Statement by Martin J. Gruenberg

Member, FDIC Board of Directors

Bank Merger Act Application: SunTrust Bank, Atlanta, Georgia, to be acquired by Branch Banking and Trust Company, Winston-Salem, North Carolina

November 19, 2019

Today the FDIC Board of Directors is considering an application for the merger of two large insured depository institutions, SunTrust and BB&T, under section 18(c) of the Federal Deposit Insurance Act, commonly referred to as the Bank Merger Act.[1] This is by far the largest bank merger ever to be considered by the FDIC[2] and offers the first meaningful consideration of the new financial stability factor for mergers added by the Dodd-Frank Act.[3]

Among several factors, the Bank Merger Act now requires that the responsible agency -- in this case, the FDIC as the regulator of the merged institution -- take into consideration "the risk to the stability of the United States banking or financial system."[4] This was a response to the 2008-2009 financial crisis when so many large, systemically important financial institutions failed or nearly failed. This in turn triggered an unprecedented U.S. government response, including the first exercise of the FDIC's systemic risk authority under the Federal Deposit Insurance Act.[5]

The proposed merger would result in the sixth largest insured depository institution and the eighth largest bank holding company in the United States. While the resulting institution is not expected to expand its cross-border activities

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[1] 12 U.S.C. 1828(c).

[2] The top 5 FDIC-supervised mergers are:
2015 - BB&T acquired Susquehanna Bank, Lancaster, PA ($19B)
2011 - Hancock Bank, Gulfport, MS ($7B) acquired Whitney Bank, New Orleans, LA ($13B)
2009 - BB&T acquired Colonial Bank, Montgomery, AL ($25B)
2006 - BB&T consolidated BB&T Co. of Virginia ($25B) into their main charter
2005 - NorthFork Bank, Mattituck, NY ($30B) acquired Greenpoint Bank, New York, NY $(32B).

[3] Section 604(f) of the Dodd-Frank Act, codified at 12 U.S.C. 1828(c)(5).

[4] Id.

[5] 12 U.S.C. 1823(c)(4)(G). The FDIC is required by statute to choose the resolution that is the least costly to the Deposit Insurance Fund, the "least cost test." 12 U.S.C 1823(c)(4). The only exception to the least cost test is the systemic risk exception, which requires a determination that compliance with the least cost test "would have serious adverse effects on economic conditions or financial stability; and [] any action or assistance under this subparagraph would avoid or mitigate such adverse effects."

or deviate significantly from its traditional banking business model, other indicators of complexity and challenges to resolvability raise potential financial stability concerns. These include a large branch network, a large insurance broker subsidiary, substantial IT systems, millions of account holders, and heavy reliance on uninsured deposits. In addition, regional banks such as these are not subject to a requirement to maintain a minimum amount of long-term unsecured debt to absorb losses in the event of failure.

My concerns with the proposed merger and its potential risk to financial stability are informed by the FDIC's experience with regional bank failures during the crisis, particularly Washington Mutual Bank and IndyMac Bank.

The Failures of Washington Mutual Bank & IndyMac Bank[6]

Washington Mutual Bank, with over $300 billion in assets at the time of its failure in September 2008, was the largest thrift institution in the United States and the 6th largest insured depository institution. Its failure was the largest in the FDIC's history.[7]

Several factors made it possible for Washington Mutual to fail with no loss to the Deposit Insurance Fund and no loss imposed on its $45 billion of uninsured deposits, approximately 24 percent of total deposits.[8] There was an acquirer with the capacity to assume all the assets and all the deposits through a traditional purchase and assumption transaction. The acquirer could act quickly at the time of failure because it had previously performed due diligence on Washington Mutual for a potential open bank acquisition.

Another important factor was that Washington Mutual had a substantial volume of unsecured debt -- $13.8 billion, or 4.5 percent of total assets -- which

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[6] For additional background, see Remarks by Martin J. Gruenberg, Member, Board of Directors of the Federal Deposit Insurance Corporation on An Underappreciated Risk: The Resolution of Large Regional Banks in the United States to The Brookings Institution Center on Regulation and Markets; Washington, D.C., October 16, 2019.

[7] Crisis and Response: An FDIC History, 2008-2013 at 182. https://www.fdic.gov/bank/historical/crisis/

[8] FFIEC Reports of Condition and Income, Second Quarter 2008.

was available to absorb losses in resolution.[9] This loss absorbing capacity was essential to meeting the least cost test and for uninsured depositors to avoid taking a loss.

Absent these factors, the FDIC likely would have had to establish a bridge bank and take over the operation of the failed institution. The failure of Washington Mutual in that scenario would have wiped out the Deposit Insurance Fund, and uninsured depositors would likely have had to take a loss in order to meet the least cost test.[10]

Imposing losses on uninsured deposits could have had a significantly destabilizing effect, especially given the stressed economic and financial environment in September 2008. The only way to avoid that outcome would have been for the FDIC to exercise the systemic risk exception. This illustrates the potential systemic risk associated with the failure of a large regional bank.

When IndyMac Bank -- a $30 billion thrift -- failed in July 2008, there was no viable acquirer, and it had no unsecured debt. The FDIC had to establish a bridge bank[11] and impose a loss on $2.6 billion of uninsured deposits, which was almost 14 percent of total deposits.[12] Lines formed around the institution on the Monday after failure. IndyMac was the most costly failure in the FDIC's history, resulting in a $12.4 billion loss to the Deposit Insurance Fund.[13]

[9] Unsecured debt is from the Receivership Balance Sheet, Second Quarter 2019, https://receivership.fdic.gov/drripbal/bank/10015 , and total assets are from the FFIEC Reports of Condition and Income, Second Quarter 2008.

