably and how it would restructure its assets.[13]

CrossLand Federal's management was also required to submit periodic status reports and to brief the senior FDIC officials responsible for overseeing the conservatorship. These reports and briefings were related to progress in addressing the business plan and specifically in the handling of troubled loans. For example, at the time of its sale, CrossLand Mortgage had a book value of $266 million. The conservatorship received 10 bids for the subsidiary and sold CrossLand Mortgage to the highest bidder for a sale price of $305 million, realizing a gain of approximately $39 million over the book value.[14]

The FDIC had a constant on-site presence at CrossLand Federal, including one or more staff attorneys assigned to the bank's corporate office headquarters to represent the FDIC and the conservator on legal issues. Senior FDIC officials were in daily contact with senior bank officers, paying particular attention to the major asset problems and actively advising on the marketing and disposition strategies for the major subsidiaries. As conservator, FDIC officials also attended monthly meetings with the bank executives where decisions on major asset disposition and other significant business matters were made. To provide further oversight of the CrossLand Federal conservatorship, a number of independent financial and operational audits were performed. These audits generally were concerned with the condition of the assets, but also reported that the conservatorship managers were doing a good job in following the operating guidelines and the business plan. Both the OTS and the FDIC conducted limited scope examinations in October

13. U.S. General Accounting Office, Report to the Chairman, Committee on Banking, Finance and Urban Affairs, House of Representatives, GAO/GGD-94-109, "Failed Bank: FDIC Sale of CrossLand Conservatorship Satisfied Least-Cost Test" (April 20, 1994), 9-12.

14. GAO/GGD-94-109, 9-12.

1992, and both concluded that the conservatorship was well managed but that the quality of its assets was still a concern. Two accounting firms reviewed the financial and compliance aspects of the conservatorship. One firm performed the financial audit and concluded that the bank's financial statements were fairly presented. The other firm was contracted by the FDIC's Office of the Inspector General to review the conservatorship's compliance with guidelines to ensure appropriate management and control of operations. That firm reviewed 80 to 90 of the largest transactions and a sample of the smaller ones, and found no significant shortcomings in the operations or controls of CrossLand Federal.[15]

Disposition of the Conservatorship

In December 1992, the FDIC began exploring its alternatives for dissolving the conservatorship of CrossLand Federal, in keeping with its charge of executing the least costly resolution for the savings bank. The FDIC identified and evaluated four possible resolution alternatives:

- Liquidation of the bank's remaining assets and liabilities;
- Piece by piece sale of the bank's assets and liabilities, with some assets retained by the receivership;
- Sale of the entire bank; and
- Sale of CrossLand Federal equity stock through a public offering.[16]

The FDIC evaluated the savings bank and estimated that the first alternative, a liquidation of the institution, would result in a cost of approximately $1.2 billion to the Bank Insurance Fund (BIF).[17] A financial advisor hired by the FDIC proposed a second alternative in March 1993. The advisor recommended a piecemeal sale of CrossLand Federal that would comprise the sale of some assets, including selected branches and their deposits, but would retain certain hard-to-sell assets by the FDIC for liquidation. This alternative was estimated to provide the FDIC an additional $110 million and $220 million in net proceeds, with a resulting cost to the BIF of between $970 million and $1.1 billion.[18] This figure reflected the FDIC's original investment of $1.2 billion, which would be reduced in the piecemeal sale by the $110 to $220 million in sale proceeds and by an estimated $10 million that was anticipated to be recovered from assets held in the receivership estate.

15. GAO/GGD-94-109, 9-12.

16. GAO/GGD-94-109, 5-8.

17. GAO/GGD-94-109, 5-8.

18. GAO/GGD-94-109, 5-8.

Table II.11-1.

