

I. INTRODUCTION

Pursuant to Section 5(e) of the Federal Deposit Insurance (FDI) Act, any insured depository institution (IDI) shall be liable for any loss incurred by the deposit insurance fund (DIF), or for any loss that the FDIC reasonably anticipates incurring, in connection with:

- (i) The default¹ of a commonly controlled IDI; or,
- (ii) Any assistance provided by the FDIC to any commonly controlled IDI in danger of default.

For purposes of Section 5(e), IDIs are commonly controlled if such institutions are controlled by the same company or if one IDI is controlled by another IDI.²

The principal objective of the cross-guarantee statute is to maximize the recovery to the DIF when the DIF has incurred a loss due to the default of a commonly controlled IDI. It is very important to ensure that the assets of any healthy, commonly controlled institution(s) will be available to the FDIC to help offset the costs to the DIF of resolving the failed institution(s). The cross-guarantee provision provides an incentive to the holding company or affiliated institution(s) to effect a transaction that will generate funds to recapitalize the failing IDI prior to default.

Waiver Authority: In addition to certain statutory exceptions and exclusions contained in Sections 5(e)(6) and (7) of the FDI Act, the FDI Act also permits the FDIC, in its discretion, to exempt any IDI from cross-guarantee liability if it determines that such exemption is in the best interests of the DIF. Procedures for requesting a conditional waiver of liability pursuant to Section 5(e)(5)(A) of the FDI Act are described below. Conditional waiver of liability refers to an exemption from liability pursuant to Section 5(e) subject to terms and conditions. The FDIC must carefully analyze the amount of any proposed assessment or settlement to avoid jeopardizing the safety and soundness of the surviving institution and increasing the risk of loss to the DIF. The determination of whether an exemption is in the best interests of the DIF rests solely with the FDIC Board.

During the term of an exemption granted under Section 5(e)(5) of the FDI Act, the IDI and all of its IDI affiliates must comply fully with the restrictions of Sections 23A and 23B of the Federal Reserve Act without regard to Section 23A(d)(1) of the Federal Reserve Act.

Regardless of whether an application requesting a waiver has been received, it is necessary in all failing IDI situations to determine whether and when to assess a cross-guarantee liability, as well as the amount of liability. Determinations of whether or not a cross-guarantee relationship exists must be made in consultation with the Legal Division at the time an institution is downgraded to problem status.³ Such determinations may occur significantly prior to the receipt of a request for a waiver.

¹ Section 3(x) of the FDI Act defines "Default" and "In Danger of Default." Cross-guarantee liability is normally considered and/or assessed in situations where IDIs have failed or are in danger of failing and a loss to the DIF has been identified or can reasonably be estimated.

² Section 3(w)(5) of the FDI Act states that the term, "Control," has the meaning given to such term in Section 2 of the Bank Holding Company Act of 1956.

³ A problem financial institution is defined as any IDI which has been assigned a composite rating of "4" or "5" under the Uniform Financial Institutions Rating System by its primary federal regulator (PFR) or by the FDIC, if it disagrees with the PFR's rating.

Decisions regarding the appropriateness and timing of any cross-guarantee assessment are based on several factors, including any potential recovery to the DIF by virtue of settlement or ultimate sale of the commonly controlled institution(s). An acceptable settlement proposal will generally provide for a substantial portion of proceeds from any sale or settlement to be paid to the FDIC or to prudently recapitalize the surviving commonly controlled institution(s) that might otherwise fail. Generally, the FDIC will assess cross-guarantee liability in all instances **except**:

- (i) When an assessment will cause an increased loss to the DIF and the loss to the DIF would not otherwise occur; or,
- (ii) When the commonly controlled institution(s) is acquired by an unaffiliated party.

In the latter case, a conditional waiver and partial payment from the sales proceeds is likely to be considered. For additional information, Case Managers should refer to the FDIC *Statement of Policy Regarding Liability of Commonly Controlled Depository Institutions*, dated October 1, 1998.

