August 23, 2023

MEMORANDUM TO: The Board of Directors

FROM: Jonathan McKernan
Member, Board of Directors

SUBJECT: Board Approval of Midsized-and-Large Failed-Bank Sales

Summary: Director McKernan presents for adoption by the Board of Directors (the "Board") of the Federal Deposit Insurance Corporation (the "Corporation") a resolution providing for Board approval of certain transactions involving insured depository institutions ("IDIs") with at least $50 billion in total assets (individually, a "midsized-or-large IDI," and, collectively, "midsized-and-large IDIs") for which the Corporation has been appointed receiver.

Discussion: Section 2(a) of the Federal Deposit Insurance Act provides that "[t]he management of the Corporation shall be vested in [the] Board of Directors." In managing the Corporation, the Board often delegates day-to-day authority to officers and agents of the Corporation. The Board has limited generally those delegations of authority by reserving for itself consideration of any matter that would establish or change existing corporation policy, could attract unusual attention or publicity, or would involve an issue of first impression (each, a "major matter"). Also, only the Board may deny a deposit-insurance application, deny a bank-merger application, or act on certain applications involving industrial banks or industrial loan companies, all of which raise important policy considerations properly reserved to the Board.

The Corporation plays a vital role within the banking system in serving as receiver for failed IDIs. In that capacity, the FDIC generally seeks a buyer interested in acquiring the deposits and assets of the failed IDI through a purchase-and-assumption transaction (a "P&A transaction"). To effectuate a P&A transaction, the FDIC may provide assistance to the acquiring

institution, provided the transaction is least costly to the Deposit Insurance Fund (the "DIF") or the systemic-risk exception has been invoked.

The Board has adopted a set of resolutions—known as the Robinson Resolution—that provide a framework for delegating authority to effectuate certain transactions involving a failed IDI for which the Corporation has been appointed receiver; those transactions include P&A transactions. The Board has also adopted resolutions—known as the Receivership Management Delegations—delegating authority to manage the receiverships of failed IDIs by, for example, selling assets.

The Robinson Resolution and Receivership Management Delegations were developed initially largely based on the Corporation's experience with failed community banks. The current Robinson Resolution—initially adopted in 1999—provides that its framework for delegating authority to determine the least-cost method of resolution and otherwise to implement any authorized transaction, including a P&A transaction, "in no event shall . . . apply to an institution with assets greater than $1 billion as reflected in the most recently available, reliable financial data for such institution." However, it has become customary for staff to recommend—and for the Board to approve—waiving that limitation as part of the actions the Board takes to authorize the Corporation's acceptance of its appointment as receiver for any IDI, regardless of its size. The current Receivership Management Delegations—initially adopted in 2002—generally include a monetary limitation, which the Board recently increased by fivefold for midsized-and-large IDIs (with Director McKernan objecting to those amendments).

The recent failures of Silicon Valley Bank, Signature Bank, and First Republic Bank resulted in significant loss to the DIF and the banking industry, an estimated total loss of $16.1 billion, $2.4 billion, and $13 billion, respectively. These are the largest IDI failures by

asset size in FDIC history after Washington Mutual Bank ("WaMu"), which resulted in no loss to the DIF. The next largest IDI failure by asset size was IndyMac Bank, which, before the recent failures, was the FDIC's most costly failure, at over $12 billion.

Concerns have been expressed regarding the auction processes for the three recent IDI failures. For example, were the auction processes designed to solicit bids from a sufficiently diverse array of bidders—including bidders outside the banking system—to develop robust competitive pressure for the assets? Why were no insured-deposits-only bids received for First Republic Bank, which, all else being equal, would be less costly to the DIF than an all-deposits P&A transaction? Consistent with the least-cost-test mandate that the Corporation's expenditures and obligations incurred be "the least costly to the [DIF] *of all possible methods* for meeting the Corporation's obligation,"[1] what other strategic options were considered, and why were they rejected? These and other questions combined with the potential for significant loss to the DIF from the failure of a midsized-or-large IDI raise such important policy considerations that it is properly the responsibility of the Board to address them directly. In fact, with the exception of the P&A transaction for First Republic Bank, the Board approved the P&A transactions for the other five largest IDI failures by asset size, the smallest being IndyMac Bank, which had approximately $32 billion in total assets when it failed in 2008.

Further, while the least-cost test is an important and significant limitation on the Corporation's discretion in resolving an IDI, its design is not sacrosanct. The statute imposes only very general guardrails on the design of the least-cost test, thus leaving the Corporation with substantial discretion. Like any model, the models used by the Corporation to estimate costs to the DIF are sensitive to inputs and assumptions underlying those models; and many of those

[1] *See* 12 U.S.C. § 1823(c)(4)(A)(ii) (emphasis added).

models are based on the Corporation's actual loss experience, which has primarily been from community bank failures. Thus, the Board even has a role to play in the design and application of the least-cost test at the time a midsized-or-large IDI fails.

The importance of Board responsibility—and accountability—is likely to increase as further enhancements are made to the resolution framework. Two of today's proposals—one to revise the Corporation's resolution plan rule and the other to require certain midsized-and-large IDIs to issue a minimum amount of long-term debt—are intended to provide the Corporation with additional optionality to resolve midsized-and-large IDIs. Should these proposals be finalized substantially as proposed, the Corporation may find that the resolution of some midsized-and-large IDIs poses no risk of loss to the DIF—as the long-term debt absorbs sufficient losses—and either the least-cost test does not apply because the Corporation provides no assistance to an acquiring institution or multiple bids are equally least costly to the DIF (i.e., multiple bids would result in no loss to the DIF). Consequently, the Corporation will be left to balance five statutory mandates.[2] The importance of Board involvement is all the greater in such a situation where the Corporation has greater discretion and must balance competing interests, especially if the Corporation elects to use that discretion to sell assets to a global systemically important banking organization ("GSIB") or does not pursue a sale that maximizes net-present-value return.

The attached proposed resolution would revive the Board's active role in the resolution of failed midsized-and-large IDIs after the Board votes to authorize the Corporation to accept appointment as receiver. The attached proposed resolution would circumscribe appropriately the Board's direct involvement to approving any transaction or series of transactions—including a

[2] *See* 12 U.S.C. § 1821(d)(13)(E); *see also* 12 U.S.C. § 1823(d)(3)(D).

series of transactions involving a bridge depository institution—that involve all or a substantial part of the assets, the deposits, or the insured deposits of a midsized-or-large IDI for which the Corporation has been appointed receiver (each such transaction, a "midsized-or-large failed-bank sale"). The $50 billion asset threshold is largely consistent with the asset size at which the Board—with the exception of First Republic Bank—historically has approved P&A transactions for failed IDIs, taking into account inflation, and is consistent with the threshold proposed today to impose requirements on IDIs to submit resolution submissions as well as the asset threshold used in the Board's recent revisions to the Receivership Management Delegations. If adopted, the attached resolution would provide for the Board to approve each future midsized-or-large failed-bank sale unless the Board includes specified language in a subsequent Board resolution.[3]

Conclusion: Director McKernan recommends the Board adopt the attached resolution providing for Board approval of each future midsized-or-large failed-bank sale.

[3] If the Robinson Resolution is amended or replaced with a delegations framework more tailored to the resolution of IDIs of differing sizes and complexities, it may be appropriate to rescind the proposed resolution, if adopted.