CrossLand Federal Savings Bank
Four Possible Resolution Alternatives
Potential Cost to the Bank Insurance Fund
($ in Millions)

Alternative	Cost
Liquidation of conservatorship assets and liabilities	$1,175
Piece-by-piece sale of CrossLand Federal, with certain hard-to-sell assets retained in the receivership	970 to 1,080
Sale of entire CrossLand Federal per bid received (whole bank with loss sharing)	899
Sale of CrossLand Federal equity stock by private placement or public offering	889

Note: The cost of all four alternatives includes the net proceeds plus an expected return from assets held in the FDIC receivership of CrossLand. The cost to the FDIC is projected by offsetting the expected net proceeds to the FDIC, plus the return from the FDIC receivership, against the $1.2 billion that the FDIC injected in cash.

Source: U.S. General Accounting Office, report to the chairman, Committee on Banking, Finance and Urban Affairs, House of Representatives, GAO/GGD-94-109, "Failed Bank: FDIC Sale of CrossLand Conservatorship Satisfied Least-Cost Test" (April 20, 1994).

A third alternative for resolving CrossLand Federal was its sale to another financial institution. Nine institutions showed initial interest in bidding for CrossLand Federal. The FDIC estimated that a bid would generate $291 million in net premium for CrossLand Federal, thereby costing the BIF $899 million, or the FDIC's original $1.2 billion investment reduced by the $291 million premium and by the $10 million in anticipated recoveries from the assets in the receivership.[19]

At the same time the FDIC was considering these alternatives, it was also exploring a fourth alternative: resolving CrossLand Federal through a public offering or private placement of stock. In early 1993, improving market conditions for savings bank securities were helping some publicly traded savings banks recapitalize. In April 1993, the FDIC decided to investigate the option of converting CrossLand Federal to stock form and selling all or a majority of the equity ownership of CrossLand Federal through a private placement or public offering. As part of this process, the FDIC engaged two investment banking firms to pursue the equity sales strategy. In the spring of 1993, these firms concluded that the sale of CrossLand Federal would generate approximately $300 million in proceeds.[20] If the estimate were correct, this alternative would be the least costly, with an estimated cost to the BIF of $889 million. See table II.11-1.[21]

19. GAO/GGD-94-109, 5-8.

20. GAO/GGD-94-109, 5-8.

21. GAO/GGD-94-109, 5-8.

The Resolution—August 12, 1993

In early 1993, the FDIC's two investment firms prepared for a private placement or public offering of CrossLand Federal to institutional investors. The offering circular for CrossLand Federal reported that, during the conservatorship period, the institution had made progress in reducing and restructuring its franchise in the New York area and in selling or restructuring its nonperforming assets. The investment banking firms were proactive in assembling the group of investors, and the FDIC staff made itself available to the investors and had frequent interaction with them.

While the FDIC Board of Directors determined that a stock sale of the institution was likely to produce disposition proceeds greater than any other disposition alternative, it also agreed to consider traditional P&A bids for CrossLand Federal's assets and liabilities to increase competition and accommodate potential interest that might result from a due diligence process. Only one bid for a P&A transaction was received, and it was approximately $30 million more costly than the institutional placement of the stock. On August 12, 1993, the FDIC Board of Directors approved the sale of CrossLand Federal by placing the stock with institutional investors in a registered public offering for $332 million, plus warrants for an additional one million shares of stock in the institution. The sale was closed on August 19, 1993.

To effect the transaction, CrossLand Federal was converted from a federal mutual savings bank to a federal stock savings bank. In the conversion, the FDIC received convertible preferred stock of the bank that automatically converted into 12 million shares of common stock on the FDIC's transfer of the stock to the new owners. The common stock was sold for $282 million, or $23.50 a share. CrossLand Federal issued to the FDIC $50 million of subordinated debentures that were simultaneously sold to the institutional investors, bringing the total proceeds of the transaction, net of $11 million of advisory fees, to $321 million. The FDIC also received warrants providing it with the right to purchase one million (about 8.3 percent) of the 12 million shares of the common stock of the bank at an exercise price of $23.50 per share. The warrants could be exercised at any time before their expiration date of August 19, 2003; the warrants were exercised in 1996, resulting in a gain of $18 million.

