


April 15, 2015

MEMORANDUM TO: The Board of Directors

FROM: Bret Edwards 
Director
Division of Resolutions and Receiverships

SUBJECT: Advance Notice of Proposed Rulemaking on
Large Bank Deposit Insurance Determination Modernization

RECOMMENDATION

Staff recommends that the Board of Directors (“Board”) approve the attached Advance Notice of Proposed Rulemaking (“ANPR”) for publication in the Federal Register. Through this ANPR, the FDIC would request comment (with a comment period of 90 days) on whether rulemaking should be initiated to require that certain insured depository institutions that have a large number of deposit accounts, such as more than two million accounts,¹ modify their deposit account systems to facilitate prompt insurance determinations in the event of one of these institution’s failure without significant advance notice and opportunity for the FDIC to plan.


SUMMARY

Following the failure of an insured depository institution, the FDIC seeks to make most insured deposits available to depositors by the next business day (usually the Monday following a Friday closing).² The size and complexity of some insured depository institutions, however, may pose challenges to the FDIC in meeting this goal. Previously, the FDIC sought to address these challenges through the promulgation of section 360.9 of the FDIC’s regulations (12 C.F.R. § 360.9). Section 360.9 requires insured institutions covered by its requirements to maintain processes that would provide the FDIC with standard deposit account information promptly in the event of the institution’s failure. In addition, section 360.9 requires these institutions to maintain the technological capability to automatically place and release holds on deposit accounts. If a bank with a large number of deposit accounts were to fail with little prior warning, however, additional measures may be needed to ensure the rapid application of deposit insurance limits to all deposit accounts. Staff has therefore reached the conclusion that further changes are needed.

¹ This threshold would affect about 37 institutions as of December 31, 2014.

² Certain types of deposits (for example, pass-through deposits and trust accounts) typically require more time to be made available.

Concur:


Charles Yi
General Counsel

The attached ANPR would request comment on whether certain banks that have a large number of deposit accounts, such as more than two million accounts, should be required to: (1) enhance their recordkeeping to maintain (and be able to provide the FDIC) substantially more accurate and complete data on each depositor's ownership interest by right and capacity (such as single or joint ownership) for all or a large subset of the bank's deposit accounts; and (2) develop and maintain the capability to calculate the insured and uninsured amounts for each depositor by deposit insurance capacity for all or a substantial subset of deposit accounts at the end of any business day. The ANPR contemplates that a failed bank's information technology systems and data would be used to calculate the insured and uninsured amounts of deposits and that, for a large subset of deposits, including those where depositors have the greatest need for immediate access to funds (such as transaction accounts and money market deposit accounts (MMDAs)), deposit insurance determinations would be made on closing night.

The ANPR seeks comment on its applicability and on the appropriate factors to consider in determining the applicability of any requirements.

The ANPR explicitly states that it does not contemplate imposing requirements on community banks.

Publication of the ANPR would begin the process of gathering information, initiating a dialogue with the industry, and formulating solutions to enhance the capacity for making prompt insurance determinations at failed banks with a large number of deposit accounts.

BACKGROUND

Under section 11 of the Federal Deposit Insurance Act ("FDI Act"), the FDIC is responsible for paying deposit insurance "as soon as possible" following the failure of an insured depository institution.³ While the FDIC may pay insurance either in cash (a "payout") or by making available to each depositor a "transferred deposit" in another insured depository institution (which could be a bridge bank), in most cases the FDIC uses transferred deposits.

Although the statutory requirement that the FDIC pay insurance "as soon as possible," does not obligate the FDIC to pay insurance within a specific period of days or weeks, the FDIC strives to pay insurance by the next business day after a bank fails (usually the Monday following a Friday failure).

Prompt payment of deposit insurance following a failure is essential for several reasons. First, prompt payment of deposit insurance maintains public confidence in the FDIC guarantee as well as confidence in the banking system. Second, depositors must have prompt access to their insured funds in order to meet their financial needs and obligations. Third, a delay in the payment of deposit insurance – especially in the case of the failure of one of the largest insured depository institutions – could have systemic consequences and harm the national economy.

³ 12 U.S.C. 1821(f)(1).

Fourth, a delay could reduce the franchise value of the failed bank and thus increase the FDIC's resolution costs.⁴

In applying the "standard maximum deposit insurance amount" or "SMDIA" of \$250,000, the law requires the FDIC to aggregate the amounts of all deposits in the insured depository institution that are maintained by a depositor "in the same capacity and the same right." For example, before the \$250,000 limit is applied, all single ownership accounts owned by a particular depositor must be aggregated. Such accounts, however, are insured separately from joint ownership accounts because joint ownership represents a separate "capacity and right."