The FDIC may entertain requests for waivers of cross-guarantee liability from affiliated or unaffiliated parties of an IDI in default or in danger of default.

- Conditional waivers of liability will be considered in those cases where the waiver facilitates an alternative that would be in the best interests of the DIF. In addition to partial payment, conditional waivers may include other conditions, such as provision of requisite capital and managerial resources that substantially lessen the exposure to the DIF. A conditional waiver granted to an unaffiliated acquirer of an IDI in default or in danger of default will be granted for a fixed period, generally not to exceed a period of time reasonably required to identify and resolve existing problems.
- If one or more IDIs in a commonly controlled relationship is otherwise solvent, well managed and viable, it may be in the FDIC's best interest to waive or reduce claims against such entities. In determining whether a conditional waiver is appropriate, consideration will be given to actions of a holding company that may contribute to or diminish FDIC losses as well as proposals to strengthen any other weakened IDIs.
- When an IDI is sold to an acquirer with no financial interest, directly or indirectly, in the IDI prior to the acquisition, it is the general policy of the FDIC to forego issuance of a notice of assessment to the acquirer and its affiliate institutions in the event of a default of an IDI formerly affiliated with the acquired IDI. The FDIC will review all such transactions prior to making a final decision.

Requests for a waiver of cross-guarantee liability may also be submitted in non-failure situations by holding companies or institutions that have acquired another institution. If such a request is received, the Regional Office (RO) should contact the appropriate Associate Director (Risk Management Applications Section (RMAS), Large Bank Supervision Branch (LBS), or Division of Complex Institution Supervision & Resolution (CISR) for guidance.

The FDIC's general practice is not to grant a cross-guarantee waiver to an institution for which the directors and/or executive officers who materially contributed to the failing institution's problems remain involved in any capacity with the institution seeking the waiver.

II. FORM OF APPLICATION

Section 303.245 of the FDIC Rules and Regulations outlines the filing procedures for waiver applications. Applicants should submit a letter application to the appropriate Regional Director in accordance with Section 303.245(c). The application should contain the following information:

1. The basis for the waiver request;
2. Discussion of any significant events (e.g., change of control, capital injection, etc.) that may have an impact on the applicant and/or any potentially liable institution(s);
3. Current, and, if applicable, pro forma financial information regarding the applicant and potentially liable institution(s); and,
4. An explanation of the benefits to the DIF resulting from the waiver and any related events.

The FDIC may request additional information at any time during the processing of the filing. For example, since the applicant, in most cases, will be a bank holding company, a certified copy of a resolution adopted by the company's board of directors authorizing this transaction should be requested.

III. ACCEPTING AND PROCESSING THE APPLICATION

Case Managers are to review and process the application following the steps below and should refer to *Applications Overview*, Section 1.1 of these Procedures, for general information regarding receipt and acceptance of applications.

1. Upon receipt of an application, the RO must promptly notify the RMAS Associate Director; the Division of Resolutions and Receiverships (DRR) Resolution Strategy Associate Director; and, the appropriate Legal Division Deputy General Counsel; or, their designees. In the case of institutions with total assets greater than \$10 billion, notify the appropriate LBS or CISR Associate Director. Refer to *Applications Overview*, Section 1.1 of these Procedures, for instructions regarding filings requiring WO action or input.
2. All applications are to be entered into the appropriate internal database within three business days of receipt. In all cases, dates and comments in the record should be updated regularly to reflect the current status of the application.
3. Prepare a memorandum for submission to the Washington Office (WO) recommending whether demand for payment should be (a) immediate; (b) in the future; or (c) part of a negotiated settlement with the surviving commonly controlled institution(s); or whether an assessment should not be made. In developing the recommendation, the Case Manager is to consult with Legal staff, DRR, and appropriate WO RMS staff. The memorandum should be from the RMS Regional Director, the DRR Regional Manager, and the Regional Counsel, to the RMS Director. A copy needs to also be sent to the appropriate Legal Division Deputy General Counsel, and the DRR Resolutions Strategy Associate Director.