Finally, to effect the bank's sale, the FDIC provided the buyers with protection against large, unexpected losses on certain of CrossLand Federal's bad assets through a loss sharing agreement. Loss sharing was by then a familiar concept, having been used a total of 14 times, covering $20.6 billion in initial total assets in the resolution of failing institutions. The loss sharing agreement with CrossLand Federal covered approximately $2.8 billion in total assets, including all multi-family and commercial real estate loans ($1.7 billion), construction loans ($324.4 million), commercial business loans ($96.9 million), and investments in real estate ($560.4 million).[22] The assets were primarily

22. FDIC, *The Cost of Large Resolution Transactions* (March 12, 1996).

CrossLand Federal's high-risk assets (both performing and nonperforming). Unlike previous loss sharing agreements, this loss sharing required the new bank to assume all losses up to the "threshold amount," which was $179 million. The FDIC agreed to only reimburse the acquirer for 80 percent of net loan charge-offs and reimbursable expenses that exceeded the threshold amount during the agreement's five-year term. If the acquirer recovers any additional income from these assets, the FDIC is entitled to 80 percent of the net amounts for an additional three years (until June 30, 2001).

Many of these assets had already been partially charged off during the conservatorship so that their book value would more appropriately reflect their value. By having the new investor group agree to absorb the first $179 million in losses, the FDIC's risk was minimal. At the time of the resolution, the FDIC estimated the cost under the loss sharing agreement to be $28 million. The new institution reached the threshold loss figure in December 1995, and the FDIC revised its loss share estimate to $32 million; see table II.11-2 for details on the loss sharing agreement.

The Stock Transactions

When the conservatorship was established, the FDIC had contributed $525.2 million into the equity of CrossLand Federal. A large portion of these funds covered the negative equity that had existed on CrossLand's books. When the FDIC converted the mutual institution to stock form, it received 120,000 shares of convertible preferred stock that was converted into 12 million shares of common stock of the bank on transfer by the FDIC to the institutional investors. Institutional investors paid the FDIC $282 million in cash, plus $50 million in subordinated debentures and gave the FDIC warrants for the purchase of one million shares of common stock of the bank at $23.50 per share. In 1994, the bank became a wholly owned subsidiary of Brooklyn Bancorp, Inc. (Bancorp) and, in accordance with the original sale agreement, the warrants automatically converted to warrants for Bancorp common stock with identical terms and conditions. On February 29, 1996, Republic New York Corporation (Republic) acquired Bancorp for an aggregate cash purchase price of $529.6 million or $41.50 per common share. As part of this transaction, the FDIC exchanged its Bancorp warrants at a price equal to the aggregate difference between their exercise price of $23.50 per share ($23.5 million) and Republic's cash offer of $41.50 per share ($41.5 million), for a net gain of $18 per share. Bancorp was required to pay all expenses associated with the registration of the warrants.[23] See table II.11-3 for a summary of stock transactions.

23. FDIC, *The Cost of Large Resolution Transactions*.

Table II.11-2.

CrossLand Federal Savings Bank Loss Sharing Data as of December 31, 1997
($ in Millions)

	Amount
Beginning balance loss share assets	$2,820
Permitted advances and additions	32
Total loss share assets	**2,852**
Principal collected	2,234
Principal charged off	320
Protection forfeited, assets removed from pool, and adjustments to beginning balance	5
Total principal reductions	**2,559**
Remaining balance of loss share assets*	294
FDIC's original estimate of loss sharing payments	**28**
FDIC's actual loss sharing payments as of December 31, 1997	6
FDIC's remaining anticipated payments	28
FDIC's revised estimate of total loss sharing payments	**34**
Revised estimate of total payments as a percentage of original estimated payments	**121.43%**
Revised estimate of total payments as a percentage of total loss share assets	**1.19%**

*Total does not foot due to rounding differences.
Source: FDIC, "Summary of Loss Sharing Assistance Agreements Through December 31, 1997" (February 23, 1998).