[10] Notice of Proposed Rulemaking: Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, 83 Fed. Reg. 66024, 66029 fn. 27 (Dec. 21, 2018), citing Offices of Inspector General, U.S. Department of Treasury and FDIC, Evaluation of Federal Regulatory Oversight of Washington Mutual Bank (April 2010).

[11] Because IndyMac was a thrift, it was technically resolved through a conservatorship. However, the IndyMac conservatorship was functionally equivalent to a bridge bank. Prior to enactment of the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289 (July 30, 2008), the FDIC's authority to establish a bridge bank did not apply to a thrift. Given this change in the law, future transactions are expected to involve bridge banks rather than conservatorships.

[12] Uninsured deposit losses in IndyMac were reduced as a result of section 335 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted in July 2010. The Act applied the increase in deposit insurance coverage to $250,000 retroactively to any failure on or after January 1, 2008, and made it permanent. Pub. L. No. 111-203 (July 21, 2010). 12 U.S.C. 1821(a)(1)(E).

[13] Crisis and Response at 182.

Pending Merger Application

Given that background, I would like to turn to the proposed merger before the FDIC Board.

Based on September 30, 2019 Call Report data, BB&T and SunTrust together hold approximately $150 billion in deposits in excess of the deposit insurance limit. The combined institution is expected to hold approximately $331 billion in deposits, indicating that about 45 percent of the deposits would be uninsured. [14] In addition, the combined institution is expected to have over 14 million deposit accounts based on recent Call Report data from the individual institutions.

Total assets of the combined institution are expected to be about $450 billion. The individual institutions each report some long-term unsecured debt, which if combined would amount to approximately 3.6 percent of total assets at the time of the merger.[15]

In the event of failure of the merged institution, the universe of potential acquirers would be quite limited for an institution of this size. It is likely that only a Global Systemically Important Bank, or GSIB, would have the capacity to make such an acquisition. Even then, based on the experiences in the financial crisis, interest in, and support for, such acquisitions may be limited among the GSIBs. Absent a viable purchase and assumption bid, the FDIC would likely have to establish a bridge bank to manage an orderly failure of the institution.

The large branch network, substantial IT systems, and millions of account holders would make the management of a bridge bank a significant operational challenge. The volume of accounts, combined with the estimates of uninsured deposits, would also pose a challenge to an orderly resolution with a rapid deposit insurance determination over the course of a weekend.[16]

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[14] FFIEC Reports of Condition and Income, Third Quarter 2019. These numbers have not been adjusted for the 30-branch divestiture described in recent announcements. https://www.justice.gov/opa/pr/justice/-department-requires-divestitures-order-bbt-and-suntrust-proceed-merger.

[15] FFIEC Reports of Condition and Income, Second Quarter 2019. Long-term debt typically refers to debt with a remaining maturity of 12 months or longer. See, e.g., 12 CFR Part 252.

[16] The FDI Act requires the FDIC to make insured deposits available "as soon as possible", and the FDIC typically closes failed banks on a Friday absent exigent circumstances and makes insured deposits available the next business day. 12 U.S.C. 1821(f).

For either a traditional purchase and assumption transaction or a bridge bank strategy, the adequacy of long-term unsecured debt to absorb losses would likely be essential to meeting the least cost test.

As noted above, the combined institution is projected to have approximately 3.6 percent of total assets in long-term unsecured debt at the time of merger. However, unlike GSIBs, regional banks are not required to maintain a minimum amount of long-term unsecured debt to absorb losses in the event of failure. In the absence of a regulatory requirement, there is no certainty that current unsecured debt would remain available.

Absent such loss-absorbing capacity, the least cost test would likely require that uninsured depositors take losses. The effect of large numbers of accountholders suffering losses on uninsured deposits at a failed regional bank could trigger knock-on consequences for other banks, particularly in a stressed economic environment.

Only the systemic risk exception under the Federal Deposit Insurance Act would allow for a resolution strategy other than least cost in order to avoid losses to uninsured depositors. The systemic risk exception by its terms requires a determination that compliance with the least cost test "would have serious adverse effects on economic conditions or financial stability".[17] It illustrates the potential systemic risk posed by the failure of the proposed merged institution.

Given the limited availability of potential acquirers if the merged institution were to fail, the heavy reliance on uninsured depositors, and the lack of an unsecured debt requirement, the failure could well pose a "risk to the stability of the United States banking or financial systems."[18]

It is true that the merged institution would be subject to resolution plan and minimum liquidity requirements, as well as a requirement to develop the technological capability to enable the FDIC to make deposit insurance determinations over the weekend after failure. However, each of these requirements has been weakened by recent rulemakings.[19]

[17] See footnote 5, above.
[18] See footnote 3, above.
[19] See footnote 6, above.

Conclusion

In conclusion, this proposed merger is by far the largest ever considered by the FDIC. It is the first informed by the experience of the 2008-2009 financial crisis. It is also the first large merger before the FDIC subject to the new financial stability standard established by the Dodd-Frank Act.

The experience during the crisis with the failures of Washington Mutual Bank and Indy Mac Bank raise serious questions as to whether the failure of the proposed merged institution would pose a risk to U.S. financial stability. The measures taken since the crisis have not yet satisfactorily answered those questions.

It underscores the need to maintain the prudential and resolution plan requirements that have been adopted, not weaken them. It also underscores the need for the FDIC to focus intensely on strengthening its capabilities to manage the orderly failure of regional banks as well as GSIBs.

Based on the statutory factors, I will not vote against this application. However, it would be a serious mistake not to recognize and address the very significant financial stability risks the merged institution would present.