The memorandum should address the following, as applicable and available:

- The basis for the waiver request and the projected benefits;
- The effect of the waiver on the DIF;
- The current condition/viability of the liable institution(s), including the earnings, capital and liquidity positions absent any cross-guarantee assessment;
- Any interdependence among the commonly controlled institutions (e.g. operations, management, loan participations, etc.);
- The effect of the failure on the commonly controlled institution(s);
- Other operational issues affecting the commonly controlled institutions;
- Marketing efforts being undertaken to sell the liable institution(s);
- The proposed distribution of the sale proceeds, if the application was prompted by the potential sale of a surviving affiliate;
- Any known individuals or groups interested in the acquisition of the failing IDI and whether there is potential for an open bank sale;
- The views of the state authority and/or other federal regulatory agency involved regarding a cross-guarantee assessment;
- A DRR cost/benefit analysis, including the presence of synergies from marketing the institutions together;
- Any legal or policy issues, including a discussion of any similar situations in which the FDIC has taken a different approach than the one recommended by staff in the present matter; and,
- The RO's recommended action on the requested waiver.

If it appears inevitable that a commonly controlled IDI will fail if the FDIC has sought, or would normally seek, cross-guarantee assessment, the general policy of the FDIC is to forego actual assessment against that IDI. Otherwise, the FDIC expects to receive compensation of some type in settlement of cross-guarantee claims; however, not all such settlements will result in the immediate receipt of a cash payment and, in some cases, acceptance of another payment method may be appropriate, such as warrants, preferred stock, or other long-term obligation. After deliberations of the settlement negotiation team (comprised of representatives from RMS, DRR, and Legal Division) and prior to finalizing such settlement options with interested parties, the RMS Regional Director, or designee, shall contact the appropriate Associate Director (RMAS, LBS, or CISR) with the proposed recommendation.

4. Complete the appropriate Summary of Investigation (SOI) form⁴. Retrieve the Application Summary Statement from the system of record and attach it to the SOI. SOI comments should reference the above noted memorandum.
5. Submit the SOI, the recommendation memorandum, and other relevant documentation including a draft approval or denial letter to the WO for action by the FDIC Board. Refer to *Applications Overview*, Section 1.1 of these Procedures, for procedures on forwarding applications to the WO.

⁴ Case Managers are to follow the general instructions and detailed discussion of SOI requirements for all types of applications located in *Summary of Investigation*, Section 1.2 of these Procedures, as well as the specific instruction in this Section.

6. The FDIC Board will provide the applicant with written notification of the final action immediately after the decision is rendered.
7. Update the appropriate internal database with the action date, the expiration date, the hours devoted to the application, and other required information.
8. To the extent a pending filing (such as a merger or a change in control) may be impacted by the decision, notify relevant FDIC staff reviewing the other filing of the outcome.

IV. TIME FRAME FOR PROCESSING

Statutory: A statutory processing timeline is provided for requests by limited partnerships and certain affiliates of limited partnerships that filed registration statements with the Securities and Exchange Commission on or before April 10, 1989, showing intent to acquire one or more IDIs. Within 10 business days after the date of submission of such a request together with such information as reasonably requested by the FDIC, the statute provides that the FDIC shall make a determination on the request and shall so advise the applicant. See Section 5(e)(C) of the FDI Act.

RO Processing Guideline: 60 days from receipt of a substantially complete application.

WO Processing Guideline: 75 days.

V. PUBLICATION REQUIREMENT

No requirement.

VI. DELEGATED AUTHORITY

Delegations of authority regarding applications, notices and other filings are discussed in *Applications Overview*, Section 1.1 of these Procedures.

VII. REFERENCES

Section 5(e) of the FDI Act

Section 303.245 of the FDIC Rules and Regulations

FDIC Statement of Policy Regarding Liability of Commonly Controlled Depository Institutions, dated October 1, 1998 (63 Fed. Reg.44765 (1998))