Table II.11-3.

A Summary of the FDIC's Stock Transactions for CrossLand Federal Savings Bank
($ in Millions)

Date	Transaction	Amount
08/19/93	Cash received	$282
08/19/93	Debentures received	50
08/19/93	Cost of sale	(11)
02/29/96	Sale of warrants to Republic New York Corporation	18
	Totals	**$339**

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

FDIC Resolution Costs

The FDIC's estimate of the resolution cost of completing an insured deposit transfer in 1992 was $1.3 billion. As shown in table II.11-4, the FDIC's decision of placing the institution into conservatorship and then selling it later through the stock sale was less expensive with a total cost of approximately $740 million, or 10.2 percent, of failed bank assets as of December 31, 1995. This is also less than the $889 million estimate made by the FDIC in late 1993, when it was comparing the three different available alternatives prior to the stock offering. Part of the reason for the difference after the sale was proposed is that the franchise was sold for more than predicted and the sale of the warrants later added an additional $18 million in proceeds. Also there was approximately $15 million in proceeds received from suits involving the directors and officers of the failed bank and a bond claim on the insurance policy of the bank. Even though the resolution costs are less than what was predicted in 1993, CrossLand still ranks as one of the most costly resolutions in FDIC history.

Table II.11-4.

CrossLand Federal Savings Bank Resolution Costs

($ in Millions)

FDIC's Expenses		
Initial capital infusion	$1,200	
Loss sharing payments—estimated*	34	
FDIC's Total Expenses		**$1,234**
FDIC's Recoveries		
Net proceeds from sale of stock	$321	
Recovery of capital investment	155	
Gain on sale of stock warrants	18	
FDIC's Total Recoveries		**$494**
FDIC's Total Resolution Cost**		**$740**

*As of December 31, 1997, actual loss share payments totaled $6 million; however, the FDIC expects that prior to the end of the loss sharing agreement there will be additional claims of approximately $28 million. The total expected payments of $34 million equals about 1.2 percent of the total asset balance originally covered by loss sharing.

**Includes both receivership and FDIC corporate costs of CrossLand.

Sources: FDIC *The Cost of Large Resolution Transactions* (March 12, 1996); FDIC Division of Finance; and FDIC Division of Research and Statistics.

Lessons Learned

CrossLand was an unusual and high-profile resolution, and the FDIC learned some valuable lessons from this experience. Also, CrossLand was the first large institution to fail after passage of FDICIA. Because of this, and because of the unique way it was resolved, the failure and resolution drew a lot of attention. The United States General Accounting Office (GAO) conducted two independent investigations into the original transaction in 1992 and the resolution in 1993.

Reports from the U.S. General Accounting Office

The GAO produced two reports in connection with the failed institution. The first report, "Failed Bank: FDIC Documentation of CrossLand Savings, FSB, Decision Was Inadequate," July 7, 1992, dealt with the FDIC's decision to place CrossLand into conservatorship.[24] The second report, "Failed Bank: FDIC Sale of CrossLand Conservatorship Satisfied Least-Cost Test," April 20, 1994, was concerned with the FDIC's sale of CrossLand Federal.[25]

GAO Report, July 1992. One FDICIA requirement was that the FDIC had to select the least costly method of resolving a failing bank. CrossLand was the sixth institution to fail after passage of FDICIA and was much larger than any of the other five. The FDIC's placing of CrossLand into conservatorship was a controversial decision, and the chairmen of both the Senate and House banking committees requested that the GAO review the transaction to see if the FDIC had selected the least cost transaction.