In accordance with section 11 of the FDI Act, the FDIC has recognized a number of ownership "capacities" or account categories. Some of the most common account categories are the following: (1) single ownership accounts; (2) joint ownership accounts; (3) certain retirement accounts; and (4) revocable trust accounts (informal "payable-on-death" accounts as well as formal "living trust" accounts).⁵ While the FDIC is authorized to rely upon the account records of the failed insured depository institution to identify owners and insurance categories, the failed bank's records are often ambiguous or incomplete. In such circumstances, the FDIC is faced with making a potentially erroneous overpayment or delaying the payment of insured amounts to depositors while it manually reviews files and obtains additional information from the account holders about the ownership of the accounts.

As discussed above, the FDIC previously attempted to enhance its ability to make prompt deposit insurance determinations at larger banks through the adoption of section 360.9 of the FDIC's regulations. Section 360.9 applies to "covered institutions," with the term "covered institution" defined as an insured depository institution with at least \$2 billion in domestic deposits and at least (1) 250,000 deposit accounts; or (2) \$20 billion in total assets.⁶ Effective August 18, 2008,⁷ section 360.9 requires covered institutions to maintain processes that would provide the FDIC with standard deposit account information promptly in the event of the institution's failure. In addition, section 360.9 requires these institutions to have an automated process for placing and removing holds on deposit accounts and certain other types of accounts concurrent with or immediately following the daily deposit account processing on the day of failure.⁸ If certain banks with a large number of deposit accounts were to fail with little prior warning, however, additional measures are likely to be needed to ensure the rapid application of deposit insurance limits to all deposit accounts.

Under section 360.9, a covered institution is also required to be able to produce upon request data files that use a standard data format populated by mapping preexisting data elements regarding deposit accounts.⁹ For accounts in most of the deposit insurance categories recognized

⁴ See 70 FR 73652, 73653-54 (December 13, 2005).

⁵ Appendix A to the ANPR contains a list of deposit insurance account categories.

⁶ 12 CFR 360.9(b)(1).

⁷ See 73 FR 41180 (July 17, 2008).

⁸ 12 CFR 360.9(c).

⁹ 12 CFR 360.9(d).

by the FDIC, the required information includes the deposit insurance category.¹⁰ The required information also includes the customer's name and address.¹¹ At failure (or before), section 360.9 contemplates that the covered institution would transmit its section 360.9 data to the FDIC so that the FDIC could determine specifically which amounts were insured and which were not. In general, the determination would not be made on closing night, and, for many accounts, would not be made on closing weekend.

The self-described purpose of section 360.9 is the following: "This section is intended to allow the deposit and other operations of a large insured depository institution (defined as a 'Covered Institution') to continue functioning on the day following failure. It also is intended to permit the FDIC to fulfill its legal mandates regarding the resolution of failed insured institutions[,] to provide liquidity to depositors promptly, enhance market discipline, ensure equitable treatment of depositors at different institutions and reduce the FDIC's costs by preserving the franchise value of a failed institution."¹²

THE NEED FOR ADDITIONAL RULEMAKING

In staff's view, the lessons of the financial crisis, which peaked in the months following the promulgation of the FDIC's final rule prescribing section 360.9, illustrate definitively that further changes are needed to ensure that the FDIC can maintain the public trust in the banking system and can fulfill its statutory obligation to make insured depositors whole "as soon as possible."

A significant change to the banking industry resulting from the financial crisis affecting FDIC deposit insurance determinations arises out of further consolidation of the industry, particularly for larger firms. In 2005 the FDIC noted:

Industry consolidation raises practical concerns about the FDIC's current business model for conducting a deposit insurance determination. Larger institutions—especially those initiating recent merger activity—are considerably more complex, have more deposit accounts, greater geographic dispersion, more diversity of systems and data consistency issues arising from mergers than has been the case historically.... Should such trends continue, deposits will become even more concentrated in the foreseeable future.¹³

Such trends have not only continued, they accelerated as a result of the crisis, as reflected in Table A.

¹⁰ 12 CFR 360.9, appendix C.

¹¹ 12 CFR 360.9, appendix F.

¹² 12 CFR 360.9(a).

¹³ Advance Notice of Proposed Rulemaking, 70 FR 73652, 76354 (December 13, 2005).