Ultimately, the GAO could not confirm that the decision to place CrossLand into conservatorship was the least costly resolution alternative. The GAO found that FDIC staff had presented three possible resolution alternatives for CrossLand and had made various cost assumptions about each alternative.[26] The GAO did not find empirical evidence to support the assumptions in either its review of the presentation made to the FDIC Board of Directors or in any other FDIC files. This resulted in the GAO's questioning the validity of the cost savings of the conservatorship resolution.

The FDIC staff had estimated that the resolution of CrossLand through the conservatorship option would cost about $763 million. That estimate was based on the assumption that the FDIC would need to inject approximately $1.2 billion in cash into CrossLand Federal to adjust the value of CrossLand's loans and to bring the institution's equity to approximately 4 percent of assets. FDIC staff further estimated that CrossLand Federal would earn about $69 million after taxes for each of two years following

24. U.S. General Accounting Office, Report to Congressional Requesters, GAO/GGD-92-92, "Failed Bank: FDIC Documentation of CrossLand Savings, FSB, Decision Was Inadequate" (July 7, 1992).

25. GAO/GGD-94-109.

26. U.S. General Accounting Office, "Failed Bank: FDIC Documentation of CrossLand Savings, FSB, Decision Was Inadequate" (July 7, 1992), 3.

the establishment of the conservatorship, for a total of $138 million. After two years, the institution would pay the FDIC a cash dividend of $203 million, and the equity in the institution could be sold for roughly $375 million, for a total return to the FDIC of $578 million. FDIC staff discounted the $578 million at 15 percent for the two-year period, making the return to the FDIC about $437 million in 1992 dollars. This left a cost to the FDIC of $763 million ($1.2 billion, less $437 million) at the time of the decision to place CrossLand into conservatorship in 1992. The $763 million projected cost was about $517 million less than the next least costly resolution method of transferring insured deposits only to a healthy institution ($1.297 billion), and approximately $534 million less than a resolution through an insured deposit payoff ($1.28 billion).[27]

Approximately $440 million of the FDIC's projected $517 million cost savings in 1992 was based on the FDIC's estimate that, in a conservatorship, it would realize a savings of roughly 10 percent more on CrossLand's troubled assets than it would if the FDIC assigned the assets to a contractor for management and disposition. This belief was based on three key assumptions. First, the values of assets held in a going concern are greater than the values of assets placed in a liquidation mode. Second, it would be more efficient to retain CrossLand's "collection machinery" than incur the cost and disruption associated with replacing that system. Third, CrossLand's borrowers most likely would prefer the approach taken by the "local banker" than the approach taken by the "out-of-town liquidator." The "10 percent assumption" was the biggest factor in the recommendation to proceed with a conservatorship, and the GAO believed it should have been more firmly supported.[28] Additionally, the GAO objected to the FDIC's use in January 1992 of CrossLand asset valuations, because they had been completed in July 1991; they were based on March 31, 1991, information; and they did not cover any of CrossLand's subsidiaries. The GAO felt that such data were obsolete and may have resulted in inaccurate asset valuations.[29]

The FDIC received a draft copy of the GAO's report, and the FDIC disagreed with the GAO's findings that the decision was inadequately documented. The final report was produced with that disagreement noted. It should be noted that the law (FDICIA) that required the FDIC to comply with the least cost test had only been effective since December 19, 1991. This was less than a month before the FDIC's decision to place CrossLand into conservatorship. Responding to the draft of the GAO report, Chairman Taylor wrote: "Although specific policies and procedures may not have been fully implemented at the time of the CrossLand Savings resolution, the FDIC believes that the process which resulted in the decision to pursue interim ownership of CrossLand Savings represented full compliance with FDICIA."[30]

27. GAO/GGD-92-92, 8.

28. GAO/GGD-92-92, 10-11.

29. GAO/GGD-92-92, 9-10.

30. FDIC Chairman William Taylor, letter to Richard L. Fogel, Assistant Comptroller General, U.S. General Accounting Office (June 17, 1992); GAO/GGD-92-92, 21-22.

GAO Report, April 1994. After the FDIC arranged the sale of CrossLand Federal in August 1993, the GAO was again requested to review the FDIC's actions. In its second review, the GAO was requested by the House Committee on Banking, Finance, and Urban Affairs to determine whether the FDIC had complied with the least cost requirement of FDICIA and whether the conservatorship achieved the $517 million in savings that the FDIC had estimated in February of 1992. In its second report, the GAO found that the process used by the FDIC to approve selling CrossLand Federal in a public offering was much improved over the method used in January 1992 when the decision was made to place CrossLand into conservatorship. The GAO further reported that the documentation of the cost estimates for each alternative, as well as the underlying assumptions for those cost estimates, was also improved.[31] The GAO reported that it believed the FDIC complied with FDICIA and selected the least costly resolution alternative.

The GAO, however, reported that the FDIC did not achieve its expected savings of $517 million by selecting the use of the conservatorship resolution method in 1992. At the time of the GAO's investigation, the FDIC had reduced the savings estimate to $400 million, which the GAO further adjusted to $333 million. In establishing its original estimate, the FDIC had predicted that CrossLand Federal would, before its sale, generate income and pay dividends of $272 million. However, the conservatorship lost $235,000 in the 18-month period before its sale.

The GAO reported that the conservatorship did not restore CrossLand Federal to profitability, nor did it produce the improvements to franchise value that it had projected. FDIC Divisions of Supervision and Resolutions Executive Director John W. Stone advised the GAO that the bank's asset quality was lower than expected when CrossLand was closed in 1992: ". . . [I]t is our firm belief that the cost of liquidating CrossLand was underestimated in January 1992. It was only after the FDIC gained control of the institution that it became evident that the condition of CrossLand's assets was worse than believed in January of 1992."[32] Regardless of the large difference in the cost estimate of the transaction, the GAO also confirmed that, while CrossLand cost more than originally projected, the selection of the conservatorship resolution method was still less expensive than any of the other resolution alternatives available in 1992.

The GAO also indicated that the conservatorship was judged to be well managed and controlled. As conservator of CrossLand Federal, the FDIC provided guidelines for operating the bank and established reporting requirements for approval of strategies and business transactions, such as the disposition of assets. The FDIC hired a chief executive officer and approved his remuneration, as well as that of other CrossLand Federal executives, consistent with market studies of executive pay in comparable financial

31. GAO/GGD-92-92, 3.

32. John W. Stone, Executive Director, FDIC Divisions of Supervision and Resolutions, letter to James L. Bothwell, Director, Financial Institutions and Markets Issues, U.S. General Accounting Office (February 25, 1994); GAO/GGD-92-92, 18

institutions. The FDIC required the bank's management to prepare a business plan specifying how the bank was going to operate profitably and restructure its assets.[33]

Finally, the GAO believed that it might not have been necessary for the FDIC to protect the uninsured depositors of CrossLand or to honor the interest rates in deposit contracts on some of CrossLand's deposit accounts. The cost of protecting the uninsured did not have a major effect on the final resolution cost. The actual cost of protecting the uninsured was $11 million, which was 1.24 percent of the $889 million estimated cost at the time the conservatorship was sold in August 1993. The FDIC assumed that if it did not protect uninsured depositors from losses and honor deposit contracts on certain deposit accounts, there would be a large outflow of deposits during conservatorship. The FDIC believed that this would result in a reduced CrossLand Federal franchise value and would lower the expected sales proceeds when CrossLand Federal was sold to the private sector. In its 1992 report, the GAO had stated that the FDIC did not have documented support for the assumption on depositor reactions. In its 1994 report, the GAO noted that, after the January 1992 CrossLand resolution decision, other resolutions such as American Savings Bank in New York and the subsidiary banks of First City Bancorporation of Texas, Inc., in Texas showed that requiring uninsured depositors to absorb their share of losses in the resolution of a failed bank did not necessarily result in depositor runs. With the benefit of that experience, the FDIC agreed that, in hindsight, it was not necessary to protect the CrossLand uninsured depositors in the January 1992 resolution decision.[34]