Table A
Deposit Account Concentrations

	June 2008	December 2014	Percent Increase
Largest number of deposit accounts at a single bank	59,604,549	84,491,835	42%
Number of deposit accounts at the 10 banks having the most deposit accounts	254,180,422	318,809,420	25%

As a result of this concentration, many institutions are more complex with more serious systems and data consistency challenges.

The financial crisis also reinforced the challenges posed by multiple and rapid resolution of banks. Since the beginning of 2008, 511 insured depository institutions failed, comprising a total asset value of approximately \$696 billion. These failed banks range in asset value from a few million to over \$300 billion. Still other firms, including some of the largest banking organizations, were spared from failure only by extraordinary government intervention. These experiences indicate to staff that the conditional account holds and other requirements finalized in section 360.9 are not sufficient to mitigate the complexities of large institution failures. In staff's view, further measures are required. This is especially true because the experience of the financial crisis indicates that failures can often happen with no or little notice and time for the FDIC to prepare. Since 2009, the FDIC has been called upon to resolve 47 institutions within 30 days from the launch of the resolution process to the ultimate closure of the bank. In addition to these rapid failures, the financial condition of two banks with a large number of accounts - Washington Mutual Bank and Wachovia Bank - deteriorated very quickly in 2008, leaving the FDIC little time to prepare.

The implementation of section 360.9 requirements by covered firms also underscores the need for further measures. The FDIC has worked with covered institutions for several years to implement section 360.9. Based on its experience reviewing banks' deposit data, deposit systems and mechanisms for imposing conditional holds, staff has concluded that section 360.9 has not been as effective as had been hoped in enhancing the capacity to make prompt deposit insurance determinations. For the reasons discussed below, staff has concluded that, if certain banks with a large number of accounts were to fail with little prior notice and an insurance determination were required, additional measures would be needed, beyond those set out in section 360.9, to provide assurance that a deposit insurance determination would be made promptly and accurately. Because delays in insurance determinations could lead to bank runs or other systemic problems, staff believes that improved strategies must be implemented to ensure prompt deposit insurance determinations at failures of banks with a large number of deposit accounts.

First, in reviewing covered institutions for compliance with section 360.9 requirements, the FDIC has often found inconsistent and missing data.

Second, the continued growth following the promulgation of section 360.9 in the number of deposit accounts at larger banks and the number and complexity of deposit insurance systems

(or platforms) in many of these banks would exacerbate the difficulties of making prompt deposit insurance determinations.

Third, using the FDIC's information technology systems to make deposit insurance determinations at a failed bank with a large number of deposit accounts would require the transmission of massive amounts of deposit data from the bank's systems (now held by the bank's successor) to the FDIC's systems. The FDIC would have to process this data. The time required to transmit and process such a large amount of data present a challenge in making an insurance determination on the night of closing ("closing night") or possibly even on closing weekend, if the bank was closed on a Friday. A failed bank that has multiple deposit systems would further complicate the aggregation of deposits owned by a particular depositor in a particular right and capacity, causing additional delay.

Finally, if a bank with a large number of deposit accounts were to fail suddenly because of liquidity problems, the FDIC's opportunity to prepare for the bank's closing would be limited, thus further exacerbating the challenge in making a prompt deposit insurance determination.¹⁴

REQUEST FOR COMMENTS

The attached ANPR seeks comment on what additional regulatory action should be taken to ensure that deposit insurance determinations can be made promptly enough when certain banks with a large number of deposit accounts, such as more than two million accounts, fail. The two million account threshold would affect about 37 banks as of December 31, 2014.

Based on the FDIC's experience, however, and as reflected in the discussion that follows, the ANPR notes that it seems likely that certain banks with a large number of deposit accounts (e.g., more than two million accounts) will have to: (1) enhance their recordkeeping to maintain substantially more accurate and complete data on each depositor's ownership interest by right and capacity (such as single or joint ownership) for all or a large subset of the bank's deposit accounts; and (2) develop and maintain the capability to calculate the insured and uninsured amounts for each depositor by deposit insurance category for all or a substantial subset of deposit accounts at the end of any business day. The ANPR explicitly states, however, that it does not contemplate imposing additional requirements on community banks.

The goal of any regulatory action would be to: (1) address the additional challenges in making deposit insurance determinations posed by certain banks with a large number of deposit accounts, which have only increased in magnitude following the financial crisis; (2) enhance capabilities to make prompt deposit insurance determinations in the event of the sudden failure of one of these banks; (3) safeguard the Deposit Insurance Fund by avoiding overpayment of deposit insurance and other potential consequences from the failure of a bank with a large number of accounts; and (4) ensure that public confidence is maintained and depositors' expectations of prompt payment of insured deposits are met.