Other Lessons Learned

In addition to the points brought out in the GAO reports, the FDIC also learned valuable lessons from its operation of the CrossLand Federal conservatorship. The FDIC had previously completed several transactions that involved the FDIC's sharing of risk. Because the bank was in conservatorship, due diligence teams could determine the potential loss in the portfolio that was to be sold in the final transaction. Potential purchasers were instructed to take this into consideration when making their bids. In the transaction completed with the purchasers of CrossLand Federal, the FDIC agreed to a sales price that reflected the purchasers' estimation of the probable loss on the assets. In return, the purchasers agreed to fully absorb the first $179 million of losses on CrossLand Federal's commercial loans and real estate owned. The FDIC would reimburse the acquirers for 80 percent of further net charge-offs on those assets for a period of five years. The FDIC believed that its costs of sharing the risk on the portfolio of commercial loans and real estate owned would be lower if the assets were worked out in

33. GAO/GGD-92-92, 9.

34. GAO/GGD-92-92, 12.

an open bank environment. Because the investors absorbed the initial losses in the portfolio, the FDIC learned that it could transfer to institutional purchasers a larger portion of its risk than had been transferred in previous transactions.

At CrossLand Federal, the FDIC used lessons that it had learned previously in its oversight of large asset management firms. Ever since the 1988 resolution of First RepublicBank Corporation, Dallas, Texas, the FDIC had used contracted asset management firms, under FDIC supervision, to collect the FDIC's assets acquired from large bank failures. In the asset management contracts, the FDIC required the contractor to develop and follow a business plan approved by the FDIC, that the contractor have policies in place to support the business plan, and that audits be performed regularly to ensure compliance with the business plan. While CrossLand Federal was operated in a conservatorship, the FDIC used many of the same management principles that it had learned in its oversight of the asset management companies.

The FDIC's hiring of an outside executive to run CrossLand Federal was not an unusual move; use of private sector expertise was successful in the operation of many of the FDIC's bridge banks in previous resolutions. Although the conservatorship of CrossLand Federal lasted longer than most of the bridge banks, the FDIC considers use of an outside executive, along with a strong and focused business plan, integral to the successful resolution of CrossLand.

Additionally, the FDIC's emphasis of working assets out of an open bank, private sector environment is viewed as being cost-effective in this instance. A "credit crunch" in the Northeast at that time was causing many lenders to become more conservative, making it more difficult for borrowers to refinance. Borrowers able to work with an ongoing financial entity were more able and more willing to service their debt obligations than if they had been placed into a liquidation mode. CrossLand Federal was able to reduce its asset base by 38 percent in the 18 months that it was in operation as a conservatorship. The remaining assets stayed in an open bank environment when the bank was sold to the new investors.

Although the FDIC agreed with the GAO's findings that, in hindsight, the uninsured depositors did not need to be protected, there were valid reasons given for the action in January 1992. The FDIC's primary interest was to protect the institution's future franchise value. The estimated $11 million cost of protecting the uninsured was small, compared to the damage that could have occurred if core depositors had left the bank during the conservatorship period. The FDIC believed that, given the nature of the communities served by CrossLand, the remaining $5 billion core deposit base could be considered quite fragile. The conservatorship likely would have suffered if unaffected safety conscious depositors, anxious about losses imposed on the uninsured, had reacted by withdrawing their deposit balances. If that had happened, CrossLand Federal would have found itself more dependent on rate conscious depositors, which would have increased operating costs and further reduced the value of the franchise.

FDIC staff estimated that a seven basis point increase in the average interest rate paid on deposits would have reduced CrossLand Federal's net income by approximately

$2.5 million per annum. Richard Kraemer, whom the FDIC had hired to serve as president and chief executive officer of CrossLand Federal, estimated that imposing losses on the bank's uninsured depositors could have affected the bank's core deposit costs by as much as 25 basis points. Such an increase in deposit costs would have been very detrimental to CrossLand Federal's future franchise value.

As further support of the FDIC's action, the vast majority of all time deposits with high interest rates were set to mature within a year. The FDIC staff viewed CrossLand Federal's continuation of the relatively high interest rates as a temporary problem that could be corrected as the accounts matured. Without liquidity pressure during the conservatorship period, renewal rates on deposits could be set at market rates. Before the passage of FDICIA, the FDIC had nearly always protected all depositors in a P&A transaction and had done so in 1991 for such notable failed institutions as the Bank of New England Corporation banks, the Southeast Banking Corporation banks, and the New Hampshire Plan banks. It is difficult to predict depositor reaction and therefore it is difficult to assess what damage, if any, would have occurred if the uninsured depositors had not been covered. While it is true that the cost of protecting uninsured depositors was minimal when compared to the total cost of the entire resolution, in retrospect, the FDIC learned that its practice of protecting all depositors probably was not necessary.[35] Since the enactment of FDICIA, the FDIC has become more conscious of recognizing all resolution solutions and uses greater care at documenting costs of each alternative.

The lack of bidders willing to purchase the CrossLand franchise in January 1992 provided the FDIC with the opportunity to test a different source for resolving an institution. After the conservatorship, the investment firms engaged to help the FDIC market CrossLand Federal were very proactive in finding a group of investors to purchase the bank. The price received from these investors exceeded the highest bid the FDIC received under a traditional P&A transaction structure. The CrossLand experience showed that, in some instances, investors from other markets outside the standard banking community provide the FDIC with its lowest cost alternative.

Effect on Future Resolutions

CrossLand was one of the last large, complex banks to fail during the banking crisis period. After CrossLand Federal's sale in August 1993, only 22 insured banks failed through the end of 1994, and the largest of those had $296 million in total assets. The FDIC has not had a real opportunity to test some of the lessons learned from its

35. The GAO's April 1994 report compared the FDIC's actual $11 million cost of protecting the uninsured to the FDIC's August 1993 estimated total resolution costs of $889 million and determined the cost of protecting the uninsured as 1.24 percent of total costs. A comparison of the $11 million cost to the FDIC's actual total resolution costs of $740 million results in a cost of protecting the uninsured as 1.5 percent of total costs.

CrossLand experience. The FDIC does, however, continue to share risk with failed bank purchasers through loss sharing agreements, and it is expected that loss sharing will continue to be offered as a resolution technique in the future. It is entirely possible that, in the event of another large high-profile institution failure the FDIC would hire private sector advisors from Wall Street to assist in developing potential investors groups outside the banking community.

The FDIC has refined its procedures to comply with FDICIA elements that require the FDIC to always choose the least costly resolution alternative for a failing financial institution. Other FDICIA requirements, particularly those involving prompt corrective action, have not been used enough, because of the strong economy, to determine the effect on large bank failures.[36]

The FDIC's placing of CrossLand into a conservatorship was deemed necessary by the FDIC in 1992 because there were no acceptable bids for the institution. Although there was heavy criticism from many sides at the time, the final outcome of the sale of CrossLand Federal proved that the conservatorship option was the appropriate and least costly action for the FDIC to take. The sale was consummated 18 months after the conservatorship was started, and during that time the general economy improved and the banking environment got better. The institution was downsized to its core business, it resolved many of its problem assets, and it was operating more efficiently. The conservatorship decision was proved to be correct, and the FDIC might well make the same decision if a similar situation arises in the future.

36. Prompt corrective action requires bank regulatory agencies to take specific steps to deal with institutions that have declining levels of equity capital. Actions range from restrictions on an institution's deposit taking to closing of the institution.

PREVIOUS CHAPTER NEXT CHAPTER TABLE OF CONTENTS