If certain banks with a large number of deposit accounts were to fail and a deposit insurance determination were necessary, one possible process for making deposit insurance

¹⁴ See 71 FR 74857, 74859 (December 13, 2006).

determinations (described here for purposes of soliciting comment) would be as follows. For a large subset of deposits (“closing night deposits”), including those where depositors have the greatest need for immediate access to funds (such as transaction accounts and money market deposit accounts (“MMDAs”)), deposit insurance determinations would be made on closing night. The failed bank’s information technology systems and data would be used to calculate insured and uninsured amounts. The ANPR seeks comment on the types of deposits that should be deemed “closing night deposits.”

To make a deposit insurance determination on closing night would require that certain banks with a large number of deposit accounts:

1. Obtain and maintain data on all closing night deposits, including outstanding official items, that are sufficiently accurate and complete to allow the determination of the insured and uninsured amounts for each depositor by deposit insurance right and capacity (that is, by deposit insurance category) at the end of any business day (since failure can occur on any business day). To allow the FDIC to examine banks’ data, banks with a large number of deposit accounts would have to maintain this data using a standard format and the data would have to meet quality and completeness standards; and
2. Develop and maintain an information technology system that can calculate the insured and uninsured amounts of closing night deposits for each depositor by deposit insurance category at the end of any business day.

Deposit insurance determinations on all other deposits (“post-closing deposits”) would be made after closing night, either on closing weekend (if the bank fails and is closed on a Friday) or thereafter.¹⁵ Staff envisions that, as currently contemplated by section 360.9, the failed bank’s information technology and deposit systems would be used to place provisional holds on post-closing deposits on closing night. Staff also envisions that the failed bank’s information technology and deposit systems would be used to calculate the insured and uninsured amounts of post-closing deposits.

For this process to work, it would require that a bank with a large number of deposit accounts obtain and maintain data on all post-closing deposits that are sufficiently accurate and complete to allow a prompt determination of the insured and uninsured amounts for each depositor by deposit insurance category. Moreover, this data will likely have to be more accurate and complete than the data some of these banks maintain now and would have to be maintained using a standard format. Alternatively, this information might be gathered post-failure using a claims administration process where depositors would be required to submit a proof of claim to the FDIC. As discussed below, the ANPR seeks comment on which types of deposits should be deemed post-closing deposits and on data requirements for various types of potential post-closing deposits.

¹⁵ Examples of post-closing deposits might include brokered deposits and other pass-through coverage accounts where depositors do not typically need immediate access to funds, trust accounts, and special statutorily created categories of accounts. The ANPR solicits comments on whether these or other types of deposit accounts should be treated as post-closing deposits.

The ANPR recognizes that the deposit insurance determination processes described above and the requirements they would impose could require banks with a large number of deposit accounts to make substantial changes to their recordkeeping and information systems. The complexity of the deposit insurance coverage rules contributes to the challenge of making deposit insurance determinations at these banks. As shown in Appendix A to the ANPR, there are more than a dozen different deposit insurance categories or “rights and capacities” in which a depositor can own funds in an FDIC-insured institution.

Simplifying deposit insurance coverage rules likely would enable the FDIC to perform deposit insurance determinations much more quickly and accurately but might also entail reduced insurance coverage to some affected depositors. For example, deposit insurance coverage for trust accounts is complex in part because it depends upon the number of beneficiaries, whose names often do not appear in bank records. Replacing “per beneficiary” coverage with “per grantor” or “per trust” coverage would greatly simplify the insurance determination but result in reduced insurance coverage.

To assist the FDIC in the development of a proposed rule, the ANPR also requests comment on a variety of other issues and topics related to deposit insurance determinations, including which banks a rule should apply to, the costs of complying with and the benefits of potential requirements, the time needed for banks to implement new requirements, whether banks should be required to inform depositors how much of their deposits is insured, and when and how deposit insurance determinations for specific categories of deposits (time and savings accounts, pass through coverage accounts, including prepaid cards, trust accounts, and special statutorily created categories of accounts) should be made.

CONCLUSION

Staff recommends that the Board approve the attached ANPR for publication in the Federal Register. The solicitation of comments from the public will assist the FDIC in determining whether rulemaking should be initiated to certain depository institutions with a large number of deposit accounts to modify their deposit account systems to facilitate a more rapid insurance determination on all deposit accounts in the event of the institution’s failure.

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